

SEACHANGE INTERNATIONAL INC

Form 10-Q

September 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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 July 31, 2017

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

SEACHANGE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware 04-3197974
(State or other jurisdiction of (IRS Employer
incorporation or organization) 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

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

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 (§232.405 of this chapter) 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, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 September 1, 2017 was 35,486,383.

SEACHANGE INTERNATIONAL, INC.

Table of Contents

PART I. FINANCIAL INFORMATION

	Page
Item 1. <u>Financial Statements (interim periods unaudited)</u>	
<u>Consolidated Balance Sheets at July 31, 2017 and January 31, 2017</u>	3
<u>Consolidated Statements of Operations and Comprehensive Loss for the three and six months ended July 31, 2017 and July 31, 2016</u>	4
<u>Consolidated Statements of Cash Flows for the six months ended July 31, 2017 and July 31, 2016</u>	5
<u>Notes to Consolidated Financial Statements</u>	6-22
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	23-38
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	39
Item 4. <u>Controls and Procedures</u>	39
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	41
Item 1A. <u>Risk Factors</u>	41
Item 6. <u>Exhibits</u>	41
<u>SIGNATURES</u>	42

PART I – FINANCIAL INFORMATION

ITEM 1. Financial Statements

SEACHANGE INTERNATIONAL, INC.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share data)

	July 31, 2017 (Unaudited)	January 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 25,295	\$ 28,302
Restricted cash	8	109
Marketable securities	4,543	5,253
Accounts and other receivables, net of allowance for doubtful accounts of \$876 at July 31, 2017 and January 31, 2017, respectively	22,661	25,985
Unbilled receivables	4,347	6,553
Inventories, net	635	770
Prepaid expenses and other current assets	2,983	2,393
Total current assets	60,472	69,365
Property and equipment, net	10,611	11,485
Marketable securities, long-term	5,744	4,991
Investments in affiliates	2,000	2,000
Intangible assets, net	2,028	2,603
Goodwill, net	24,668	23,287
Other assets	1,414	2,336
Total assets	\$ 106,937	\$ 116,067
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,252	\$ 4,978
Deferred revenues	11,701	12,517
Other accrued expenses	7,632	9,928
Total current liabilities	21,585	27,423
Deferred revenue, long-term	2,753	2,419
Deferred tax liabilities, long-term	16,319	14,732
Taxes payable, long-term	1,567	1,427
Other liabilities, long-term	522	530
Total liabilities	42,746	46,531
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock, \$0.01 par value; 100,000,000 shares authorized; 35,456,454	355	353

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

shares issued and 35,415,964 outstanding at July 31, 2017, and 35,339,232		
shares issued and 35,298,742 outstanding at January 31, 2017		
Additional paid-in capital	238,232	236,677
Treasury stock, at cost; 40,490 common shares at July 31, 2017 and January 31,		
2017, respectively	(5)	(5)
Accumulated loss	(169,018)	(162,118)
Accumulated other comprehensive loss	(5,373)	(5,371)
Total stockholders' equity	64,191	69,536
Total liabilities and stockholders' equity	\$ 106,937	\$ 116,067

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

SEACHANGE INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited, amounts in thousands, except per share data)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Revenues:				
Products	\$5,039	\$2,535	\$7,788	\$6,735
Services	12,186	15,917	26,104	33,287
Total revenues	17,225	18,452	33,892	40,022
Cost of revenues:				
Products	1,336	1,108	1,890	2,682
Services	4,218	8,920	10,198	18,866
Amortization of intangible assets	255	316	509	632
Stock-based compensation expense	—	85	2	157
Total cost of revenues	5,809	10,429	12,599	22,337
Gross profit	11,416	8,023	21,293	17,685
Operating expenses:				
Research and development	6,399	7,727	11,777	16,426
Selling and marketing	2,439	4,429	5,376	8,499
General and administrative	3,084	3,835	6,727	7,906
Amortization of intangible assets	361	582	705	1,032
Stock-based compensation expense	653	854	1,528	894
Earn-outs and change in fair value of earn-outs	—	249	—	249
Professional fees - other	—	172	21	304
Severance and other restructuring costs	563	1,843	2,710	3,618
Total operating expenses	13,499	19,691	28,844	38,928
Loss from operations	(2,083)	(11,668)	(7,551)	(21,243)
Other income (expenses), net	589	(635)	955	287
Loss before income taxes	(1,494)	(12,303)	(6,596)	(20,956)
Income tax provision	35	14,581	304	14,835
Net loss	\$(1,529)	\$(26,884)	\$(6,900)	\$(35,791)
Net loss	\$(1,529)	\$(26,884)	\$(6,900)	\$(35,791)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment	83	(304)	3	303
Unrealized gain (loss) on marketable securities	3	9	(5)	18
Comprehensive loss	\$(1,443)	\$(27,179)	\$(6,902)	\$(35,470)
Net loss per share:				
Basic	\$(0.05)	\$(0.77)	\$(0.20)	\$(1.03)
Diluted	\$(0.05)	\$(0.77)	\$(0.20)	\$(1.03)
Weighted average common shares outstanding:				
Basic	35,351	35,115	35,331	34,739
Diluted	35,351	35,115	35,331	34,739

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

SEACHANGE INTERNATIONAL, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, amounts in thousands)

	Six Months Ended July 31,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$(6,900)	\$(35,791)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of property and equipment	1,198	1,567
Amortization of intangible assets	1,214	1,664
Fair value of acquisition-related contingent consideration	—	249
Stock-based compensation expense	1,530	1,051
Deferred income taxes	79	14,649
Other	8	195
Changes in operating assets and liabilities, excluding impact of acquisition:		
Accounts receivable	4,358	14,023
Unbilled receivables	2,558	(565)
Inventories	57	19
Prepaid expenses and other assets	8	1,053
Accounts payable	(2,594)	(1,607)
Accrued expenses	(3,193)	(5,307)
Deferred revenues	(870)	(5,419)
Other	230	122
Total cash used in operating activities	(2,317)	(14,097)
Cash flows from investing activities:		
Purchases of property and equipment	(274)	(403)
Purchases of marketable securities	(4,501)	—
Proceeds from sale and maturity of marketable securities	4,449	252
Acquisition of business, net of cash acquired	—	(5,243)
Other investing activities	388	(83)
Total cash provided by (used in) investing activities	62	(5,477)
Cash flows from financing activities:		
Proceeds from issuance of common stock	26	33
Payments of withholding tax on RSU vesting	(36)	(91)
Other financing activities	—	(4)
Total cash used in financing activities	(10)	(62)
Effect of exchange rate changes on cash	(742)	(431)
Net decrease in cash and cash equivalents	(3,007)	(20,067)
Cash and cash equivalents, beginning of period	28,302	58,733
Cash and cash equivalents, end of period	\$25,295	\$38,666
Supplemental disclosure of cash flow information:		
Income taxes paid	\$183	\$83
Supplemental disclosure of non-cash investing and financing activities:		

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

Fair value of common stock issued for acquisition of DCC Labs	\$—	\$2,640
Fair value of common stock issued for deferred stock consideration obligation	\$—	\$3,454
Transfer of items originally classified as inventories to equipment	\$—	\$24

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

SEACHANGE INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business and Basis of Presentation

The Company

SeaChange International, Inc. and its consolidated subsidiaries (collectively “SeaChange”, “we”, or the “Company”) is an industry leader in the delivery of multiscreen video, advertising and premium over-the-top (“OTT”) video. Our products and services facilitate the aggregation, licensing, management and distribution of video and advertising content to cable television system operators, telecommunications companies, satellite operators and media companies.

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries (“SeaChange” or the “Company”) and are prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial reports as well as rules and regulations of the Securities and Exchange Commission (“SEC”). All intercompany transactions and balances have been eliminated. Certain information and footnote disclosures normally included in financial statements prepared under U.S. GAAP have been condensed or omitted pursuant to such regulations. However, we believe that the disclosures are adequate to make the information presented not misleading. In the opinion of management, the accompanying financial statements include all adjustments, consisting of only normal recurring items, necessary to present a fair presentation of the consolidated financial statements for the periods shown. These consolidated financial statements should be read in conjunction with our most recently audited financial statements and related footnotes included in our Annual Report on Form 10-K (“Form 10-K”) as filed with the SEC. The balance sheet data as of January 31, 2017 that is included in this Quarterly Report on Form 10-Q (“Form 10-Q”) was derived from our audited financial statements. We have reclassified certain amounts previously reported in our financial statements to conform to current presentation.

Effective February 1, 2017, the Company changed how it classifies costs associated with its solution architect employees. In fiscal 2017, all solution architect costs were classified as cost of revenues. However, beginning in fiscal 2018, the Company began reflecting in cost of revenues only those costs associated with revenue-generating projects, based on the hours worked by solutions architect employees. Solutions architect costs that are not associated with revenue-generating projects are recognized as selling and marketing expenses since these employees are involved in pre-sales and other customer-facing activities.

We have adjusted prior fiscal year amounts to conform the current fiscal year presentation. The effect of this change in methodology, which is a decrease to cost of revenues and an increase to selling and marketing expenses, is reflected in our current statements of operations and comprehensive loss for the three and six months ended July 31, 2016 as follows:

	Adjustment to		
As Filed Fiscal 2017 Three Months Ended July 31, 2016	Conform to	As Filed Fiscal 2018 Three Months Ended July 31, 2016	
			(Amounts in thousands)
Cost of revenues - service	\$9,487	\$ (567)	\$ 8,920
Selling and marketing expenses	\$3,862	\$ 567	\$ 4,429

	Adjustment to		
As Filed Fiscal 2017 Six Months Ended July 31, 2016	Conform to	As Filed Fiscal 2018 Six Months Ended July 31, 2016	
			(Amounts in thousands)
Cost of revenues - service	\$19,946	\$ (1,080)	\$ 18,866
Selling and marketing expenses	\$7,419	\$ 1,080	\$ 8,499

The preparation of these financial statements in conformity with U.S. GAAP, requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Interim results are not necessarily indicative of the operating results for the full fiscal year or any future periods and actual results may differ from our estimates. During the three and six months ended July 31, 2017, there have been no material changes to our significant accounting policies that were described in our fiscal 2017 Form 10-K, as filed with the SEC.

The Company believes that existing funds and cash provided by future operating activities are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months. However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In the future, we may enter into other arrangements for potential investments in, or acquisitions of, complementary businesses, services or technologies, which could require us to seek additional equity or debt financing. Additional funds may not be available on terms that are favorable.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital or could require us to issue our stock and dilute existing stockholders. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access cash resulting from earnings in prior fiscal years that had previously been deemed permanently restricted for foreign investment would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a charge to deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings. The balance of the deferred tax liability is \$16.3 million as of July 31, 2017.

2. Significant Accounting Policies

Revenue Recognition

Our transactions frequently involve the sales of hardware, software, systems and services in multiple-element arrangements. Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when:

- persuasive evidence of an arrangement exists;
- delivery has occurred, and title and risk of loss have passed to the customer;
- fees are fixed or determinable; and
- collection of the related receivable is considered probable.

Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities is deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support agreements is recognized ratably over the period of the related agreements. Revenue from software development contracts that include significant modification or customization, including software product enhancements, is recognized based on the percentage of completion contract accounting method using labor efforts expended in relation to estimates of total labor efforts to complete the contract. The percentage of completion method requires that adjustments or re-evaluations to estimated project revenues and costs be recognized on a project-to-date cumulative basis, as changes to the estimates are identified. Revisions to project estimates are made as additional information becomes known, including information that becomes available after the date of the consolidated financial statements up through the date such consolidated financial statements are filed with the SEC. If the final estimated profit to complete a long-term contract indicates a loss, a provision is recorded immediately for the total loss anticipated. Accounting for contract amendments and customer change orders are included in contract accounting when executed. Revenue from shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues. Our share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

Contract accounting requires judgment relative to assessing risks, estimating revenues and costs and making assumptions including, in the case of our professional services contracts, the total amount of labor required to complete a project and the complexity of the development and other technical work to be completed. Due to the size and nature of many of our contracts, the estimation of total revenues and cost at completion is complicated and subject to many variables. Assumptions must be made regarding the length of time to complete the contract because costs also include estimated third-party vendor and contract labor costs. Penalties related to performance on contracts are considered in estimating sales and profit, and are recorded when there is sufficient information for us to assess anticipated performance. Third-party vendors' assertions are also assessed and considered in estimating costs and margin.

Revenue from the sale of software-only products remains within the scope of the software revenue recognition rules. Maintenance and support, training, consulting, and installation services no longer fall within the scope of the software revenue recognition rules, except when they are sold with and relate to a software-only product. Revenue recognition for products that no longer fall

under the scope of the software revenue recognition rules is like that for other tangible products and Accounting Standard Update No. (“ASU”) 2009-13, “Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements,” amended ASC 605 and is applicable for multiple-deliverable revenue arrangements. ASU 2009-13 allows companies to allocate revenue in a multiple-deliverable arrangement in a manner that better reflects the transaction’s economics.

Under the software revenue recognition rules, the fee is allocated to the various elements based on vendor-specific objective evidence (“VSOE”) of fair value. Under this method, the total arrangement value is allocated first to undelivered elements based on their fair values, with the remainder being allocated to the delivered elements. Where fair value of undelivered service elements has not been established, the total arrangement value is recognized over the period during which the services are performed. The amounts allocated to undelivered elements, which may include project management, training, installation, maintenance and technical support and certain hardware and software components, are based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation, training and project management revenue is based upon standard hourly billing rates and the estimated time necessary to complete the service. These services are not essential to the functionality of systems as these services do not alter the equipment’s capabilities, are available from other vendors and the systems are standard products. For multiple-element arrangements that include software development with significant modification or customization and systems sales where VSOE of the fair value does not exist for the undelivered elements of the arrangement (other than maintenance and technical support), percentage of completion accounting is applied for revenue recognition purposes to the entire arrangement except for maintenance and technical support.

Under the revenue recognition rules for tangible products as amended by ASU 2009-13, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, third-party evidence (“TPE”) if VSOE is not available, and best estimate of selling price (“BESP”) if neither VSOE nor TPE are available. TPE is the price of the Company’s, or any competitor’s, largely interchangeable products or services in stand-alone sales to similarly situated customers. BESP is the price at which we would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors.

The selling prices used in the relative selling price allocation method for certain of our services are based upon VSOE. The selling prices used in the relative selling price allocation method for third-party products from other vendors are based upon TPE. The selling prices used in the relative selling price allocation method for our hardware products, software, subscriptions, and customized services for which VSOE does not exist are based upon BESP. We do not believe TPE exists for these products and services because they are differentiated from competing products and services in terms of functionality and performance and there are no competing products or services that are largely interchangeable. Management establishes BESP with consideration for market conditions, such as the impact of competition and geographic considerations, and entity-specific factors, such as the cost of the product, discounts provided and profit objectives. Management believes that BESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis.

For our cloud and managed service revenues, we generate revenue from two sources: (1) subscription and support services; and (2) professional services and other. Subscription and support revenue includes subscription fees from customers accessing our cloud-based software platform and support fees. Our arrangements with customers do not provide the customer with the right to take possession of the software supporting the cloud-based software platform at

any time. Professional services and other revenue include fees from implementation and customization to support customer requirements. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For the most part, subscription and support agreements are entered into for 12 to 36 months. Generally, most of the professional services components of the arrangements with customers are performed within a year of entering a contract with the customer.

In most instances, revenue from a new customer acquisition is generated under sales agreements with multiple elements, comprised of subscription and support and other professional services. We evaluate each element in a multiple-element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within our control.

In determining when to recognize revenue from a customer arrangement, we are often required to exercise judgment regarding the application of our accounting policies to an arrangement. The primary judgments used in evaluating revenue recognized in each period involve: determining whether collection is probable, assessing whether the fee is fixed or determinable, and determining the fair value of the maintenance and service elements included in multiple-element software arrangements. Such judgments can materially impact the amount of revenue that we record in a given period. While we follow specific and detailed rules and guidelines related to revenue recognition, we make and use significant management judgments and estimates about the revenue recognized in any reporting period, particularly in the areas described above. If management made different estimates or judgments, material differences in the timing of the recognition of revenue could occur.

Impairment of Assets

Indefinite-lived intangible assets, such as goodwill, are not amortized but are evaluated for impairment at the reporting unit level annually, in our third quarter beginning August 1st. Indefinite-lived intangible assets may be tested for impairment on an interim basis in addition to the annual evaluation if an event occurs or circumstances change such as declines in sales, earnings or cash flows, sustained decline in the Company's stock price, or material adverse changes in the business climate, which would more likely than not reduce the fair value of a reporting unit below its carrying amount. See Note 6, "Goodwill and Intangible Assets," to our consolidated financial statements for more information.

We also evaluate property and equipment, intangible assets with finite useful lives and other long-lived assets on a regular basis for the existence of facts or circumstances, both internal and external that may suggest an asset is not recoverable. If such circumstances exist, we evaluate the carrying value of long-lived assets to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and compare that value to the carrying value of the assets. Our cash flow estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time.

Liquidity

We continue to realize savings related to the restructuring of our In-Home business. Additionally, during the first quarter of fiscal 2018, we made significant reductions to our headcount as part of our ongoing restructuring effort from which we expect to generate annualized savings of approximately \$10 million. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash expected to be provided by future operating activities, augmented by the plans highlighted above, are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

3. Fair Value Measurements

Definition and Hierarchy

The applicable accounting guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance establishes a framework for measuring fair value and expands required disclosure about the fair value measurements of assets and liabilities. This guidance requires us to classify and disclose assets and liabilities measured at fair value on a recurring basis, as well as fair value measurements of assets and liabilities measured on a non-recurring basis in periods subsequent to initial measurement, in a fair value hierarchy.

The fair value hierarchy is broken down into three levels based on the reliability of inputs and requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required, as well as the assets and liabilities that we value using those levels of inputs:

- Level 1 – Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.
- Level 2 – Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not very active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Valuation Techniques

Inputs to valuation techniques are observable and unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. When developing fair value estimates for certain financial assets and liabilities, we maximize the use of observable inputs and minimize the use of unobservable inputs. When available, we use quoted market prices, market comparables and discounted cash flow projections. Financial assets include money market funds, U.S. treasury notes or bonds, U.S. government agency bonds and Corporate bonds.

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs that are observable either directly or indirectly. In periods of market inactivity, the observability of prices and inputs may be reduced for certain instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3.

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following tables set forth our financial assets and liabilities that were accounted for at fair value on a recurring basis as of July 31, 2017 and January 31, 2017. There were no fair value measurements of our financial assets and liabilities using significant Level 3 inputs for the periods presented:

	Fair Value at July 31, 2017 Using Quoted Prices in Significant Active Other Markets for Observable Inputs		
	July 31, 2017	Identical Inputs (Level 1)	(Level 2)
	(Amounts in thousands)		
Financial assets:			
Cash equivalents (a)	\$2,701	\$1,998	\$ 703
Available-for-sale marketable securities:			
Current marketable securities:			
U.S. treasury notes and bonds - conventional	1,547	1,547	—
U.S. government agency issues	2,996	—	2,996
Non-current marketable securities:			
U.S. treasury notes and bonds - conventional	2,986	2,986	—
U.S. government agency issues	996	—	996
Corporate bonds	1,762	—	1,762
Total	\$12,988	\$6,531	\$ 6,457

	Fair Value at January 31, 2017 Using Quoted Prices in Significant Active Other Markets for Observable Inputs		
	January 31, 2017	Identical Inputs (Level 1)	(Level 2)
	(Amounts in thousands)		
Financial assets:			
Cash equivalents (a)	\$2,726	\$2,726	\$ —

Available-for-sale marketable securities:			
Current marketable securities:			
U.S. treasury notes and bonds - conventional	4,253	4,253	—
U.S. government agency issues	1,000	—	1,000
Non-current marketable securities:			
U.S. treasury notes and bonds - conventional	1,997	1,997	—
U.S. government agency issues	2,994	—	2,994
Total	\$12,970	\$8,976	\$ 3,994

(a) Money market funds and U.S. treasury bills are included in cash and cash equivalents on the accompanying consolidated balance sheets.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible property and equipment, goodwill, and other intangible assets, which are re-measured when the derived fair value is below carrying value on our consolidated balance sheets. For these assets and liabilities, we do not periodically adjust carrying value to fair value except in the event of impairment. If we determine that impairment has occurred, the carrying value of the asset is reduced to fair value and the difference is recorded to loss from impairment in our consolidated statements of operations and comprehensive loss.

We also have direct investments in privately-held companies, over which we do not have significant influence of their operating and financial activities and account for under the cost-method of accounting. Management periodically assesses these investments for other-than-temporary impairment, considering available information provided by the investees and any other readily available market data. If we determine that an other-than-temporary impairment has occurred, we write-down the investment to its fair value. Our ability to realize value from these investments depends on the success of those companies' businesses and their ability

to obtain sufficient capital to execute their business plans. Because private markets are not as liquid as public markets, there is also increased risk that we will not be able to sell these investments, or that when we desire to sell them we will not be able to obtain fair value for them.

During the three and six months ended July 31, 2017, the Company did not recognize any impairment charges related to goodwill, intangible assets, long-lived assets or cost-method investments.

Available-For-Sale Securities

We determine the appropriate classification of debt investment securities at the time of purchase and reevaluate such designation as of each balance sheet date. Our investment portfolio consists of money market funds, U.S. treasury notes and bonds, U.S. government agency notes and bonds and corporate bonds as of July 31, 2017 and January 31, 2017. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. Our marketable securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses, net of tax, reported in stockholders' equity as a component of accumulated other comprehensive loss. The amortization of premiums and accretion of discounts to maturity are computed under the effective interest method and are included in other income (expenses), net, in our consolidated statements of operations and comprehensive loss. Interest on securities is recorded as earned and is also included in other income (expenses), net. Any realized gains or losses would be shown in the accompanying consolidated statements of operations and comprehensive loss in other income (expenses), net. We provide fair value measurement disclosures of available-for-sale securities in accordance with one of the three levels of fair value measurement mentioned above.

The following is a summary of cash, cash equivalents and available-for-sale securities, including the cost basis, aggregate fair value and gross unrealized gains and losses, for short- and long-term marketable securities portfolio as of July 31, 2017 and January 31, 2017:

	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Amounts in thousands)			
July 31, 2017				
Cash	\$22,594	\$ —	\$ —	\$ 22,594
Cash equivalents	2,698	3	—	2,701
Cash and cash equivalents	25,292	3	—	25,295
U.S. treasury notes and bonds - short-term	1,548	1	(2)	1,547
U.S. treasury notes and bonds - long-term	2,992	—	(6)	2,986
U.S. government agency issues - short-term	2,983	15	(2)	2,996
U.S. government agency issues - long-term	1,003	—	(7)	996
Corporate bonds - long-term	1,763	—	(1)	1,762
Total cash, cash equivalents and marketable securities	\$35,581	\$ 19	\$ (18)	\$ 35,582
January 31, 2017				
Cash	\$25,576	\$ —	\$ —	\$ 25,576
Cash equivalents	2,726	—	—	2,726

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

Cash and cash equivalents	28,302	—	—	28,302
U.S. treasury notes and bonds - short-term	4,248	5	—	4,253
U.S. treasury notes and bonds - long-term	2,003	—	(6)	1,997
U.S. government agency issues - short-term	991	9	—	1,000
U.S. government agency issues - long-term	2,996	—	(2)	2,994
Total cash, cash equivalents and marketable securities	\$38,540	\$ 14	\$ (8)	\$ 38,546

The gross realized gains and losses on sale of available-for-sale securities as of July 31, 2017 and January 31, 2017 were immaterial. For purposes of determining gross realized gains and losses, the cost of securities is based on specific identification.

Contractual maturities of available-for-sale investments as of July 31, 2017 are as follows (amounts in thousands):

	Estimated Fair Value
Maturity of one year or less	\$ 4,543
Maturity between one and five years	5,744
Total	\$ 10,287

Cash, Cash Equivalents and Marketable Securities

Cash and cash equivalents consist primarily of highly liquid investments in money market mutual funds, government sponsored enterprise obligations, treasury bills, commercial paper and other money market securities with remaining maturities at date of purchase of 90 days or less.

The fair value of cash, cash equivalents, restricted cash and marketable securities at July 31, 2017 and January 31, 2017 was \$35.6 million and \$38.7 million, respectively.

Restricted Cash

At times, we may be required to maintain cash held as collateral for performance obligations with our customers which we classify as restricted cash on our consolidated balance sheets.

4. Acquisitions

DCC Labs

On May 5, 2016, we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.7 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. The stock consideration was determined by dividing the total value of \$2.7 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all the stock (681,278 shares) were initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement. One-third of the stock in escrow will be released to the former DCC Labs owners annually on the anniversary date of the acquisition beginning on May 5, 2017 and ending May 5, 2019, and one-half of the cash in escrow will be released to the former DCC Labs owners on May 5, 2017 and May 5, 2018. On May 5, 2017, \$0.3 million in cash and 227,090 shares of our common stock initially deposited with an Escrow Agent were disbursed to the sellers.

The acquisition of DCC Labs enables us to optimize the operations of our In-Home business, which develops home video gateway software including SeaChange's Nucleus and NitroX products. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe's Digital Video Broadcasting community and an HTML5 framework for building additional user experience client applications across a variety of CPE devices, including Android TV STBs, tablets, mobile and computer devices.

We accounted for the acquisition of DCC Labs as a business combination, which requires us to record the assets acquired and liabilities assumed at fair value. The amount by which the purchase price exceeds the fair value of the net assets acquired was recorded as goodwill. We engaged an independent appraiser to assist management in assessing the fair values of the tangible and intangible assets acquired and liabilities assumed and the amount of goodwill to be

recognized as of the acquisition date. Assets acquired in the acquisition include receivables, prepaid expenses and property and equipment while liabilities assumed include accounts payable, other accrued expenses, deferred taxes and income taxes payable. The amounts recorded for these assets and liabilities are final, based on information obtained about the facts and circumstances that existed as of the acquisition date.

The allocation of purchase price was as follows (amounts in thousands):

Estimated Fair value of consideration:	
Cash, net of cash acquired	\$5,243
Stock consideration	2,640
Total purchase price	\$7,883
Estimated Fair value of assets acquired and liabilities assumed:	
Current assets	826
Other long-term assets	116
Finite-life intangible assets	810
Goodwill	7,255
Current liabilities	(618)
Other long-term liabilities	(506)
Allocated purchase price	\$7,883

Acquired Goodwill

We recorded the \$7.3 million excess of the purchase price over the fair value of the identified tangible and intangible assets as goodwill, primarily due to expected synergies between the combined companies and expanded market opportunities. The goodwill is not deductible for tax purposes.

Intangible Assets

In determining the fair value of the intangible assets, the Company considered, among other factors, the intended use of the assets and the estimates of future performance of DCC Labs, based on analyses of historical financial performance. The fair values of identified intangible assets were calculated using an income-based approach based on estimates and assumptions provided by DCC Labs' and the Company's management.

The following table sets forth the components of the identified intangible assets associated with the DCC Labs acquisition and their estimated useful lives:

	Useful life	Fair Value (Amounts in thousands)
Tradenname	4 years	\$ 60
Customer contracts	2 years	230
Non-compete agreements	2 years	30
Existing technology	3 years	490
		\$ 810

Impact to Fiscal 2017 Financial Results

DCC Labs' financial results have only been included in our fiscal 2017 consolidated financial results for the period from the May 5, 2016 acquisition date through January 31, 2017. As a result, our consolidated financial results for the six months ended July 31, 2016 does not include DCC Labs' results for the period from February 1, 2016 to May 4, 2016. For that period, DCC Labs' revenue was not significant and its operating loss was approximately \$1.2 million.

Acquisition-related Costs

In connection with the acquisition, we incurred approximately \$0.2 million in acquisition-related costs, including legal, accounting and other professional services for fiscal 2017. The acquisition costs were expensed as incurred and included in professional fees – other, in our consolidated statements of operations and comprehensive loss for the period ended January 31, 2017.

5. Consolidated Balance Sheet Detail

Inventories, net

Inventories consist primarily of hardware and related component parts and are stated at the lower of cost (on a first-in, first-out basis) or market. Inventories consist of the following:

	As of	
	July	January
	31,	31,
	2017	2017
	(Amounts in thousands)	
Components and assemblies	\$455	\$ 500
Finished products	180	270
Total inventories, net	\$635	\$ 770

Property and equipment, net

Property and equipment, net consists of the following:

	Estimated	As of	
	Useful	July 31,	January
	Life	2017	2017
	(Years)	(Amounts in thousands)	
Land		\$2,780	\$2,780
Buildings	20	11,815	11,726
Office furniture and equipment	5	1,234	1,091
Computer equipment, software and demonstration equipment	3	16,497	18,194
Service and spare components	5	1,158	1,158
Leasehold improvements	1-7	1,091	1,064
		34,575	36,013
Less - Accumulated depreciation and amortization		(23,964)	(24,528)
Total property and equipment, net		\$10,611	\$11,485

Depreciation and amortization expense on property and equipment, net was \$0.6 million and \$1.2 million for the three and six months ended July 31, 2017 and \$0.8 million and \$1.6 million for the three and six months ended July 31, 2016.

Other accrued expenses

Other accrued expenses consist of the following:

	As of	
	July	January
	31,	31,
	2017	2017
	(Amounts in thousands)	
Accrued compensation and commissions	\$1,050	\$1,799
Accrued bonuses	918	1,871
Accrued restructuring	293	1,023
Employee benefits	277	885
Taxes	1,615	919
Accrued other	3,479	3,431
Total other accrued expenses	\$7,632	\$9,928

6. Goodwill and Intangible Assets

Goodwill

Goodwill represents the difference between the purchase price and the estimated fair value of identifiable assets acquired and liabilities assumed. We are required to perform impairment tests related to our goodwill annually, which we perform during the third quarter of each fiscal year, or when we identify certain triggering events or circumstances that would more likely than not

reduce the estimated fair value of the goodwill of the Company below its carrying amount. At July 31, 2017 and January 31, 2017, we had goodwill of \$24.7 million and \$23.3 million, respectively. The change in the carrying amount of goodwill for the six months ended July 31, 2017 is due to the impact of foreign currency translation adjustments related to goodwill balances that are recorded in currencies other than the U.S. dollar. The following table represents the changes in the carrying amount of goodwill for the six months ended July 31, 2017 (amounts in thousands):

Balance as of February 1, 2017:	
Goodwill, gross	\$62,566
Accumulated impairment losses	(39,279)
Goodwill, net	23,287
Cumulative translation adjustment	1,381
Balance as of July 31, 2017:	
Goodwill, gross	63,947
Accumulated impairment losses	(39,279)
Goodwill, net	\$24,668

We considered potential impairment indicators of goodwill as of July 31, 2017, and noted no indicators that would require us to perform an impairment test. However, at the time of this report, the Company is in the process of its annual goodwill impairment testing and expects it to be completed by the end of the third quarter of fiscal 2018.

In the second quarter of fiscal 2017, triggering events prompted us to perform “Step 1” of the goodwill impairment test. The triggering events included; a sustained decrease in our stock price during the period, the withdrawal of the permanent reinvestment assertion on earnings generated by our Irish operations and a decline in actual revenue for the quarter compared to projected amounts, which was previously reported in a Current Report on Form 8-K furnished to the SEC on August 23, 2016. The outcome of that preliminary “Step 1” analysis revealed that as of July 31, 2016, the fair value of the net assets exceeded its carrying value by a range of \$15.4 million to \$25.0 million, or 15.0% to 24.4% of the carrying value of our net assets.

During the third quarter of fiscal 2017, we finalized our “Step 1” analysis of the goodwill impairment test. Our forecast indicated that the estimated fair value of net assets may be less than the carrying value which is a potential indicator of impairment. As such, we were required to perform “Step 2” of the impairment test during which we compare the implied fair value of our goodwill to its carrying value.

We determined based on “Step 1” of our fiscal 2017 annual impairment test, that the fair value of our reporting unit was less than its carrying value, which was \$102.5 million at August 1, 2016. As a result, we performed “Step 2” of the impairment test. In “Step 2” of the impairment test we compared the implied fair value of our goodwill to its carrying value. After adjusting the carrying value of all assets, liabilities and equity to fair value at August 1, 2016, the estimated implied fair value of goodwill was calculated to be \$22.3 million. Since the implied fair value of goodwill of \$22.3 million is less than the carrying value of \$45.8 million as of August 1, 2016, we recorded an impairment charge of \$23.5 million to loss on impairment of long-lived assets in our consolidated statements of operations and comprehensive loss in January 2017.

Intangible Assets

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

Intangible assets, net, consisted of the following at July 31, 2017 and January 31, 2017:

	As of July 31, 2017			As of January 31, 2017			
	Weighted average remaining life (Years)	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Finite-life intangible assets:							
Customer contracts	2.3	\$31,114	\$ (29,547)	\$1,567	\$30,056	\$ (28,019)	\$2,037
Non-compete agreements	0.8	2,537	(2,525)	12	2,374	(2,356)	18
Completed technology	2.5	11,097	(10,695)	402	10,496	(9,997)	499
Trademarks, patents and other	2.8	7,164	(7,117)	47	7,125	(7,076)	49
Total finite-life intangible assets	2.4	\$51,912	\$ (49,884)	\$2,028	\$50,051	\$ (47,448)	\$2,603

As of July 31, 2017, the estimated future amortization expense for our finite-life intangible assets is as follows (amounts in thousands):

Fiscal Year Ended January 31,	Estimated Amortization Expense
2018 (for the remaining six months)	\$ 854
2019	862
2020	305
2021	7
2022	—
2023 and thereafter	—
Total	\$ 2,028

7. Commitments and Contingencies Indemnification and Warranties

We provide indemnification, to the extent permitted by law, to our 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 our request in such capacity. With respect to acquisitions, we provide indemnification to, or assume indemnification obligations for, the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' governing documents. As a matter of practice, we have maintained directors' and officers' liability insurance including coverage for directors and officers of acquired companies.

We enter into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require us to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to our products. From time to time, we also indemnify 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 our products and services or resulting from the acts or omissions of us, our employees, authorized agents or subcontractors. From time to time we have received requests from customers for indemnification of patent litigation claims. Management cannot reasonably estimate any potential losses, but these claims could result in material liability for us. There are no current pending legal proceedings, in the opinion of management, that would have a material adverse effect on our financial position, results from operations and cash flows. There is no assurance that future legal proceedings arising from ordinary course of business or otherwise, will not have a material adverse effect on our financial position, results from operations or cash flows.

We warrant that our products, including software products, will substantially perform in accordance with our standard published specifications in effect at the time of delivery. In addition, we provide maintenance support to our customers and therefore allocate a portion of the product purchase price to the initial warranty period and recognize revenue on a straight-line basis over that warranty period related to both the warranty obligation and the maintenance support agreement. When we enter into arrangements that include revenue for extended warranties beyond the standard duration, the revenue is deferred and recognized on a straight-line basis over the contract period. Related costs are expensed as incurred.

8. Severance and Other Restructuring Costs

Restructuring Costs

During the six months ended July 31, 2017, we incurred restructuring charges of \$2.5 million primarily from employee-related benefits for terminated employees and costs to close facilities.

The following table shows the activity in accrued restructuring reported as a component of other accrued expenses on the consolidated balance sheet as of July 31, 2017 (amounts in thousands):

	Employee-Related Benefits	Closure of Leased Facilities	Other Restructuring	Total
Accrual balance as of January 31, 2017	\$ 785	\$ 130	\$ 108	\$1,023
Restructuring charges incurred	2,218	89	190	2,497
Cash payments	(2,771)	(232)	(240)	(3,243)
Other charges	16	—	—	16
Accrual balance as of July 31, 2017	\$ 248	\$ (13)	\$ 58	\$293

During the third quarter of fiscal 2017, we implemented a restructuring program (“Restructuring Plan”) with the purpose of reducing costs and assisting in restoring SeaChange to profitability and positive cash flow. The total estimated restructuring costs associated with the Restructuring Plan are anticipated to be approximately \$7.5 million and will be recorded in severance and other restructuring costs in our consolidated statements of operations and comprehensive loss as they are incurred. We recorded \$2.4 million of restructuring expense in connection with this plan during the six months ended July 31, 2017, which was primarily made up of employee-related costs. Since its implementation, we have recognized \$5.5 million in restructuring charges related to the Restructuring Plan and we expect to incur any remaining charges by the end of fiscal 2018. Any changes to the estimate of executing the Restructuring Plan will be reflected in our future results of operations.

During the second quarter of fiscal 2017, we restructured our operations in connection with the acquisition of DCC Labs. This restructuring resulted in a workforce reduction within our In-Home engineering and services organization and in the closing of our facility in Portland, Oregon and a substantial reduction to our facility in Milpitas, California. We recorded \$0.1 million of restructuring expense in connection with this action during the six months ended July 31, 2017, which was primarily made up of facility and other costs not related to employees. We incurred charges totaling \$2.0 million in severance and other restructuring costs from the second quarter of fiscal 2017 through the second quarter of fiscal 2018 related to the acquisition. Once we complete our integration plan, any further reduction in workforce may result in additional restructuring charges.

9. Stockholders’ Equity

2011 Compensation and Incentive Plan

In July 2011, our stockholders approved the adoption of our 2011 Compensation and Incentive Plan (the “2011 Plan”). The 2011 Plan provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units (“RSUs”), deferred stock units (“DSUs”) and other equity based non-stock option awards as determined by the plan administrator to officers, employees, consultants, and directors of the Company.

On July 13, 2017, our stockholders approved an amendment to the 2011 Plan which increased the number of shares under the 2011 Plan by 4,000,000 shares and correspondingly increased the number of incentive stock options that can be authorized for issuance under the 2011 Plan. We are currently in the process of preparing a Registration Statement on Form S-8 to register these shares with the SEC. The shares will become available for future grant under the 2011 Plan and freely tradeable without restrictions under the Securities Act immediately upon the effectiveness of the registration which we expect to be during the third quarter of fiscal 2018.

We may satisfy awards upon the exercise of stock options or the vesting of stock units with newly issued shares or treasury shares. The Board of Directors is responsible for the administration of the 2011 Plan and determining the terms of each award, award exercise price, the number of shares for which each award is granted and the rate at which each award vests. In certain instances, the Board of Directors may elect to modify the terms of an award. As of July 31, 2017, there were 322,118 shares available for future grant under the 2011 Plan.

Option awards may be granted to employees at an exercise price per share of not less than 100% of the fair market value per common share on the date of the grant. Stock units may be granted to any officer, employee, director, or consultant at a purchase price per share as determined by the Board of Directors. Option awards granted under the 2011 Plan generally vest over a period of one to four years and expire ten years from the date of the grant.

In fiscal 2016, the Board of Directors developed a new Long-Term Incentive (“LTI”) Program under which the named executive officers and other key employees of the Company will receive long-term equity-based incentive awards, which are intended to align the interests of our named executive officers and other key employees with the long-term interests of our stockholders and to emphasize and reinforce our focus on team success. Long-term equity-based incentive compensation awards are made in the form of stock options, RSUs and performance stock units (“PSUs”) subject to vesting based in part on the extent to which employment continues for three years.

We have granted market-based options to certain officers concurrent with their appointment. These stock options have an exercise price equal to our closing stock price on the date of grant and will vest in approximately equal increments based upon the closing price of SeaChange's common stock. We record the fair value of these stock options using the Monte Carlo simulation model, since the stock option vesting is variable depending on the closing price of our traded common stock. The model simulated the daily trading price of the market-based stock options expected terms to determine if the vesting conditions would be triggered during the term. Effective April 6, 2016, Ed Terino, who previously served as our Chief Operating Officer ("COO"), was appointed Chief Executive Officer ("CEO") of SeaChange and was granted 600,000 market-based options, bringing the total of his market-based options, when added to the 200,000 market-based options he received upon hire as COO in June 2015, to 800,000 market-based options. The fair value of these 800,000 stock options was estimated to be \$2.1 million. As of July 31, 2017, \$0.5 million remained unamortized on these market-based stock options, which will be expensed over the next 1.9 years, the remaining weighted average amortization period.

2015 Employee Stock Purchase Plan

In July 2015, we adopted the 2015 Employee Stock Purchase Plan (the "ESPP"). The purpose of the ESPP is to provide eligible employees, including executive officers of SeaChange, with the opportunity to purchase shares of our common stock at a discount through accumulated payroll deductions of up to 15%, but not less than one percent of their eligible compensation, subject to any plan limitations. Offering periods typically commence on October 1st and April 1st and end on March 31st and September 30th with the last trading day being the exercise date for the offering period. On each purchase date, eligible employees will purchase our stock at a price per share equal to 85% of the closing price of our common stock on the exercise date, but no less than par value. The maximum number of shares of our common stock which will be authorized for sale under the ESPP is 1,150,000 shares. Stock-based compensation expense related to the ESPP was not significant for the three and six months ended July 31, 2017.

10. Accumulated Other Comprehensive Loss

The following shows the changes in the components of accumulated other comprehensive loss for the six months ended July 31, 2017:

	Changes in Fair Value		
	Foreign Currency Translation Adjustment	of Available- for-Sale Investments	Total
	(Amounts in thousands)		
Balance at January 31, 2017	\$(5,377)	\$ 6	\$(5,371)
Other comprehensive loss	3	(5)	(2)
Balance at July 31, 2017	\$(5,374)	\$ 1	\$(5,373)

Unrealized holding gains (losses) on securities available-for-sale are not material for the periods presented.

Comprehensive loss consists of our net loss and other comprehensive income (loss), which includes foreign currency translation adjustments and changes in unrealized gains and losses on marketable securities available-for-sale. Except in unusual circumstances, we do not recognize tax effects on foreign currency translation adjustments because they are not expected to result in future taxable income or deductions.

11. Segment Information, Significant Customers and Geographic Information
Segment Information

Our operations are organized into one reportable segment. Operating segments are defined as components of an enterprise evaluated regularly by the Company's chief operating decision maker in deciding how to allocate resources and assess performance. Our reportable segment was determined based upon the nature of the products offered to customers, the market characteristics of each operating segment and the Company's management structure.

Significant Customers

One customer accounted for 10% or more of our total revenues for the three and six months ended July 31, 2017 and 2016 as follows:

	Three Months Ended July 31, 2017		Six Months Ended July 31, 2016	
Customer A	27%	28%	27%	30%

Geographic Information

The following table summarizes revenues by customers' geographic locations for the periods presented:

Revenues by customers' geographic locations:	Three Months Ended July 31, 2017		2016		Six Months Ended July 31, 2017		2016	
	Amount	%	Amount	%	Amount	%	Amount	%
	(Amounts in thousands, except percentages)							
North America (1)	\$8,320	48%	\$8,520	46%	\$16,646	49%	\$19,191	48%
Europe and Middle East	6,478	38%	8,439	46%	13,643	40%	17,580	44%
Latin America	2,142	12%	1,265	7%	2,863	9%	2,450	6%
Asia Pacific	285	2%	228	1%	740	2%	801	2%
Total	\$17,225		\$18,452		\$33,892		\$40,022	

(1) Includes total revenues for the United States for the periods shown as follows (amounts in thousands, except percentage data):

	Three Months Ended July 31, 2017		Six Months Ended July 31, 2016	
U.S. Revenue	\$7,047	\$6,689	\$14,075	\$15,135
% of total revenues	40.9%	36.3%	41.5%	37.8%

12. Income Taxes

We recorded an income tax provision of approximately \$35,000 and \$14.6 million for the three months ended July 31, 2017 and 2016. We recorded a tax provision of \$0.3 million and \$14.8 million for the six months ended July 31, 2017

and 2016. In the second quarter of fiscal 2017, we recorded a charge of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2018 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of July 31, 2017, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

We file income tax returns in the U.S. federal jurisdiction, various state jurisdictions, and various foreign jurisdictions. We have closed out an audit with the Internal Revenue Service (“IRS”) through fiscal 2013, however, the taxing authorities will still have the ability to review the propriety of certain tax attributes created in closed years if such tax attributes are utilized in an open tax year, such as our federal research and development credit carryovers.

13. Net Loss Per Share

Net loss per share is presented in accordance with authoritative guidance which requires the presentation of “basic” and “diluted” earnings per share. Basic earnings (loss) per share is computed by dividing earnings (loss) 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 dilutive shares of common stock, such as stock awards, calculated using the

treasury stock method. Basic and diluted net loss per share was the same for all the periods presented as the impact of potential dilutive shares outstanding was anti-dilutive.

The following table sets forth our computation of basic and diluted net loss per common share (amounts in thousands, except per share amounts):

	Three Months		Six Months Ended	
	Ended July 31, 2017	2016	July 31, 2017	2016
Net loss	\$(1,529)	\$(26,884)	\$(6,900)	\$(35,791)
Weighted average shares used in computing net loss per				
share - basic and diluted	35,351	35,115	35,331	34,739
Net loss per share:				
Basic	\$(0.05)	\$(0.77)	\$(0.20)	\$(1.03)
Diluted	\$(0.05)	\$(0.77)	\$(0.20)	\$(1.03)

The number of common shares used in the computation of diluted net loss per share for the three and six months ended July 31, 2017 and 2016 does not include the effect of the following potentially outstanding common shares because the effect would have been anti-dilutive (amounts in thousands):

	Three Months		Six Months	
	Ended July 31, 2017	2016	Ended July 31, 2017	2016
Stock options	1,636	1,633	1,657	1,284
Restricted stock units	365	613	889	601
Deferred stock units	158	45	130	42
Performance stock units	473	214	128	244
Total	2,632	2,505	2,804	2,171

14. Recent Accounting Standard Updates

We consider the applicability and impact of all ASUs on our consolidated financial statements. Updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations. Recently issued ASUs which we feel may be applicable to us are as follows:

Recently Issued Accounting Standard Updates – Not Yet Adopted

Revenue from Contracts with Customers (Topic 606)

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU. 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies using International Financial Reporting Standards and U.S. GAAP. The core principle requires entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB voted to approve a one year deferral, making the standard effective for public entities for annual and interim periods beginning after December 15, 2017.

In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” The purpose of ASU 2016-08 is to clarify the guidance on principal versus agent considerations. It includes indicators that help to determine whether an entity controls the specified good or service before it is transferred to the customer and to assist in determining when the entity satisfied the performance obligation and as such, whether to recognize a gross or a net amount of consideration in their consolidated statement of operations.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies that entities are not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. ASU 2016-10 also addresses how to determine

whether promised goods or services are separately identifiable and permits entities to make a policy election to treat shipping and handling costs as fulfillment activities. In addition, it clarifies key provisions in Topic 606 related to licensing.

In May 2016, the FASB issued ASU 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815)." ASU 2016-11 rescinds previous SEC comments that were codified in Topic 605, Topic 932 and Topic 815. Upon adoption of Topic 606, certain SEC comments including guidance on accounting for shipping and handling fees and costs and consideration given by a vendor to a customer should not be relied upon.

In May 2016, the FASB also issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients." ASU 2016-12 provides clarity around collectability, presentation of sales taxes, non-cash consideration, contract modifications at transition and completed contracts at transition. ASU 2016-12 also includes a technical correction within Topic 606 related to required disclosures if the guidance is applied retrospectively upon adoption.

In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." ASU 2016-20 allows entities not to make quantitative disclosures about remaining performance obligations in certain cases and requires entities that use any of the optional exemptions to expand their qualitative disclosures. ASU 2016-20 also clarifies other areas of the new revenue standard, including disclosure requirements for prior period performance obligations, impairment guidance for contract costs and the interaction of impairment guidance in ASC 340-40 with other guidance elsewhere in the Codification.

The Company will adopt Topic 606 effective February 1, 2018 under the modified retrospective method and will only apply this method to contracts that are not completed as of the date of adoption. The modified retrospective method will result in a cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at the date of initial application for any open contracts as of the adoption date. The Company has established an implementation team, including the utilization of third-party resources, to assist with its assessment of the impact of the new revenue guidance on its operations, consolidated financial statements and related disclosures. In addition, the Company has made investments in systems to enable timely and accurate reporting under the new standard. To date, the Company's assessment has included (1) utilizing questionnaires to assist with the identification of revenue streams, (2) performing sample contract analyses for each revenue stream identified, (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard, (4) performing detailed analyses of contracts with larger customers, and (5) developing plans to test transactions for consistency with contract provisions that affect revenue recognition. Based on the preliminary results of the evaluation, which is still in process, the Company currently believes that the most significant potential changes to be the allocation of transaction price to performance obligations which will be based on a relative standalone selling price analysis, which may differ from the Company's historical allocation of transaction consideration under legacy U.S. GAAP, and the timing of revenue recognition which may be at a later point in time than under legacy U.S. GAAP. As part of the preliminary procedures completed by the Company they have also assessed accounting for incremental costs to obtain a contract and costs incurred in fulfilling a contract. Based on preliminary results of the evaluation, which is still in process, the Company currently believes that the most significant potential change to be accounting for commissions, as these incremental

costs are expected to be capitalized and will be amortized over a period of time which could extend beyond the initial contract term. The Company also anticipates changes to the consolidated balance sheet related to accounts receivable, contract assets, and contract liabilities, as well as, significant changes to its disclosures to comply with the new disclosure requirements under Topic 606. The Company is continuing to design the necessary changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Further, the Company is continuing to assess what incremental disaggregated revenue and other disclosures will be required in its consolidated financial statements, which the Company believes will be significant. Given the continuing analysis and implementation, the Company cannot reasonably estimate quantitative information related to the impact of the new guidance on its consolidated financial statements at this time.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires a lessee to recognize a right-of-use asset and a lease liability for operating leases with terms over twelve months, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. It also requires lessees to classify leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. ASU 2016-02 is effective for us in the first quarter of fiscal 2020. Early

adoption is permitted. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Cash Flow Statement

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and annual periods beginning in our first quarter of fiscal 2019, and early adoption is permitted. ASU 2016-15 must be applied retrospectively to all periods presented but may be applied prospectively if retrospective application would be impracticable. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance is effective for us in the first quarter of fiscal 2019 and early adoption is permitted. ASU 2016-18 must be applied retrospectively to all periods presented. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Intangibles-Goodwill and Other

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350), which simplifies the subsequent measurement of goodwill by removing “Step 2” of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance is effective for us beginning in the first quarter of fiscal 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Stock Compensation

In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment awards require an entity to apply modification accounting under ASC 718. The guidance is effective for us beginning in the first quarter of fiscal 2019 and early adoption is permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

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

Forward-Looking Statements

This Form 10-Q contains or incorporates forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and such statements involve risks and uncertainties. The following information should be read in conjunction with the unaudited consolidated financial information and the notes thereto included in this Form 10-Q. 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 Form 10-K for our fiscal year ended January 31, 2017 and elsewhere in this Form 10-Q. These factors may cause our actual results to differ materially from any forward-looking statement. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate, and management's beliefs and assumptions. We undertake no obligation to publicly update or revise the statements in light of future developments. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as "expect," "anticipate," "intend," "plan," "believe," "could," "estimate," "may," "target," "project," or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict.

Business Overview

We are an industry leader in the delivery of multiscreen, advertising and premium over-the-top ("OTT") video headquartered in Acton, Massachusetts. Our products and services facilitate the aggregation, licensing, management and distribution of video and advertising content for cable television system operators, telecommunications companies, satellite operators and media companies. We currently operate under one reporting segment.

We address what we see as the continuing rise of Internet Protocol television ("IPTV") and OTT services by such companies as Netflix, Hulu, Amazon, mlbam, Kaltura, Ooyala and Brightcove and by media companies such as HBO, CBS and BBC. This rise of IPTV and OTT video services in the United States has increased the demand for multiscreen capabilities on a range of consumer devices operating on cloud-based platforms. We have been increasing our strategic investments in research and development related to our cloud-based offerings, as well as in sales and marketing as we focus on our go-to-market efforts in these areas.

We continue to invest in developing next generation capabilities in our four main product offerings, video back office, advertising, content management and user experience. Our suite of products allows us to provide customers with end-to-end video delivery capabilities across multiple platforms, thus reducing cost and increasing speed and ease of use for end users. We believe that by delivering innovative solutions to both our existing customer base and to content owners that are looking to provide end-to-end solutions, we can meet their growing needs and help them get to market faster, which will help them drive new revenue growth. We have virtualized our solutions and products to make integrating with existing networks simple and this is a core competency of our platform. We have optimized our software solutions to serve a wide range of consumer devices.

We expect to increase software sales in North America and Europe, the Middle East and Africa ("EMEA") through targeted sales efforts in those regions. In addition, we believe that we have the opportunity for revenue growth by expanding our selling efforts in new geographic areas such as Asia Pacific and Latin America. We also believe that our existing service operator customers will continue upgrading to new features that can increase average revenue per subscriber, reduce operating and capital expenses, and lower customer churn.

We continue to experience fluctuations in our revenues from period to period due to the following factors:

- Changes to estimated times to complete long-term projects;
- The time required to deliver and install the product and for the customer to accept the product and services;
- Timing of customers in selecting programs to launch our services to their end users;
- The ability of our customers to process the purchase order within their organization in a timely manner;
- The transition from perpetual license to subscription, cloud-based revenue and the associated deviation from our traditional professional services delivery model;
- Budgetary approvals by our customers for capital purchases;
- Uncertainty caused by potential consolidation in the industry; and
- Changes in foreign exchange rates.

These, together with other factors, could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, a longer period of time before we may recognize revenue attributable to a sale, changes in cost estimates on long-term contracts that could result in a loss provision, gross margin deterioration, slower adoption of new technologies, the transition to software-as-a-service (“SaaS”) delivery, and increased price competition.

On May 5, 2016, we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.7 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. The stock consideration was determined by dividing the total value of \$2.7 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all the stock (681,278 shares) were initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement. One-third of the stock in escrow will be released to the former DCC Labs owners annually on the anniversary date of the acquisition beginning on May 5, 2017 and ending May 5, 2019, and one-half of the cash in escrow will be released to the former DCC Labs owners on May 5, 2017 and May 5, 2018. On May 5, 2017, \$0.3 million in cash and 227,090 shares of our common stock initially deposited with an Escrow Agent were disbursed to the sellers.

The acquisition of DCC Labs enables us to optimize the operations of our In-Home business, which develops home video gateway software including SeaChange’s Nucleus and NitroX products. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe’s Digital Video Broadcasting community, and an HTML5 framework for building additional user experience client applications across a variety of CPE devices, including Android TV STBs, tablets, mobile and computer devices.

In conjunction with the DCC Labs acquisition, SeaChange commenced a workforce reduction within its In-Home engineering and services organization, which allowed us to achieve approximately \$8 million in annualized cost savings. This reduction in workforce has resulted in aggregate charges of \$2.0 million in severance and other restructuring costs since its implementation.

In addition to the reduction in workforce associated with the acquisition of DCC Labs, we implemented additional company-wide cost savings efforts during the second half of fiscal 2017, including a worldwide reduction in workforce, to help improve operations and optimize our cost structure with the goal of assisting in restoring SeaChange to profitability and positive cash flow. In the first half of fiscal 2018, we recognized \$2.4 million of restructuring costs related to these cost-saving initiatives and have recognized \$5.5 million since the program was implemented.

We recorded an income tax provision of \$14.6 million in fiscal 2017, primarily relating to deferred income tax expense of \$14.7 million related to the undistributed foreign earnings of certain of our foreign subsidiaries. Prior to the end of the second quarter of fiscal 2017, we asserted that the undistributed earnings of all our foreign subsidiaries were permanently reinvested and, accordingly were not subject to U.S. income taxes. In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet the Company’s working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016, and recorded a deferred tax liability of \$14.7 million related to the foreign income on the \$58.6 million of undistributed earnings. As of July 31, 2017, the balance of the deferred tax liability is \$16.3 million. There is no certainty as to the timing of when such foreign earnings will be distributed via dividend to the United States in whole or in part. In addition, when the foreign earnings are distributed to the United States, we anticipate that a substantial portion of the resulting U.S. income taxes would be reduced by existing tax attributes.

Governance Changes

Following our 2017 annual meeting of stockholders on July 13, 2017, we have made significant changes to our Board of Directors as follows:

• Thomas Olson resigned from the Board of Directors following the outcome of the 2017 annual meeting of stockholders where Mr. Olson received fewer votes “for” his re-election than votes “against”. The Board of Directors accepted Mr. Olson’s resignation on July 18, 2017.

• Steven Craddock retired from the Board of Directors effective August 17, 2017. Mr. Craddock’s decision to resign did not involve a disagreement with SeaChange on any matter relating to SeaChange’s operations, policies or practices.

• William Markey was appointed Chairman of the Board effective August 17, 2017.

• Mark Bonney was appointed to our Board of Directors on August 17, 2017 pursuant to the terms of a Cooperation Agreement entered into between SeaChange and VIEX Capital Advisors, which also provides for a “standstill” period through August 30, 2018.

•Andy Sriubas, an experienced strategist and commercial expert in media and technology, was also appointed to the Board of Directors on August 17, 2017. Mr. Sriubas has been an advisor to the Board of Directors since May 2016.

In addition to the appointment of Mr. Markey as Chairman of the Board, the Audit, Compensation, and Corporate Governance and Nominating Committees were reconstituted as follows:

- Audit Committee: Mary Palermo Cotton (Chair), William Markey, Mark Bonney and Andrew Sriubas.
- Compensation Committee: Mark Bonney (Chair), Mary Palermo Cotton and Andrew Sriubas.
- Corporate Governance and Nominating Committee: William Markey (Chair), Mary Palermo Cotton and Royce E. Wilson.

Results of Operations

The following discussion summarizes the key factors our management believes are necessary for an understanding of our consolidated financial statements. As mentioned in Note 1. “Nature of Business and Basis of Presentation – Basis of Presentation,” to this Form 10-Q, effective February 1, 2017, as a result of a change in how we review our business, costs associated with our Solutions Architect employees which were formerly classified as research and development expenses, are now classified as selling and marketing expenses. Management feels that the tasks of these employees are more in line with the tasks of the sales group rather than with research and development. In addition, all Solutions Architect research and development costs prior to February 1, 2017, which were primarily employee-related costs, were reclassified to cost of revenues because they all related to revenue-generating projects. Beginning on February 1, 2017, this reclassification is from selling and marketing expense to cost of revenues and the amount is determined based on the hours worked on revenue-generating projects by Solutions Architect employees. Prior fiscal year amounts were adjusted to conform to this presentation. The effect of this change in methodology, which has no effect on loss from operations, is reflected in our current statements of operations and comprehensive loss for the three and six months ended July 31, 2016.

Revenues

The following table summarizes information about our revenues for the three months ended July 31, 2017 and 2016:

	Three Months Ended July 31,		Increase/ (Decrease) \$	Increase/ (Decrease) % Change	Six Months Ended July 31,		Increase/ (Decrease) \$	Increase/ (Decrease) % Change	
	2017	2016	Amount	% Change	2017	2016	Amount	% Change	
(Amounts in thousands, except for percentage data)									
Revenues:									
Product	\$5,039	\$2,535	\$ 2,504	98.8 %	\$7,788	\$6,735	\$ 1,053	15.6 %	
Service	12,186	15,917	(3,731)	(23.4 %)	26,104	33,287	(7,183)	(21.6 %)	
Total revenues	17,225	18,452	(1,227)	(6.6 %)	33,892	40,022	(6,130)	(15.3 %)	
Cost of product revenues	1,363	1,190	172	14.5 %	1,942	2,847	(904)	(31.8 %)	
Cost of service revenues	4,446	9,239	(4,792)	(51.9 %)	10,657	19,490	(8,834)	(45.3 %)	
Total cost of revenues	5,809	10,429	(4,620)	(44.3 %)	12,599	22,337	(9,738)	(43.6 %)	

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

Gross profit	\$11,416	\$8,023	\$3,393	42.3	%	\$21,293	\$17,685	\$3,608	20.4	%		
Gross product profit margin	73.0	%	53.0	%	20.0	%	75.1	%	57.7	%	17.4	%
Gross service profit margin	63.5	%	42.0	%	21.6	%	59.2	%	41.4	%	17.7	%
Gross profit margin	66.3	%	43.5	%	22.8	%	62.8	%	44.2	%	18.6	%

Product Revenue. The increase in product revenue for the three and six months ended July 31, 2017 of \$2.5 million and \$1.1 million, respectively, was primarily due to a \$1.8 million and \$1.1 million increase in our video platform revenue for the three and six months ended July 31, 2017, as compared to the same periods of fiscal 2017. Also, there was a \$0.5 million and \$0.7 million increase in hardware revenue.

Service Revenue. Service revenue decreased \$3.7 million for the three months ended July 31, 2017 and decreased \$7.2 million for the six months ended July 31, 2017, as compared to the same periods of fiscal 2017. The decline was primarily due to less revenue recognized for professional services provided on our video platform during the current fiscal year. Additionally, there was a decrease in maintenance and support revenue provided on post-warranty contracts.

During each period shown in the table above, one customer accounted for more than 10% of our total revenue. See Note 11, "Segment Information, Significant Customers and Geographic Information," to our consolidated financial statements for more information.

International revenues accounted for approximately 59% and 64% of total revenues in the three months ended July 31, 2017 and 2016, respectively. For the six months ended July 31, 2017 and 2016, international revenues accounted for 58% and 62% of total revenues. The decrease in the international sales as a percentage of total revenue for the three and six months ended July 31, 2017, as compared to the same prior period is primarily due to the decrease in revenue outside the United States at a higher rate than the decrease in domestic revenue.

Gross Profit and Margin. Cost of revenues consists primarily of the cost of resold third-party products and services, purchased components and subassemblies, labor and overhead relating to the assembly and testing of complete systems and costs related to customized software development contracts.

Our gross profit margin increased 23 percentage points for the three months ended July 31, 2017, as compared to the same period of the prior fiscal year and increased 19 percentage points for the six months. Product gross margin increased 20 percentage points for the three months and 17 percentage points for the six months ended July 31, 2017, as compared to the same periods in the prior fiscal year, primarily due to an increase in software revenue and decrease in costs, specifically employee-related costs resulting from the cost-savings initiatives implemented beginning in the third quarter of fiscal 2017. Service profit margins increased 22 percentage points for the three months ended and increased 18 percentage points for the six months ended July 31, 2017, as compared to the same periods of the prior fiscal year, in part due to lower employee-related costs described above.

Operating Expenses

Research and Development

The following table provides information regarding the change in research and development expenses during the periods presented:

	Three Months Ended July 31,		Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change	Six Months Ended July 31,		Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change
	2017	2016			2017	2016		
Research and development expenses	\$6,399	\$7,727	\$ (1,328)	(17.2 %)	\$11,777	\$16,426	\$ (4,649)	(28.3 %)
% of total revenues	37.1 %	41.9 %			34.7 %	41.0 %		

(Amounts in thousands, except for percentage data)

Research and development expenses consist primarily of employee costs, which include salaries, benefits and related payroll taxes, depreciation of development and test equipment and an allocation of related facility expenses. During the three and six months ended July 31, 2017, research and development costs decreased \$1.3 million and \$4.6 million, respectively, as compared to the same periods of fiscal 2017, primarily due to lower labor costs associated with the decreased headcount from the restructuring of the research and development group after our acquisition of DCC Labs in May 2016 and to cost-savings efforts implemented in the second half of fiscal 2017.

Selling and Marketing

The following table provides information regarding the change in selling and marketing expenses during the periods presented:

	Three Months				Six Months			
	Ended July 31, 2017	2016	Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change	Ended July 31, 2017	2016	Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change
(Amounts in thousands, except for percentage data)								
Selling and marketing expenses	\$2,439	\$4,429	\$ (1,990)	(44.9 %)	\$5,376	\$8,499	\$ (3,123)	(36.7 %)
% of total revenues	14.2 %	24.0 %			15.9 %	21.2 %		

Selling and marketing expenses consist primarily of payroll costs, which include salaries and related payroll taxes, benefits and commissions, travel expenses and certain promotional expenses. Selling and marketing expenses decreased \$2.0 million and \$3.1 million for the three and six months ended July 31, 2017, respectively, as compared to the same periods of the prior fiscal year, primarily due to lower employee-related costs. These lower costs were a result of the cost-savings initiatives implemented in the second half of fiscal 2017. Partially offsetting the decreases for each period is an increase in marketing payroll costs resulting from the addition of employees from the DCC Labs acquisition in May 2016.

General and Administrative

The following table provides information regarding the change in general and administrative expenses during the periods presented:

	Three Months				Six Months					
	Ended July 31, 2017		2016		Ended July 31, 2017		2016		Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change
General and administrative expenses	\$3,084	\$3,835	\$ (751)	(19.6 %)	\$6,727	\$7,906	\$ (1,179)	(14.9 %)		
% of total revenues	17.9 %	20.8 %			19.8 %	19.8 %				

General and administrative expenses consist primarily of employee costs, which include salaries and related payroll taxes and benefit-related costs, legal and accounting services and an allocation of related facilities expenses. General and administrative expenses decreased \$0.8 million and \$1.2 million in the three and six months ended July 31, 2017, respectively, as compared to the same periods of fiscal 2017, primarily due to a decrease in labor costs resulting from the reduction of our headcount as part of our cost-savings initiatives implemented in the second half of fiscal 2017. This decrease was partially offset by an increase in professional fees, such as internal and external audit fees, and legal fees.

Amortization of Intangible Assets

The following table provides information regarding the change in amortization of intangible assets expenses during the periods presented:

	Three Months				Six Months					
	Ended July 31, 2017		2016		Ended July 31, 2017		2016		Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change
Amortization of intangible assets	\$616	\$898	\$ (282)	(31.4 %)	\$1,214	\$1,664	\$ (450)	(27.0 %)		
% of total revenues	3.6 %	4.9 %			3.6 %	4.2 %				

Amortization expense relates to the costs of acquired intangible assets and capitalized internally-developed software costs. The decrease in amortization expense for the three and six months ended July 31, 2017, as compared to the same periods of fiscal 2017, is primarily due to the fully amortized intangible assets from prior acquisitions as well as a change in foreign exchange rates.

Stock-based Compensation Expense

The following table provides information regarding the change in stock-based compensation expense during the periods presented:

	Three Months Ended July 31, 2017			Six Months Ended July 31, 2017			Six Months Ended July 31, 2016		
	2017	2016	Increase/ (Decrease) \$ Amount	2017	2016	Increase/ (Decrease) \$ Amount	2017	2016	Increase/ (Decrease) \$ Amount
Stock-based compensation expense	\$653	\$939	\$ (286)	\$1,530	\$1,051	\$ 479	\$1,530	\$1,051	\$ 479
% of total revenues	3.8 %	5.1 %	(30.5 %)	4.5 %	2.6 %	45.6 %	4.5 %	2.6 %	45.6 %

Stock-based compensation expense is related to the issuance of stock grants to our employees, executives and members of our Board of Directors. Stock-based compensation expense decreased \$0.3 million in the three months ended July 31, 2017 primarily due to a decrease in expense related to non-performance based RSUs due to lower grant day stock prices and to a decrease in stock compensation expense on the CEO's market-based stock options. Stock compensation expense increased \$0.5 million for the six months ended July 31, 2017, as compared to the same period in fiscal 2017, primarily due to the reversal of our former CEO's stock-based compensation in the first quarter of fiscal 2017 upon his departure from the Company. This increase is partially offset by a decrease in stock-based compensation expense related to non-performance based RSUs due to lower grant day stock prices.

Severance and Other Restructuring Costs

The following table provides information regarding the change in severance and other restructuring costs during the periods presented:

	Three Months		Increase/		Increase/		Six Months		Increase/		Increase/	
	Ended		(Decrease)		(Decrease)		Ended		(Decrease)		(Decrease)	
	July 31,		\$	%	\$	%	July 31,		\$	%	\$	%
	2017	2016	Amount	Change	2017	2016	Amount	Change	Amount	Change	Amount	Change
(Amounts in thousands, except for percentage data)												
Severance and other restructuring costs	\$563	\$1,843	\$ (1,280)	(69.5 %)	\$2,710	\$3,618	\$ (908)	(25.1 %)				
% of total revenues	3.3 %	10.0 %			8.0 %	9.0 %						

Severance and other restructuring costs decreased \$1.3 million for the three months ended July 31, 2017, as compared to the same period of fiscal 2017. Charges in fiscal 2018 include \$0.3 million related to a cost reduction initiative implemented in the second half of fiscal 2017 which we expect to be completed by the end of fiscal 2018, \$0.1 million of charges related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$0.2 million. Charges in fiscal 2017 included \$0.1 million related to the restructuring activities of our Timeline Labs operations, \$1.4 million related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$0.4 million, including severance related to our former CFO.

Severance and other restructuring costs decreased \$0.9 million for the six months ended July 31, 2017, as compared to the same period of fiscal 2017. Charges in fiscal 2018 include \$2.4 million related to a cost reduction initiative implemented in the second half of fiscal 2017 which we expect to be completed by the end of fiscal 2018, \$0.1 million of charges related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$0.2 million. Charges in fiscal 2017 included \$0.7 million related to the restructuring activities of our Timeline Labs operations, \$1.5 million related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$1.4 million, including severance related to our former CEO and CFO.

Other Income (Expenses), Net

The table below provides detail regarding our other income, net:

Three Months	Increase/	Increase/	Six Months	Increase/	Increase/
Ended	(Decrease)	(Decrease)	Ended	(Decrease)	(Decrease)

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

	Ended				Ended			
	July 31, 2017	2016	(Decrease) \$ Amount	(Decrease) % Change	July 31, 2017	2016	(Decrease) \$ Amount	(Decrease) % Change
	(Amounts in thousands, except for percentage data)							
Interest income, net	\$33	\$38	\$ (5)	(13.2 %)	\$60	\$77	\$ (17)	(22.1 %)
Foreign exchange gain (loss)	604	(676)	1,280	>100%	845	198	647	>100%
Miscellaneous (expense) income	(48)	3	(51)	>100%	50	12	38	>(100%)
	\$589	\$(635)	\$ 1,224		\$955	\$287	\$ 668	

For the three and six months ended July 31, 2017, foreign exchange gain increased by \$1.3 million and \$0.6 million, respectively, as compared to the same periods of fiscal 2017. We remeasure our foreign denominated intercompany balances periodically. The strengthening of the U.S. dollar compared to other foreign currencies during the periods presented, primarily the British Pound and Euro, resulted in this increase.

Income Tax Provision

	Three Months				Six Months			
	Ended July 31, 2017	2016	Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change	Ended July 31, 2017	2016	Increase/ (Decrease) \$ Amount	Increase/ (Decrease) % Change
	(Amounts in thousands, except for percentage data)							
Income tax provision	\$35	\$14,581	\$ (14,546)	(99.8 %)	\$304	\$14,835	\$ (14,531)	(98.0 %)
% of total revenues	0.2%	79.0 %			0.9 %	37.1 %		

We recorded an income tax provision of approximately \$35,000 and \$14.6 million for the three months ended July 31, 2017 and 2016. We recorded a tax provision of \$0.3 million and \$14.8 million for the six months ended July 31, 2017 and 2016. In the second quarter of fiscal 2017, we recorded a charge of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2018 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of July 31, 2017, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

We file income tax returns in the U.S. federal jurisdiction, various state jurisdictions, and various foreign jurisdictions. We have closed out an audit with the Internal Revenue Service (“IRS”) through fiscal 2013, however, the taxing authorities will still have the ability to review the propriety of certain tax attributes created in closed years if such tax attributes are utilized in an open tax year, such as our federal research and development credit carryovers.

Non-GAAP Measures.

We define non-GAAP (loss) income from operations as U.S. GAAP operating loss plus stock-based compensation expenses, amortization of intangible assets, provision for loss contract, earn-outs and change in fair value of earn-outs, non-operating expense professional fees and severance and other restructuring costs. We discuss non-GAAP (loss) income from operations in our quarterly earnings releases and certain other communications as we believe non-GAAP operating (loss) income from operations is an important measure that is not calculated according to U.S. GAAP. We use non-GAAP (loss) income from operations in internal forecasts and models when establishing internal operating budgets, supplementing the financial results and forecasts reported to our Board of Directors, determining a component of bonus compensation for executive officers and other key employees based on operating performance and evaluating short-term and long-term operating trends in our operations. We believe that the non-GAAP (loss) income from operations financial measure assists in providing an enhanced understanding of our underlying operational measures to manage the business, to evaluate performance compared to prior periods and the marketplace, and to establish operational goals. We believe that the non-GAAP financial adjustments are useful to investors because they allow investors to evaluate the effectiveness of the methodology and information used by management in our financial and operational decision-making.

Non-GAAP (loss) income from operations is a non-GAAP financial measure and should not be considered in isolation or as a substitute for financial information provided in accordance with U.S. GAAP. This non-GAAP financial measure may not be computed in the same manner as similarly titled measures used by other companies. We expect to continue to incur expenses similar to the financial adjustments described above in arriving at non-GAAP (loss) income from operations and investors should not infer from our presentation of this non-GAAP financial measure that these costs are unusual, infrequent or non-recurring.

The following table includes the reconciliations of our U.S. GAAP loss from operations, the most directly comparable U.S. GAAP financial measure, to our non-GAAP (loss) income from operations for the three and six months ended July 31, 2017 and 2016 (amounts in thousands, except per share and percentage data):

	Three Months Ended July 31, 2017			Three Months Ended July 31, 2016			
	GAAP As Reported	Adjustments	Non-GAAP	GAAP As Reported	Adjustments	Non-GAAP	
Revenues:							
Products	\$5,039	\$ —	\$ 5,039	\$2,535	\$ —	\$ 2,535	
Services	12,186	—	12,186	15,917	—	15,917	
Total revenues	17,225	—	17,225	18,452	—	18,452	
Cost of revenues:							
Products	1,336	—	1,336	1,108	—	1,108	
Services	4,218	766	4,984	8,920	—	8,920	
Amortization of intangible assets	255	(255)	—	316	(316)	—	
Stock-based compensation	—	—	—	85	(85)	—	
Total cost of revenues	5,809	511	6,320	10,429	(401)	10,028	
Gross profit	11,416	(511)	10,905	8,023	401	8,424	
Gross profit percentage	66.3 %	(3.0 %)	63.3 %	43.5 %	2.2 %	45.7 %	
Operating expenses:							
Research and development	6,399	—	6,399	7,727	—	7,727	
Selling and marketing	2,439	—	2,439	4,429	—	4,429	
General and administrative	3,084	—	3,084	3,835	—	3,835	
Amortization of intangible assets	361	(361)	—	582	(582)	—	
Stock-based compensation expense	653	(653)	—	854	(854)	—	
Earn-outs and change in fair value of							
earn-outs	—	—	—	249	(249)	—	
Professional fees: other	—	—	—	172	(172)	—	
Severance and other restructuring costs	563	(563)	—	1,843	(1,843)	—	
Total operating expenses	13,499	(1,577)	11,922	19,691	(3,700)	15,991	
(Loss) income from operations	\$(2,083)	\$ 1,066	\$(1,017)	\$(11,668)	\$ 4,101	\$(7,567)	
(Loss) income from operations							
percentage	(12.1 %)	6.2 %	(5.9 %)	(63.2 %)	22.2 %	(41.0 %)	
Weighted average common shares							
outstanding:							
Basic	35,351	35,351	35,351	35,115	35,115	35,115	
Diluted	35,351	35,565	35,351	35,115	35,171	35,115	

Non-GAAP operating (loss)
income per

share:						
Basic	\$(0.06)	\$ 0.03	\$(0.03)	\$(0.33)	\$ 0.12	\$(0.21)
Diluted	\$(0.06)	\$ 0.03	\$(0.03)	\$(0.33)	\$ 0.12	\$(0.21)

30

	Six Months Ended July 31, 2017			Six Months Ended July 31, 2016		
	GAAP As Reported	Adjustments	Non-GAAP	GAAP As Reported	Adjustments	Non-GAAP
Revenues:						
Products	\$7,788	\$ —	\$ 7,788	\$6,735	\$ —	\$ 6,735
Services	26,104	—	26,104	33,287	—	33,287
Total revenues	33,892	—	33,892	40,022	—	40,022
Cost of revenues:						
Products	1,890	—	1,890	2,682	—	2,682
Services	10,198	593	10,791	18,866	—	18,866
Amortization of intangible assets	509	(509)	—	632	(632)	—
Stock-based compensation	2	(2)	—	157	(157)	—
Total cost of revenues	12,599	82	12,681	22,337	(789)	21,548
Gross profit	21,293	(82)	21,211	17,685	789	18,474
Gross profit percentage	62.8 %	(0.2 %)	62.6 %	44.2 %	2.0 %	46.2 %
Operating expenses:						
Research and development	11,777	—	11,777	16,426	—	16,426
Selling and marketing	5,376	—	5,376	8,499	—	8,499
General and administrative	6,727	—	6,727	7,906	—	7,906
Amortization of intangible assets	705	(705)	—	1,032	(1,032)	—
Stock-based compensation expense	1,528	(1,528)	—	894	(894)	—
Earn-outs and change in fair value of						
earn-outs	—	—	—	249	(249)	—
Professional fees: other	21	(21)	—	304	(304)	—
Severance and other restructuring costs	2,710	(2,710)	—	3,618	(3,618)	—
Total operating expenses	28,844	(4,964)	23,880	38,928	(6,097)	32,831
(Loss) income from operations	\$(7,551)	\$ 4,882	\$(2,669)	\$(21,243)	\$ 6,886	\$(14,357)
(Loss) income from operations percentage	(22.3 %)	14.4 %	(7.9 %)	(53.1 %)	17.2 %	(35.9 %)
Weighted average common shares						
outstanding:						
Basic	35,331	35,331	35,331	34,739	34,739	34,739
Diluted	35,331	35,485	35,331	34,739	34,804	34,739
Non-GAAP operating (loss) income per share:						

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

Basic	\$ (0.22)	\$ 0.14	\$ (0.08)	\$ (0.61)	\$ 0.20	\$ (0.41)
Diluted	\$ (0.22)	\$ 0.14	\$ (0.08)	\$ (0.61)	\$ 0.20	\$ (0.41)

The changes in the table above during the three and six months ended July 31, 2017, compared to the same period of 2016, were a result of the factors described in connection with revenues and operating expenses under Item 2.

“Management’s Discussion and Analysis of Financial Conditions and Results of Operations – Results of Operations,” of this Form 10-Q.

In managing and reviewing our business performance, we exclude several items required by U.S. GAAP. Management believes that excluding these items is useful in understanding the trends and managing our operations. We provide these supplemental non-GAAP measures in order to assist the investment community in seeing SeaChange through the “eyes of management,” and therefore enhance the understanding of SeaChange’s operating performance. Non-GAAP financial measures should be viewed in addition to, not as an alternative to, our reported results prepared in accordance with U.S. GAAP. Our non-GAAP financial measures reflect adjustments based on the following items:

Provision for Loss Contract. We entered a fixed-price customer contract on a multi-year arrangement, which included multiple vendors. As the system integrator on the project, we are subject to any cost overruns or increases with these vendors resulting in delays of acceptance by our customer. Delays of customer acceptance on this project result in incremental expenditures and require us to recognize a loss on this project in the period the determination is made. As a result, we recorded an estimated loss of \$9.2 million in fiscal 2016. Subsequently, because of changes in the scope of the project and negotiations with the fixed-price customer, we recorded adjustments since fiscal 2016 totaling \$4.7 million to reduce this estimated loss. We believe that the exclusion of this item, which is recorded in cost of revenues – services, allows a comparison of operating results that would otherwise impair comparability between periods.

Amortization of Intangible Assets. We incur amortization expense of intangible assets related to various acquisitions that have been made in recent years. These intangible assets are valued at the time of acquisition, are then amortized over a period of several years after the acquisition and generally cannot be changed or influenced by management after the acquisition. We believe that exclusion of these expenses allows comparisons of operating results that are consistent over time for the Company's newly-acquired and long-held businesses.

Earn-outs and Change in Fair Value of Earn-outs. Earn-outs and the change in fair value of earn-outs are considered by management to be non-recurring expenses to the former shareholders of the businesses we acquire. We also incur expenses due to changes in fair value related to contingent consideration that we believe would otherwise impair comparability among periods.

Stock-based Compensation Expense. We incur expenses related to stock-based compensation included in our U.S. GAAP presentation of cost of revenues and operating expenses. Although stock-based compensation is an expense we incur and is viewed as a form of compensation, the expense varies in amount from period to period, and is affected by market forces that are difficult to predict and are not within the control of management, such as the market price and volatility of our shares, risk-free interest rates and the expected term and forfeiture rates of the awards.

Professional Fees - Other. We have excluded the effect of legal and other professional costs associated with our acquisitions, divestitures, litigation and strategic alternatives because the amounts are considered significant non-operating expenses.

Severance and Other Restructuring Costs. We incur charges due to the restructuring of our business, including severance charges and facility reductions resulting from our restructuring and streamlining efforts and any changes due to revised estimates, which we generally would not have otherwise incurred in the periods presented as part of our continuing operations.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Liquidity and Capital Resources

The following table includes key line items of our consolidated statements of cash flows:

Six Months Ended Increase/

Edgar Filing: SEACHANGE INTERNATIONAL INC - Form 10-Q

	July 31,		(Decrease)
	2017	2016	\$ Amount
	(Amounts in thousands)		
Total cash used in operating activities	\$(2,317)	\$(14,097)	\$ 11,780
Total cash provided by (used in) investing activities	62	(5,477)	5,539
Total cash used in financing activities	(10)	(62)	52
Effect of exchange rate changes on cash	(742)	(431)	(311)
Net decrease in cash and cash equivalents	\$(3,007)	\$(20,067)	\$ 17,060

Historically, we have financed our operations and capital expenditures primarily with cash on-hand. Cash, cash equivalents, restricted cash, and marketable securities decreased from \$38.7 million at January 31, 2017 to \$35.6 million at July 31, 2017.

We continue to realize savings related to the restructuring of our In-Home business. Additionally, during the first quarter of fiscal 2018, we made significant reductions to our headcount as part of our ongoing restructuring effort of which we expect to generate annualized savings of approximately \$10 million. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash expected to be provided by future operating activities, augmented by the plans highlighted above, are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In the future, we may enter other arrangements for potential investments in, or acquisitions of, complementary businesses, services or technologies, which could require us to seek additional equity or debt financing. Additional funds may not be available on favorable terms.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital or could require us to issue our stock and dilute existing stockholders. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access cash resulting from earnings in prior fiscal years that had previously been deemed permanently restricted for foreign investment would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings. The balance of the deferred tax liability as of July 31, 2017 is \$16.3 million.

Operating Activities

Below are key line items affecting cash from operating activities:

	Six Months Ended July 31,		Increase/ (Decrease)
	2017	2016	\$ Amount
	(Amounts in thousands)		
Net loss	\$(6,900)	\$(35,791)	\$ 28,891
Adjustments to reconcile net loss to cash used in operating activities	4,029	19,375	(15,346)
Net loss including adjustments	(2,871)	(16,416)	13,545
Decrease in receivables	6,916	13,458	(6,542)
Decrease in inventory	57	19	38
Decrease in prepaid expenses and other current assets	8	1,053	(1,045)
Decrease in accounts payable	(2,594)	(1,607)	(987)
Decrease in accrued expenses	(3,193)	(5,307)	2,114
Decrease in deferred revenues	(870)	(5,419)	4,549
All other - net	230	122	108
Net cash used in operating activities	\$(2,317)	\$(14,097)	\$ 11,780

We used net cash in operating activities of \$2.3 million for the six months ended July 31, 2017. This cash used in operating activities was primarily the result of our net loss including adjustments of \$3.5 million offset by changes in working capital, which include a decrease in receivables of \$6.9 million due to the timing of customer payments, offset by a decrease in accrued expenses of \$3.2 million related to the payment of severance and bonuses, a \$2.6 million decrease in accounts payable due to the timing of payments to vendors and a \$0.9 million decrease in deferred revenue.

Investing Activities

Cash flows from investing activities are as follows:

	Six Months Ended July 31,		Increase/ (Decrease)
	2017	2016	\$ Amount
	(Amounts in thousands)		
Purchases of property and equipment	\$(274)	\$(403)	\$ 129
Purchases of marketable securities	(4,501)	—	(4,501)
Proceeds from sale and maturity of marketable securities	4,449	252	4,197
Acquisition of business, net of cash acquired	—	(5,243)	5,243
Other investing activities	388	(83)	471
Net cash provided by (used in) investing activities	\$62	\$(5,477)	\$ 5,539

Cash provided by investing activities includes the release of restricted cash of \$0.2 million and \$0.2 million in proceeds from the sale of property and equipment during the quarter. This was offset by cash used of \$0.3 million for the purchase of capital assets during the quarter.

Financing Activities

Cash flows from financing activities are as follows:

	Six Months		
	Ended		Increase/ (Decrease)
	July 31,	2016	\$ Amount
	2017		(Amounts in thousands)
Proceeds from issuance of common stock	\$26	\$33	\$ (7)
Payments of withholding tax on RSU vesting	(36)	(91)	55
Other financing activities	—	(4)	4
Net cash used in financing activities	\$(10)	\$(62)	\$ 52

In the six months ended July 31, 2017, cash used in financing activities reflects cash outflows for payments of withholding taxes on the vesting of certain employees' restricted stock units. This is partially offset by proceeds received from the issuance of common stock for the employee stock purchase plan.

The effect of exchange rate changes decreased cash and cash equivalents by \$0.7 million for the six months ended July 31, 2017, primarily due to the translation of European subsidiaries' cash balances, which use the Euro as their functional currency, to U.S. dollars.

Effects of Inflation

Management believes that financial results have not been significantly impacted by inflation and price changes in materials we use in manufacturing our products.

Contractual Obligations

There have been no significant changes outside the ordinary course of our business in our contractual obligations disclosed in our Form 10-K for the fiscal year ended January 31, 2017.

Critical Accounting Policies and Significant Judgment and Estimates

The accounting and financial reporting policies of SeaChange are in conformity with U.S. GAAP, which requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis, including those related to revenue recognition, allowance for doubtful accounts, acquired intangible assets and goodwill, stock-based compensation, impairment of long-lived assets and accounting for income taxes. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

Actual results may differ from these estimates.

Revenue Recognition

Our transactions frequently involve the sales of hardware, software, systems and services in multiple-element arrangements. Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when:

- persuasive evidence of an arrangement exists;
- delivery has occurred, and title and risk of loss have passed to the customer;
- fees are fixed or determinable; and
- collection of the related receivable is considered probable.

Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities is deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support agreements is recognized ratably over the period of the related agreements. Revenue from software development contracts that include significant modification or customization, including software product enhancements, is recognized based on the percentage of completion contract accounting method using labor efforts expended in relation to estimates of total labor efforts to complete the contract. The percentage of completion method requires that adjustments or re-evaluations to estimated project revenues and costs be recognized on a project-to-date cumulative basis, as changes to the estimates are identified. Revisions to project estimates are made as additional information becomes known, including information that becomes available after the date of the consolidated financial statements up through the date such consolidated financial statements are filed with the SEC. If the final estimated profit to complete a long-term contract indicates a loss, a provision is recorded immediately for the total loss anticipated. Accounting for contract amendments and customer change orders are included in contract accounting when executed. Revenue from shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues. Our share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

Contract accounting requires judgment relative to assessing risks, estimating revenues and costs and making assumptions including, in the case of our professional services contracts, the total amount of labor required to complete a project and the complexity of the development and other technical work to be completed. Due to the size and nature of many of our contracts, the estimation of total revenues and cost at completion is complicated and subject to many variables. Assumptions must be made regarding the length of time to complete the contract because costs also include estimated third-party vendor and contract labor costs. Penalties related to performance on contracts are considered in estimating sales and profit, and are recorded when there is sufficient information for us to assess anticipated performance. Third-party vendors' assertions are also assessed and considered in estimating costs and margin.

Revenue from the sale of software-only products remains within the scope of the software revenue recognition rules. Maintenance and support, training, consulting, and installation services no longer fall within the scope of the software revenue recognition rules, except when they are sold with and relate to a software-only product. Revenue recognition for products that no longer fall under the scope of the software revenue recognition rules is like that for other tangible products and Accounting Standard Update No. ("ASU") 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements," amended ASC 605 and is applicable for multiple-deliverable revenue arrangements. ASU 2009-13 allows companies to allocate revenue in a multiple-deliverable arrangement in a manner that better reflects the transaction's economics.

Under the software revenue recognition rules, the fee is allocated to the various elements based on vendor-specific objective evidence ("VSOE") of fair value. Under this method, the total arrangement value is allocated first to undelivered elements based on their fair values, with the remainder being allocated to the delivered elements. Where fair value of undelivered service elements has not been established, the total arrangement value is recognized over the period during which the services are performed. The amounts allocated to undelivered elements, which may include project management, training, installation, maintenance and technical support and certain hardware and software components, are based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation, training and project management revenue is based upon standard hourly billing rates and the estimated time necessary to complete the service. These services are not essential to the functionality of systems as these services do not alter the equipment's capabilities, are available from other vendors and the systems are standard products. For multiple-element arrangements that include software development with significant modification or customization and systems sales where VSOE of the fair value does not exist for the undelivered elements of the arrangement (other than maintenance and technical support), percentage of completion

accounting is applied for revenue recognition purposes to the entire arrangement except for maintenance and technical support.

Under the revenue recognition rules for tangible products as amended by ASU 2009-13, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, third-party evidence (“TPE”) if VSOE is not available, and best estimate of selling price (“BESP”) if neither VSOE nor TPE are available. TPE is the price of the Company’s, or any competitor’s, largely interchangeable products or services in stand-alone sales to similarly situated customers. BESP is the price at which we would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors.

The selling prices used in the relative selling price allocation method for certain of our services are based upon VSOE. The selling prices used in the relative selling price allocation method for third-party products from other vendors are based upon TPE. The selling prices used in the relative selling price allocation method for our hardware products, software, subscriptions, and customized services for which VSOE does not exist are based upon BESP. We do not believe TPE exists for these products and services because they are differentiated from competing products and services in terms of functionality and performance and there are no competing products or services that are largely interchangeable. Management establishes BESP with consideration for market conditions, such as the impact of competition and geographic considerations, and entity-specific factors, such as the cost of the product, discounts provided and profit objectives. Management believes that BESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis.

For our cloud and managed service revenues, we generate revenue from two sources: (1) subscription and support services; and (2) professional services and other. Subscription and support revenue includes subscription fees from customers accessing our cloud-based software platform and support fees. Our arrangements with customers do not provide the customer with the right to take possession of the software supporting the cloud-based software platform at any time. Professional services and other revenue include fees from implementation and customization to support customer requirements. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. For the most part, subscription and support agreements are entered into for 12 to 36 months. Generally, most of the professional services components of the arrangements with customers are performed within a year of entering a contract with the customer.

In most instances, revenue from a new customer acquisition is generated under sales agreements with multiple elements, comprised of subscription and support and other professional services. We evaluate each element in a multiple-element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within our control.

In determining when to recognize revenue from a customer arrangement, we are often required to exercise judgment regarding the application of our accounting policies to an arrangement. The primary judgments used in evaluating revenue recognized in each period involve: determining whether collection is probable, assessing whether the fee is fixed or determinable, and determining the fair value of the maintenance and service elements included in multiple-element software arrangements. Such judgments can materially impact the amount of revenue that we record in a given period. While we follow specific and detailed rules and guidelines related to revenue recognition, we make and use significant management judgments and estimates about the revenue recognized in any reporting period, particularly in the areas described above. If management made different estimates or judgments, material differences in the timing of the recognition of revenue could occur.

Recent Accounting Standard Updates

Recently Issued Accounting Standard Updates – Not Yet Adopted

We consider the applicability and impact of all ASUs. Updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations. Recently issued ASUs which we feel may be applicable to us but have not yet been adopted are as follows:

Revenue from Contracts with Customers (Topic 606)

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU. 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies using International Financial Reporting Standards and U.S. GAAP. The core principle requires entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB voted to approve a one year deferral, making the standard effective for public entities for annual and interim periods beginning after December 15, 2017.

In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” The purpose of ASU 2016-08 is to clarify the guidance on principal versus agent considerations. It includes indicators that help to determine whether an entity controls the specified good or service before it is transferred to the customer and to assist in determining when the entity satisfied the performance obligation and as such, whether to recognize a gross or a net amount of consideration in their consolidated statement of operations.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies that entities are not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. ASU 2016-10 also addresses how to determine

whether promised goods or services are separately identifiable and permits entities to make a policy election to treat shipping and handling costs as fulfillment activities. In addition, it clarifies key provisions in Topic 606 related to licensing.

In May 2016, the FASB issued ASU 2016-11, "Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815)." ASU 2016-11 rescinds previous SEC comments that were codified in Topic 605, Topic 932 and Topic 815. Upon adoption of Topic 606, certain SEC comments including guidance on accounting for shipping and handling fees and costs and consideration given by a vendor to a customer should not be relied upon.

In May 2016, the FASB also issued ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients." ASU 2016-12 provides clarity around collectability, presentation of sales taxes, non-cash consideration, contract modifications at transition and completed contracts at transition. ASU 2016-12 also includes a technical correction within Topic 606 related to required disclosures if the guidance is applied retrospectively upon adoption.

In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." ASU 2016-20 allows entities not to make quantitative disclosures about remaining performance obligations in certain cases and requires entities that use any of the optional exemptions to expand their qualitative disclosures. ASU 2016-20 also clarifies other areas of the new revenue standard, including disclosure requirements for prior period performance obligations, impairment guidance for contract costs and the interaction of impairment guidance in ASC 340-40 with other guidance elsewhere in the Codification.

The Company will adopt Topic 606 effective February 1, 2018 under the modified retrospective method and will only apply this method to contracts that are not completed as of the date of adoption. The modified retrospective method will result in a cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at the date of initial application for any open contracts as of the adoption date. The Company has established an implementation team, including the utilization of third-party resources, to assist with its assessment of the impact of the new revenue guidance on its operations, consolidated financial statements and related disclosures. In addition, the Company has made investments in systems to enable timely and accurate reporting under the new standard. To date, the Company's assessment has included (1) utilizing questionnaires to assist with the identification of revenue streams, (2) performing sample contract analyses for each revenue stream identified, (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard, (4) performing detailed analyses of contracts with larger customers, and (5) developing plans to test transactions for consistency with contract provisions that affect revenue recognition. Based on the preliminary results of the evaluation, which is still in process, the Company currently believes that the most significant potential changes to be the allocation of transaction price to performance obligations which will be based on a relative standalone selling price analysis, which may differ from the Company's historical allocation of transaction consideration under legacy U.S. GAAP, and the timing of revenue recognition which may be at a later point in time than under legacy U.S. GAAP. As part of the preliminary procedures completed by the Company they have also assessed accounting for incremental costs to obtain a contract and costs incurred in fulfilling a contract. Based on preliminary results of the evaluation, which is still in process, the Company currently believes that the most significant potential change to be accounting for commissions, as these incremental

costs are expected to be capitalized and will be amortized over a period of time which could extend beyond the initial contract term. The Company also anticipates changes to the consolidated balance sheet related to accounts receivable, contract assets, and contract liabilities, as well as, significant changes to its disclosures to comply with the new disclosure requirements under Topic 606. The Company is continuing to design the necessary changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Further, the Company is continuing to assess what incremental disaggregated revenue and other disclosures will be required in its consolidated financial statements, which the Company believes will be significant. Given the continuing analysis and implementation, the Company cannot reasonably estimate quantitative information related to the impact of the new guidance on its consolidated financial statements at this time.

Leases

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 requires a lessee to recognize a right-of-use asset and a lease liability for operating leases with terms over twelve months, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. It also requires lessees to classify leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. ASU 2016-02 is effective for us in the first quarter of fiscal 2020. Early adoption is permitted. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Cash Flow Statement

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and annual periods beginning in our first quarter of fiscal 2019, and early adoption is permitted. ASU 2016-15 must be applied retrospectively to all periods presented but may be applied prospectively if retrospective application would be impracticable. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance is effective for us in the first quarter of fiscal 2019 and early adoption is permitted. ASU 2016-18 must be applied retrospectively to all periods presented. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Intangibles-Goodwill and Other

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350), which simplifies the subsequent measurement of goodwill by removing “Step 2” of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance is effective for us beginning in the first quarter of fiscal 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

Stock Compensation

In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment awards require an entity to apply modification accounting under ASC 718. The guidance is effective for us beginning in the first quarter of fiscal 2019 and early adoption is permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk

We face exposure to financial market risks, including adverse movements in foreign currency exchange rates and changes in interest rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results. Our foreign currency exchange exposure is primarily associated with product sales arrangements or settlement of intercompany payables and receivables among subsidiaries and their parent company, and/or investment/equity contingency considerations denominated in the local currency where the functional currency of the foreign subsidiary is the U.S. dollar.

Our principal currency exposures relate primarily to the U.S. dollar, the Euro and the Philippine peso. All foreign currency gains and losses are included in other income (expenses), net, in the accompanying consolidated statements of operations and comprehensive loss. For the six months ended July 31, 2017, we recorded \$0.8 million in gains due to the international subsidiary translations and cash settlements of revenues and expenses.

A substantial portion of our earnings are generated by our foreign subsidiaries whose functional currency is other than the U.S. dollar. Therefore, our earnings could be materially impacted by movements in foreign currency exchange rates upon the translation of the subsidiary's earnings into the U.S. dollar. If the U.S. dollar had strengthened by 10% compared to the Euro, our total revenues would have decreased by \$0.5 million and \$1.0 million for the three and six months ended July 31, 2017, respectively, and it would have decreased our income from operations by \$0.3 million and \$0.4 million for the same periods.

Interest Rate Risk

Exposure to market risk for changes in interest rates relates primarily to our investment portfolio of marketable debt securities of various issuers, types and maturities. We do not use derivative instruments in our investment portfolio, and our investment portfolio only includes highly liquid instruments. Our cash and marketable securities include cash equivalents, which we consider to be investments purchased with original maturities of 90 days or less. There is risk that losses could be incurred if we were to sell any of our securities prior to stated maturity. Given the short maturities and investment grade quality of the portfolio holdings at July 31, 2017, a hypothetical 10% adverse change in interest rates should not have a material adverse impact on the fair value of our investment portfolio.

ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this Form 10-Q. Edward Terino, our Chief Executive Officer, and Peter R. Faubert, our Chief Financial Officer, reviewed and participated in this evaluation. Based upon that evaluation, Messrs. Terino and Faubert concluded that our disclosure controls and procedures were not operating effectively as of July 31, 2017. Our disclosure controls and procedures were not effective because of the continued impact of the material weaknesses identified and described in the "Report of Management on Internal Control over Financial Reporting" included in Item 9A of our Form 10-K for fiscal year ended January 31, 2017 relating to the design of controls around certain professional services revenue recognition on projects generating revenue of less than \$25,000 per month, deferred revenue related to undelivered products reconciled the month prior to quarter end and rolled forward and journal entry review processes at an international subsidiary for journal entries less than \$50,000. In addition, as of January 31, 2017, we identified an ineffective control related to currency translation adjustments arising from intercompany notes.

Notwithstanding the material weaknesses discussed above, our management, including our Chief Executive Officer and Chief Financial Officer, believes that the consolidated financial statements contained in this Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with U.S. GAAP. The material weaknesses described above did not result in any adjustments or restatements of our audited and unaudited consolidated financial statements or disclosures for any prior period previously reported by the Company.

In fiscal 2018, we have continued to implement our comprehensive remediation plan related to our internal control over financial reporting. This plan includes enhancing existing internal controls and designing and implementing new ones aimed at remediating the material weaknesses. The status of our remediation plan for each material weakness described above as of the date of this report is as follows:

- We have enhanced our internal controls over financial reporting to expand our review of professional services revenue to include revenue recognized on projects below \$25,000;
- We have enhanced our internal controls over financial reporting to include a review of all journal entries at an international subsidiary for completeness and accuracy; and
- We have enhanced our internal controls over financial reporting to develop a process whereby the corporate controller and tax director review the impact of currency translation adjustments on intercompany notes payable on a quarterly basis.

The status of our remediation plan has been, and will continue to be, reported by management to the Audit Committee of the Board of Directors on a regular basis. In addition, we have assigned personnel to oversee the improvements to the overall design of our internal control environment and to address the root causes of our material weaknesses. Remediation generally requires making changes to how controls are designed and then adhering to those changes for a sufficient period of time such that the operating effectiveness of those changes is demonstrated through testing.

As we continue to evaluate and work to improve our internal control over financial reporting, we may take additional measures to address these control deficiencies or modify our remediation plan. We cannot make assurances, however, of when we will remediate such weaknesses, nor can we be certain of whether additional actions will be required.

Changes in internal control over financial reporting. As a result of the evaluation completed by us, and in which Messrs. Terino and Faubert participated, we have concluded that, except as described above with respect to our remediation plan, there were no changes during the fiscal quarter ended July 31, 2017 in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We enter into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require us to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to our products. From time to time, we also indemnify 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 our products and services or resulting from the acts or omissions of us, our employees, authorized agents or subcontractors. Management cannot reasonably estimate any potential losses, but these claims could result in material liability for us.

ITEM 1A. Risk Factors

In addition to other information set forth in this Form 10-Q, you should carefully consider the risk factors discussed in Part I, "Item 1A. Risk Factors" in our Form 10-K for the fiscal year ended January 31, 2017, which could materially affect our business, financial conditions, and results of operations. The risks described in our Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

ITEM 6. Exhibits

(a) Exhibits

See the Exhibit Index following the signature page to this Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, SeaChange International, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: September 7, 2017

SEACHANGE INTERNATIONAL, INC.

by: /s/ PETER R. FAUBERT

Peter R. Faubert

Chief Financial Officer, Senior Vice President,

Finance and Administration and

Treasurer

Index to Exhibits

No.	Description
10.1	<u>Second Amended and Restated 2011 Compensation and Incentive Plan (filed as Appendix A to the Company's Proxy Statement on Schedule 14A previously filed May 26, 2017 with the Commission (File No. 000-21393) and incorporated herein by reference).</u>
10.2	<u>Cooperation Agreement, dated as of August 17, 2017, between SeaChange International, Inc. and Viex Capital Advisors, LLC, Viex Opportunities Fund, LP-Series One, Viex Special Opportunities Fund II, LP, Viex GP, LLC, Viex Special Opportunities GP II, LLC and Eric Singer (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed August 17, 2017 with the Commission (File No. 000-21393) and incorporated herein by reference).</u>
31.1	<u>Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*</u>
32.2	<u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

* Furnished herewith.