

SEACHANGE INTERNATIONAL INC  
Form 10-K  
April 14, 2011

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-K

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

For the fiscal year ended January 31, 2011

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

Commission File Number: 0-21393

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SEACHANGE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction  
of incorporation or organization)

04-3197974  
(IRS Employer  
Identification No.)

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

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

Securities Registered Pursuant To Section 12(b) Of The Act:

Common Stock, \$.01 par value

Securities Registered Pursuant To Section 12(g) Of The Act:

None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or in any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

As of July 30, 2010, the aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the closing price for the registrant's Common Stock on the NASDAQ Global Select Market on such date was \$265,646,760. The number of shares of the registrant's Common Stock outstanding as of the close of business on April 1, 2011 was 31,999,414.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the definitive Proxy Statement (which is expected to be filed within 120 days after the Company's fiscal year end) relating to the registrant's Annual Meeting of Stockholders to be held on or about July 20, 2011 to be filed pursuant to Regulation 14A are incorporated by reference into Part III of this Annual Report on Form 10-K.

## PART I

### ITEM 1. Business

SeaChange International, Inc. (“SeaChange”, “we” or “us”), a Delaware corporation founded on July 9, 1993, is a global leader in the delivery of multi-screen video. Our products and services facilitate the aggregation, licensing, storage, management and distribution of video, television programming and advertising content. We sell our products and services worldwide to cable system operators, including Cablevision, Comcast, Cox Communications, Virgin Media, and Rogers; telecommunications companies, including Telekom Austria, Turk Telekom and Verizon Communications; and broadcast television companies, including ABC Disney, Ascent Media, Clear Channel, China Central Television and Viacom.

Our products and services are designed to enable our customers to reduce subscriber turnover and access new revenue-generating opportunities from subscribers, advertisers and electronic commerce initiatives. Using our products and services, we believe our customers can increase their revenues by offering additional services such as on demand television programming on a variety of devices. This capability allows the operator to offer programming for viewing whenever a subscriber chooses on traditional television, personal computers or mobile devices, while incorporating the ability for subscribers to pause, rewind and fast-forward on demand content. Our products also allow our customers to insert advertising into broadcast and on demand programming. Our advertising products allow our customers to target advertising segments to specific subscribers in a particular geographic and/or demographic market. In addition, our systems enable broadband system operators to offer other interactive television services that allow subscribers to customize and/or dynamically interact with their television, enhancing their viewing experience.

The primary thrust of our business has been to enable the delivery of video assets in the evolving “On Demand” television environment. Through acquisitions and partnerships we have expanded our capabilities, products and services to address the needs of video content owners, broadcasters, and content aggregators, and to address the delivery of content to devices other than the television, such as mobile phones, tablets and PCs. Traditionally, our products and services included hardware and software for content management and delivery systems, middleware that drives set top box applications, advertising systems that help pay for content and services that involve the acquisition and distribution of video content. As the industry has evolved, we have reduced our dependence on hardware products and focused on providing high margin, recurring revenue generating software products. We believe that our strategy of expanding our product line will position SeaChange to support and maintain our existing customer base, take advantage of new customers entering the on demand marketplace and to enter adjacent markets.

Our core technologies provide a foundation for products and services that can be deployed in next generation video delivery systems capable of increased levels of subscriber interactivity. We have received several awards for technological excellence, including Emmy Awards for our patented MediaCluster® technology and for our role in the growth of video on demand.

#### Industry Background

##### Cable System Operators and Telecommunications Companies

According to SNL Kagan, the number of households paying for TV access today, such as cable subscription but excluding satellite has been estimated at 131 million in the Americas and approximately 750 million worldwide. Cable system operators and telecommunications companies worldwide continue to spend billions of dollars to upgrade their networks from analog to digital, yielding a significant increase in available bandwidth, channel capacity and two-way interactive capability. We believe this investment reflects their intent to provide multi-screen video on demand, advertising insertion, and other value-added services to their customers that will differentiate them from competing

service providers, including satellite delivery systems.

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Currently, all of the major North American cable system operators have deployed video on demand services in most residential markets, allowing subscribers to watch video programming at any time with pause, rewind, fast forward and a number of additional interactive capabilities. The various on demand applications offered by cable system operators and, increasingly, telecommunications operators, include movies-on-demand, subscription video on demand, such as Home Box Office (HBO), as well as news, sports, music videos, games, niche programming and time-shifted broadcast programming.

Cable companies have also begun to market telephone services. In response, telecommunications operators, notably AT&T and Verizon in the U.S., are aggressively providing competitive digital television and video services. Elsewhere, international telecommunications companies with high-speed network capacity are actively exploring and launching similar multi-screen video services. The advent of multi-screen video delivery can be seen in deployments such as Virgin Media in the UK and Starhub in Singapore where subscribers have access to content across all three platforms – TV, PC and Mobile.

In addition, because cable television programming is transmitted over broadband (high bandwidth networks), cable system and telecom operators have the opportunity to segment and target their programming to viewers in selected geographies. We believe that the ability of operators to target viewers will extend to individual household-level targeting of advertisements in video on demand applications, generating revenue which may help support the worldwide deployment and growth of video on demand content and services.

#### Broadcast Television Companies

Both domestically and internationally, broadcast television companies face a number of new challenges to their business. In digital broadcasting, changing ownership trends, new consumer alternatives (e.g., cable television, satellite television, or internet) and evolving viewership models (e.g. cell phones, tablets) are creating a more complex competitive environment for our customers that calls for greater efficiencies and business innovation.

Some television broadcasters are using digital bandwidth to originate multiple program streams. As this application further develops, television broadcasters will require more video storage and delivery systems that can effectively manage and deliver these multiple television signals. As a result, we believe that television broadcasters will continue to automate their entire programming and advertising to reduce overall operating costs and improve reliability. We expect new opportunities to emerge for broadcasters and video on demand operators to create new business synergies that will likely require sophisticated software to manage these digital video storage and delivery systems.

#### SeaChange Business Segments

The Company reports its financial results within three segments: Software, Servers and Storage, and Media Services. Financial information about our business segments is included in Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements.

|                             | Year ended January 31,             |      |                   |      |                   |      |
|-----------------------------|------------------------------------|------|-------------------|------|-------------------|------|
|                             | 2011                               |      | 2010              |      | 2009              |      |
|                             | Amount                             | %    | Amount            | %    | Amount            | %    |
|                             | (in thousands, except percentages) |      |                   |      |                   |      |
| <b>Revenues by segment:</b> |                                    |      |                   |      |                   |      |
| Software                    | \$ 156,610                         | 72 % | \$ 131,314        | 65 % | \$ 132,237        | 65 % |
| Servers and Storage         | 32,086                             | 15 % | 50,557            | 25 % | 53,640            | 27 % |
| Media Services              | 28,031                             | 13 % | 19,794            | 10 % | 15,959            | 8 %  |
| <b>Total</b>                | <b>\$ 216,727</b>                  |      | <b>\$ 201,665</b> |      | <b>\$ 201,836</b> |      |



## Software

In 2006, we began selling our SeaChange Axiom® On Demand software independent of our hardware and offering subscription services for the software in an effort to increase market share and enhance revenue stability through more recurring revenues. Additionally, by porting our software to other third party hardware platforms, we increased our market share with opportunities at competitive vendors' installations.

We also develop, sell and support software products in the middleware and advertising categories. Our middleware and application business is focused on producing set-top box client middleware software products and end-to-end interactive television applications, and performing system integration and software customization services. Our client middleware solutions include the VODlink® Platform Suite built for and deployed on common North American cable set top boxes, and the TV Navigator™ platform deployed in Europe and Asia.

Our advertising insertion software products are available for both the traditional analog environment, and for the digital environment, which provides the cable operator with a significant increase in available bandwidth, channel capacity and two-way capability. Based on currently available industry sources and our internal data, we believe our Spot System is the leading analog video insertion system in the United States in the multichannel television market for advertisements and other short-form video. Over the last several years, our customers have begun to migrate to digital video ad insertion, and we believe our digital video ad insertion system is establishing a strong market position as well. Our SeaChange AdPulse™ On Demand Advertising software platform allows operators to generate new advertising revenue from inserting ads, dynamically, in on demand content while it provides detailed tracking and reporting on views and usage of inserted ads.

In September of 2009 we acquired a private software company, eventIS Group B.V. ("eventIS"), in Eindhoven, the Netherlands. eventIS is Europe's leading provider of video on demand back-office software supporting operators in 25 countries. This software complements and extends the capabilities of our video on demand software products. We expect that eventIS's leading market position in Europe will foster increased revenue growth as VOD investments in Europe are forecasted to grow significantly over the next several years. According to SNL Kagan, there are 80 million cable television subscribers in Europe compared to 70 million in the United States. However, unlike in the U.S., digital cable penetration rates are quite low. Penetration rates in Europe are expected to rise with the increased investments in VOD products and services from European cable television providers.

In February 2010, we acquired VividLogic Inc ("VividLogic"), a private California software provider. VividLogic's products and services will allow the Company to expand its software product portfolio to participate more competitively in the middleware and home network markets. VividLogic provides applications and development services for Consumer Electronics ("CE") manufacturers and cable television providers. VividLogic's software products and services focus on home networking applications and "tru2way" development. In the home networking area, VividLogic's emphasis is on the development of software to meet the content protection requirements under the IEEE 1394 requirements. In addition, VividLogic is working with CE manufacturers and service providers to develop software to be used in next generation home media gateways. In the tru2way area, VividLogic provides products and services for CE and set top box manufacturers who are looking to migrate their hardware for tru2way capability. Tru2way is a technology platform sponsored by the U.S. cable television industry that is expected to foster interactive television applications for consumers.

In October 2010 we introduced SeaChange Adrenalin, our fourth generation, multi-screen, back office software platform. Adrenalin integrates our legacy Axiom software with technology gained through our acquisitions of eventIS and Mobix Interactive, Ltd. (Mobix). This new platform allows SeaChange customers to migrate to a multi-screen delivery environment by building on existing infrastructure and capabilities.

Revenue sources from the Software segment fall into two categories:

- product revenues such as licensing, and software development for those products; and
- related services such as subscriptions (annual software subscriptions for upgrades), professional services, installation, training, project management, product maintenance, and technical support for those software products. Approximately sixty percent of our software revenue is now recurring from these services.



## Servers and Storage

Combining the advantages of standards-based hardware with our patented MediaCluster® technology, our hardware products deliver high-density streaming, clustered ingest and scalable storage for video on demand, time-shifted TV, network PVR (Personal Video Recorder) applications, as well as broadcast play to air and archiving.

Revenue sources for our Servers and Storage segment fall into several categories. New deployments are typically sold on a capacity basis and include one year of maintenance. As our customers add more content and more users, they return to purchase more streaming and storage capacity. The additional content usually also leads to increased usage levels by the subscribers which also translates in to add-on-sales. Recurring revenue consists of maintenance contracts after the first year.

We offer several configurations of our MediaCluster video servers to meet the evolving needs of our customers for independently scalable ingest, streaming and storage.

Servers and Storage segment includes:

- product revenues from video on demand (“VOD”) and broadcast server product lines and
- related services such as professional services, installation, training, project management, product maintenance, and technical support for those products.

We have engaged in a restructuring of our Servers and Storage business segment, during our fiscal year 2011, including a continued effort to offshore manufacturing of these products. This restructuring will enable our Servers and Storage business unit to align its cost structure with decreased VOD server revenues as compared to the prior fiscal years.

## Media Services

Through the acquisitions of On Demand Group Limited (ODG), in fiscal 2006, and Mobix, in fiscal 2009, SeaChange expanded its media content services, consisting of content aggregation and distribution. ODG is a leader in Europe in the development and deployment of Pay TV services. This segment specializes in aggregating content for video on demand and Pay-Per-View platforms, and provides marketing, promotional and production services to cable operators and telecommunications providers throughout Europe.

As an example, we source, acquire, package, and market Virgin Media’s video on demand services by providing access to content from local and Hollywood studio providers in multiple formats including music videos, television programs and feature length movies. Through ODG, we have a content rights management system and a content preparation center for incorporating video content for VOD services from the major content suppliers around the world. Revenue from the Media Services segment is generated from customer contracts depending on the services rendered.

The software acquired through Mobix is key to providing video on demand services to mobile service operators such as Vodacom in South Africa, O2, and 3UK in the UK, and 3 Italia.

## Service and Support

We install, maintain and support our hardware and software products worldwide. We offer basic and advanced on-site training for customer employees. We currently provide installation, maintenance and technical support to all our customers. We offer maintenance and technical support to customers, agents and distributors of our hardware,

software and systems on a 24-hour, seven-day a week basis. Generally, our systems sales include at least one year of maintenance. A separate professional services group provides network design and architecture as well as systems integration services.

Customer support centers worldwide provide 24/7 coverage. We have support centers in the U.S., the Netherlands, Philippines, China, Japan, U.K., France, Turkey and Ireland.

## Strategy

Our strategy is to maintain and expand our position as a global leader in the delivery of multi-screen video. We develop, manufacture and market digital video systems and services that include the management, aggregation, licensing, storage, and distribution of video, and advertising content. The key elements of our strategy are to:

- **Develop, Maintain and Extend Long-term Customer Relationships.** We focus our product development, marketing and direct sales efforts on maintaining and extending long-term customer relationships with cable system operators, telecommunications companies and television broadcasters across the world. We believe that the fundamental shift from broadcast to on demand applications and the growing emphasis on interactive technologies will continue to present opportunities for us to develop, market and support solutions to our existing customers as well as to new additional markets.
- **Offer Integrated Solutions.** Our customers operate complex networks that require the delivery and management of video programming across multiple channels and target zones. We believe that our integrated solutions can provide advantages in cost and implementation for digital video applications while interoperating with existing and emerging third-party equipment and software. To continue to address these needs, we intend to provide and further develop, internally and with our partners, integrated applications and support services for our customers. We believe that providing complete integrated solutions has been a significant factor in our success in the advertising and video on demand markets to date.
- **Establish and Maintain Technological Leadership.** We believe our competitive position is dependent in large part on the features and performance of our systems. As a result, we focus our research and development efforts on introducing systems with improved hardware and software capabilities. We have been granted patents and have patents pending for our various technologies. We have received several awards for technological excellence, including Emmy Awards for our patented MediaCluster® technology and for our role in the growth of video on demand. As of January 31, 2011, 39% of our employees were focused on research and product development efforts.
- **Provide Superior Customer Service and Support.** Our products function in customer environments where continuous operation is critical. As a result, we believe that providing a high level of service and support gives us a competitive advantage and is a differentiating factor in developing and maintaining key customer relationships. Our in-depth industry and application knowledge allows us to better understand the service needs of our customers. As of January 31, 2011, 41% of our employees were dedicated to customer service and support, including project design and implementation, maintenance, installation and training. Customers have access to service personnel via 24/7 telephone support. In addition, we believe that the acquisitions and investments that we have made in media services and in system integration and customization services have positioned us as an integral partner with our customers to ensure optimal performance of their systems.

## Customers

We currently sell our products primarily to cable system operators, broadcast and telecommunications companies. Our customer base is highly concentrated among a limited number of large customers, primarily due to the fact that the cable, movie, broadcast, and telecommunications industries in the United States are dominated by a limited number of large companies. A significant portion of our revenues across each of our segments in any given fiscal period have been derived from substantial orders placed by these large organizations. For the year ended January 31, 2011, Comcast and Virgin Media comprised 22% and 12%, respectively, of our total sales. We expect that we will continue to be dependent upon a limited number of customers for a significant portion of our revenues in future periods. As a result of this customer concentration, our business, financial condition and results of operations could be materially adversely affected by the failure of anticipated orders to materialize and by deferrals or cancellations of orders as a

result of changes in customer requirements or new product announcements or introductions. In addition, the concentration of customers may cause variations in revenue, expenses and operating results on a quarterly basis due to seasonality of orders or the timing and relative size of orders received and shipped during a fiscal quarter.

We do not believe that our backlog at any particular time is meaningful as an indicator of our future level of sales for any particular period. Because of the nature of our products and our use of standard components, substantially the entire backlog at the end of a quarter can be manufactured and shipped to the customer before the end of the following quarter. However, because of the requirements of particular customers these orders may not be shipped or, if shipped, the related revenues may not be recognized in the ensuing quarter. Therefore, there is no direct correlation between the backlog at the end of any quarter and our total sales for the following quarter or other periods.

### Selling and Marketing

We sell and market our products in the United States primarily through a direct sales organization and internationally through direct sales and independent agents and distributors, complemented by a coordinated marketing effort of our product marketing personnel. Direct and indirect sales activities are conducted from our Massachusetts headquarters and through sales representatives deployed across the world. We also market certain of our products to systems integrators and value-added resellers.

In light of the complexity of our digital video products, we primarily employ a consultative direct sales process. Working closely with customers to understand and define their needs enables us to obtain better information regarding market requirements, enhance our expertise in our customers' industries, and more effectively and precisely convey to customers how our solutions address the customer's specific needs. In addition to the direct sales process, customer references and visits by potential customers to sites where our products are in place are often critical in the sales process.

We use several marketing programs focused on our targeted markets to support the sale and distribution of our products. We use exhibitions at a limited number of prominent industry trade shows and conferences and presentations at technology seminars to promote awareness of us and our products. We also publish articles in trade and technical journals and we produce promotional product literature.

### Research and Product Development

Our management believes that our success will depend to a substantial degree upon our ability to develop and introduce in a timely fashion new integrated solutions and enhancements to our existing products that meet changing customer requirements in our current and new markets. We have made, and intend to continue to make, substantial investments in product and technological development. Our direct sales and marketing groups closely monitor changes in customer needs, changes in the marketplace and emerging industry standards, and are therefore better able to focus our research and development efforts to address these evolving industry requirements.

We believe that the experience of our product development personnel is an important factor in our success. We perform our research and product development activities at our headquarters and in offices in New Hampshire, Pennsylvania, California, the Netherlands, Philippines, and China.

### Manufacturing

Our manufacturing operation is located at our facility in Acton, Massachusetts. This manufacturing operation consists primarily of component and subassembly procurement, systems integration and final assembly, testing and quality control of the complete systems. We rely on independent contractors to manufacture components and subassemblies to our specifications. We are reviewing several contract manufacturers in China to assemble certain VOD and Broadcast products, starting in the later part of fiscal year 2012.



## Competition

The markets in which we compete are characterized by intense competition, with a large number of suppliers providing different types of products to different segments of the markets. In new markets for our products, we compete principally based on price. In markets in which we have an established presence, we compete principally on the basis of the breadth of our products' features and benefits, including the flexibility, scalability, professional quality, ease of use, reliability and cost effectiveness of our products, and our reputation and the depth of our expertise, customer service and support. While we believe that we currently compete favorably overall with respect to these factors and that our ability to provide integrated solutions to manage, store and distribute digital video differentiates us from our competitors, in the future we may not be able to continue to compete successfully with respect to these factors. In the market for long-form video products including video on demand, we compete with various companies offering video software and server platforms such as Arris Group Inc. (through its 2007 acquisition of C-Cor Corporation), Cisco Systems, Inc. (through its 2006 acquisition of Arroyo Video Solutions, Inc.), Motorola Mobility Inc. (through its 2006 acquisition of Broadbus Technologies, Inc.) and Ericsson (through its 2007 acquisition of Tandberg Television). In the digital advertisement insertion market, we generally compete with Ericsson and Arris Group Inc. We expect the competition in each of these markets to intensify in the future as existing and new competitors with significant market presence and financial resources, including computer hardware and software companies and television equipment manufacturers, enter these rapidly evolving markets.

Many of our current and prospective competitors have significantly greater financial, technical, manufacturing, sales, marketing and other resources. As a result, these competitors may be able to devote greater resources to the development, promotion, sale and support of their products. Moreover, these companies may introduce additional products that are competitive with ours or enter into strategic relationships to offer complete solutions, and in the future our products may not be able to compete effectively with these products.

## Proprietary Rights

Our success and our ability to compete are dependent, in part, upon our proprietary rights. We have been granted sixteen U.S. patents and have filed foreign patent applications related thereto for various technologies developed and used in our products. In addition, we rely on a combination of contractual rights, trademark laws, trade secrets and copyright laws to establish and protect our proprietary rights in our products. It is possible that in the future not all of these patent applications will be issued or that, if issued, the validity of these patents would not be upheld. It is also possible that the steps taken by us to protect our intellectual property will be inadequate to prevent misappropriation of our technology or that our competitors will independently develop technologies that are substantially equivalent or superior to our technology. In addition, the laws of some foreign countries in which our products are or may be distributed do not protect our proprietary rights to the same extent as do the laws of the United States. We have been involved, and continue to be involved, in significant intellectual property litigation, and we may be a party to litigation in the future to enforce our intellectual property rights or as a result of an allegation that we infringe others' intellectual property.

## Employees

As of January 31, 2011, we employed 1,202 persons, including 470 in research and development, 491 in customer service and support, 94 in selling and marketing, 55 in manufacturing and facilities, and 92 in general and administration functions. We believe that our relations with our employees are good. None of our employees are represented by a collective bargaining agreement.

## Geographic Information

Geographic information is included in Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements.

Available Information

SeaChange is subject to the informational requirements pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). SeaChange files periodic reports, proxy statements and other information with the Securities and Exchange Commission (SEC). Such reports, proxy statements and other information may be obtained by visiting the Public Reference Room of the SEC at 100 F Street, N.E., Washington, DC 20549 or by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an internet site (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding issuers that file electronically.



Financial and other information about SeaChange, including SeaChange's Code of Ethics and Business Conduct and charters for SeaChange's Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee, is available on our website ([www.schange.com](http://www.schange.com)). We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information contained on our web site is not incorporated by reference into this document and should not be considered a part of this Annual Report. Our web site address is included in this document as an inactive textual reference only.

ITEM 1A. Risk Factors

Any statements contained in this Form 10-K that do not describe historical facts may constitute forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These statements relate to future events or our future financial performance and are identified by words such as “may,” “will,” “could,” “should,” “expect,” “plan,” “intend,” “seek,” “anticipate,” “believe,” “estimate,” “potential,” or “continue” or other comparable terms or the negative of those terms. Forward-looking statements in this Form 10-K include certain statements regarding the effect of certain accounting standards on our financial position and results of operations, the effect of certain legal claims against us, projected changes in our revenues, earnings and expenses, exchange rate sensitivity, interest rate sensitivity, liquidity, product introductions, industry changes and general market conditions. Our actual future results may differ significantly from those stated in any forward-looking statements. Any such forward-looking statements contained herein are based on current expectations, but are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. Factors that may cause such differences include, but are not limited to, the factors discussed below. Each of these factors, and others, are discussed from time to time in our filings with the SEC.

Our business is dependent on customers’ continued spending on video systems and services, and reductions by customers in spending adversely affect our business.

Our performance is dependent on customers’ continued spending for video systems and services. Spending for these systems and services is cyclical and can be curtailed or deferred on short notice. A variety of factors affect the amount of spending, and, therefore, our sales and profits, including:

- general economic conditions;
- customer specific financial or stock market conditions;
- availability and cost of capital;
- governmental regulation;
- demand for services;
- competition from other providers of video systems and services;
- acceptance of new video systems and services by our customers; and
- real or perceived trends or uncertainties in these factors.

Any reduction in spending by our customers would adversely affect our business. We continue to have limited visibility into the capital spending plans of our current and prospective customers. Fluctuations in our revenue can lead to even greater fluctuations in our operating results. Our planned expense levels depend in part on our expectations of future revenue. Our planned expenses include significant investments, particularly within the research and development organization, which we believe are necessary to continue to provide innovative solutions to meet our current and prospective customers’ needs. As a result, it is difficult to forecast revenue and operating results. If our revenue and operating results are below the expectations of our investors and market analysts, it could cause a decline in the price of our common stock.

Our future success is dependent on the continued development of the video-on-demand market and if video-on-demand does not continue to develop, our business may not continue to grow.

A large portion of our revenue comes from sales and services related to our video-on-demand products. However, the video-on-demand market continues to develop as a commercial market, both within and outside North America. The potential size of the video-on-demand market and the timing of its development are uncertain. The success of this market requires that broadband system operators continue to upgrade their cable networks to support digital two-way transmission service and successfully market video-on-demand and similar services to their cable television

subscribers. Some cable system operators, particularly outside of North America, are still in the early stages of commercial deployment of video-on-demand service to major residential cable markets and, accordingly, to date our digital video systems have been commercially available only to a limited number of subscribers. Also, the telecommunications companies have also begun to adapt their networks to support digital two-way transmission and begun marketing video-on-demand services. If cable system operators and telecommunications companies fail to make the capital expenditures necessary to upgrade their networks or determine that broad deployment of video-on-demand services is not viable as a business proposition or if our digital video systems cannot support a substantial number of subscribers while maintaining a high level of performance, our revenues will not grow as we have planned.

Our business is impacted by worldwide economic cycles, which are difficult to predict.

The global economy and financial markets experienced disruption in recent years, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. These economic developments and the rate of recovery from these developments affect businesses such as ours and those of our customers and vendors in a number of ways that could result in unfavorable consequences to us. A continued slow recovery from these events or further disruption and deterioration in economic conditions may reduce customer purchases of our products and services, thereby reducing our revenues and earnings. In addition, these events may, among other things, result in increased price competition for our products and services, increased risk in the collectability of our accounts receivable from our customers, increased risk in potential reserves for doubtful accounts and write-offs of accounts receivable, and higher operating costs as a percentage of revenues. We have taken actions to address the effects of the economic crisis and the slow recovery, including implementing cost control and reduction measures. It is possible that we may need to take further cost control and reduction measures. We cannot predict whether these measures will be sufficient to offset certain of the negative trends that might affect our business.

We have taken measures to address the variability in the market for our products and services, which could have long-term negative effects on our business or impact our ability to adequately address a rapid increase in customer demand.

We have taken measures to address the variability in the market for our products and services. These measures include shifting more of our operations to lower cost regions, outsourcing manufacturing processes, implementing cost reduction programs, reducing the number of our employees, and reducing planned capital expenditures and expense budgets. We cannot ensure that the measures we have taken will not impair our ability to effectively develop and market products and services, to remain competitive in the industries in which we compete, to operate effectively, to operate profitably during slowdowns or to effectively meet a rapid increase in customer demand. These measures may have long-term negative effects on our business by reducing our pool of technical talent, decreasing or slowing improvements in our products and services, making it more difficult to hire and retain talented individuals and to quickly respond to customers or competitors in an upward cycle.

Our business is subject to uncertainties introduced by our ongoing evaluation of strategic options and the restructuring of our Servers and Storage business.

In December 2010, the Company announced that the Board of Directors had formed an Independent Advisory Committee to explore a broad range of business development and other initiatives, and the Independent Advisory Committee continues to evaluate a range of strategic options for the Company. The market price of our common stock could be subject to significant fluctuations in response to developments relating to this process or the public perception that developments may occur.

We have also incurred significant expenditures in connection with the previously-announced restructuring of our Servers and Storage business that resulted from our strategic review of this business. The purpose of this restructuring was to align the cost structure of this business with its anticipated future revenue stream, which has been declining significantly over the past two years and which we anticipate may continue to decline as we transition to primarily a software business. We cannot assure that the steps we have taken to restructure our Servers and Storage business are sufficient to enable this business to operate on a profitable basis or that we will not incur additional losses in this business in future periods. As a result, we continue to evaluate future alternatives for our Servers and Storage business segment. This ongoing evaluation may result in further restructuring of this business and may adversely affect our business by causing our customers to cancel or defer purchases of these products.



Because our customer base is highly concentrated among a limited number of large customers, the loss of or reduced demand by, or return of product by one of these customers, could have a material adverse effect on our business, financial condition and results of operations.

Our customer base is highly concentrated among a limited number of large customers, and, therefore, a limited number of customers account for a significant percentage of our revenues in any fiscal period. We generally do not have written agreements that require customers to purchase fixed minimum quantities of our products. Our sales to specific customers tend to vary significantly from year to year and from quarter to quarter depending upon these customers' budgets for capital expenditures and our new product introductions. We believe that a significant amount of our revenues will continue to be derived from a limited number of large customers in the future. The loss of, reduced demand for products or related services by, or return of a product previously purchased by any of our major customers could have a material adverse effect on our business, financial condition and results of operations.

In addition, the industry has experienced consolidation among our customers which may cause delays or reductions in capital expenditure plans and/or increased competitive pricing pressures as the number of available customers decline and their relative purchasing power increases in relation to suppliers. Any of these factors could adversely affect our business.

Cancellation or deferral of purchases of our products or the return of previously purchased products could cause our operating results to be below the expectations of the public market stock analysts who cover our stock, resulting in a decrease in the market price of our common stock.

We derive a substantial portion of our revenues from purchase orders that exceed \$1.0 million in value. Therefore, any significant cancellation or deferral of purchases of our products or the return of previously purchased products could have a material adverse effect on our business, financial condition and results of operations in any particular quarter due to the resulting decrease in revenue and gross margin and our relatively fixed costs. In addition, to the extent significant sales occur earlier than expected, operating results for subsequent quarters may be adversely affected because our operating costs and expenses are based, in part, on our expectations of future revenues, and we may be unable to adjust spending in a timely manner to compensate for any revenue shortfall. Because of these factors, in some future quarter our operating results may be below the expectations of public market analysts and investors which may adversely affect the market price of our common stock.

Timing of significant customer orders may cause our quarterly operating results to fluctuate, making period-to-period comparisons of our operating results less meaningful.

We have experienced significant variations in the revenue, expenses and operating results from quarter to quarter and these variations are likely to continue. We believe that fluctuations in the number and size of orders being placed from quarter to quarter are principally attributable to the buying patterns and budgeting cycles of broadband system operators, including telecommunications companies, and broadcast companies, the primary buyers of the digital video-on-demand, advertising and broadcast systems, respectively. We expect that there will continue to be fluctuations in the number and value of orders received. In addition, certain of our product sales are subject to acceptance by our customer, and the timing of customer acceptance may be subject to delay due to circumstances beyond our control. As a result, our results of operations have in the past and likely will, at least in the near future, fluctuate in accordance with this purchasing activity making period-to-period comparisons of our operating results less meaningful. In addition, because these factors are difficult for us to forecast, our business, financial condition and results of operations for one quarter or a series of quarters may be adversely affected and below the expectations of public market analysts and investors, resulting in a decrease in the market price of our common stock.

Due to the lengthy sales cycle involved in the sale of our products, our quarterly results may vary and should not be relied on as an indication of future performance.

Digital video-on-demand, advertising, movie and broadcast products are relatively complex and their purchase generally involve a significant commitment of capital, with attendant delays frequently associated with large capital expenditures and implementation procedures within an organization. Moreover, the purchase of these products typically requires coordination and agreement among a potential customer's corporate headquarters and its regional and local operations. For these and other reasons, the sales cycle associated with the purchase of our digital video-on-demand, advertising, movie and broadcast products is typically lengthy and subject to a number of significant risks, including customers' budgetary constraints and internal acceptance reviews, over which we have little or no control. Based upon all of the foregoing, we believe that our quarterly revenues and operating results are likely to vary significantly in the future, that period-to-period comparisons of our results of operations are not necessarily meaningful and that these comparisons should not be relied upon as indications of future performance.

If there were a decline in demand or average selling prices for our products, including our Video-On-Demand products and Advertising products, our revenues and operating results would be materially affected.

We expect our VOD and advertising products to continue to account for a significant portion of our revenues. Accordingly, a decline in demand or average selling prices for these products, whether as a result of new product introductions by others, price competition, technological change, inability to enhance the products in a timely fashion, or otherwise, could have a material adverse effect on our business, financial condition and results of operations.

If we are unable to manage our growth and the related expansion in our operations effectively, our business may be harmed through a diminished ability to monitor and control effectively our operations, and a decrease in the quality of work and innovation of our employees.

Our ability to successfully offer new products and services and implement our business plan in a rapidly evolving market requires effective planning and management. We are also continuing to transition towards greater reliance on our software products and services for an increased portion of our total revenue. In light of the growing complexities in managing our expanding portfolio of products and services, our anticipated future operations will continue to strain our operational and administrative resources. To manage future growth effectively, we must continue to improve our operational controls and internal controls over financial reporting, and to integrate the businesses we have acquired and our new personnel and to manage our expanding international operations. A failure to manage our growth may harm our business through a decreased ability to monitor and control effectively our operations, and a decrease in the quality of work and innovation of our employees upon which our business is dependent.

Because our business is susceptible to risks associated with international operations, we may not be able to maintain or increase international sales of our products and services, and we may not realize the full amount of the anticipated savings in connection with our continued trend towards the manufacture and assembly of our products outside of North America and EMEA.

Our international operations are expected to continue to account for a significant portion of our business in the future. However, in the future we may be unable to maintain or increase international sales of our products and services. Our international operations are subject to a variety of risks, including:

- difficulties in establishing and managing international distribution channels;
- difficulties in selling, servicing and supporting overseas products and services and in translating products and services into foreign languages;
  - the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property;
    - multiple and possibly overlapping tax structures;
  - negative tax consequences such as withholding taxes and employer payroll taxes;
- changes in labor laws and regulations affecting our ability to hire and retain employees; and
  - economic or political changes in international markets.



We are exposed to fluctuations in currency exchange rates that could negatively impact our financial results and cash flows.

To date, most of our revenues have been denominated in U.S. dollars, while a significant portion of our international expenses are incurred in the local currencies of countries in which we operate. Because a portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. An increase in the value of the dollar could increase the real cost to our customers of our products in those markets outside the United States where we often sell in dollars, and a weakened dollar could increase local currency operating costs. In preparing our consolidated financial statements, certain financial information is required to be translated from foreign currencies to the United States dollar using either the spot rate or the weighted-average exchange rate. If the United States dollar changes relative to applicable local currencies, there is a risk our reported sales, operating expenses, and net income could significantly fluctuate. We are not able to predict the degree of exchange rate fluctuations, nor can we estimate the effect any future fluctuations may have upon our future operations.

Our ability to compete could be jeopardized if we are unable to protect our intellectual property rights from third-party challenges.

Our success and ability to compete depends upon our ability to protect our proprietary technology that is incorporated into our products. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. Although we have issued patents, we cannot assure that any additional patents will be issued or that the issued patents will not be invalidated. We also enter into confidentiality or license agreements with our employees, consultants and corporate partners, and control access to and distribution of our software, documentation and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise misappropriate and use our products or technology without authorization, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. We may need to resort to litigation in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. If competitors are able to use our technology, our ability to compete effectively could be harmed.

We have been and in the future could become subject to litigation regarding intellectual property rights, which could seriously harm our business and require us to incur significant legal costs to defend our intellectual property rights.

The industry in which we operate is characterized by vigorous protection and pursuit of intellectual property rights or positions, which on occasion, have resulted in significant and often protracted litigation. We have from time to time received, and may in the future receive, communications from third parties asserting infringements on patent or other intellectual property rights covering our products or processes. We are currently engaged in intellectual property litigation with Arris Group, Inc., and we may be a party to litigation in the future to enforce our intellectual property rights or as a result of an allegation that we infringe others' intellectual property. Any parties asserting that our products infringe upon their proprietary rights would force us to defend ourselves and possibly our customers or manufacturers against the alleged infringement, as many of our commercial 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. These claims and any resulting lawsuit, if successful, could subject us to significant liability for damages and invalidation of our proprietary rights. This possibility of multiple damages serves to increase the incentive for plaintiffs to bring such litigation. In addition, these lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention away from our operations.

Although we carry general liability insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. In addition, any potential intellectual property litigation also could force us to stop selling, incorporating or using the products that use the infringed intellectual property or obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, although this license may not be available on reasonable terms, or at all, or redesign those products that use the infringed intellectual property. If we are forced to take any of the foregoing actions, our business may be seriously harmed.

If content providers, such as movie studios, limit the scope of content licensed for use in the digital video-on-demand market, our business, financial condition and results of operations could be negatively affected because the potential market for our products would be more limited than we currently believe and have communicated to the financial markets.

The success of the video-on-demand market is contingent on content providers, such as movie studios, permitting their content to be licensed for use in this market. Content providers may, due to concerns regarding either or both marketing and illegal duplication of the content, limit the extent to which they provide content to the video-on-demand market. A limitation of content for the video-on-demand market would indirectly limit the market for our video-on-demand system which is used in connection with that market.

If we are unable to successfully introduce new products or enhancements to existing products, our financial condition and operating results may be adversely affected by a decrease in sales of our products.

Because our business plan is based on technological development of new products and enhancements to our existing products, our future success is dependent on our successful introduction of these new products and enhancements. In the future we may experience difficulties that could delay or prevent the successful development, introduction and marketing of these and other new products and enhancements, or find that our new products and enhancements do not adequately meet the requirements of the marketplace or achieve market acceptance. Announcements of currently planned or other new product offerings may cause customers to defer purchasing our existing products. Moreover, despite testing by us and by current and potential customers, errors or failures may be found in our products, and, even if discovered, may not be successfully corrected in a timely manner. These errors or failures could cause delays in product introductions and shipments, or require design modifications that could adversely affect our competitive position. Currently, we are developing a new generation of products and systems to enable the delivery of video to multiple customer screens. Our inability to develop new products or enhancements on a timely basis or the failure of these new products or enhancements to achieve market acceptance could have a material adverse effect on our business, financial condition and results of operations.

Because we purchase certain material components used in manufacturing our products from sole suppliers and we use a limited number of third party manufacturers to manufacture our products, our business, financial condition and results of operations could be materially adversely affected by a failure of these suppliers or manufacturers.

Certain key components of our products are currently purchased from a sole supplier, including computer chassis, switching gear, an interface controller video transmission board, encoder and decoder hardware, and operating system and applications software. We have in the past experienced quality control problems, where products did not meet specifications or were damaged in shipping, and delays in the receipt of these components. These problems were generally of short duration and did not have a material adverse effect on our business and results of operations. However, we may in the future experience similar types of problems which could be more severe or more prolonged. While we believe that there are alternative suppliers available for these components, we believe that the procurement of these components from alternative suppliers could take up to a year. In addition, these alternative components may not be functionally equivalent or may be unavailable on a timely basis or on similar terms. The inability to obtain sufficient key components as required, or to develop alternative sources if and as required in the future, could result in delays or reductions in product shipments which, in turn, could have a material adverse effect on our business, financial condition and results of operations.

In addition, we rely on a limited number of third parties who manufacture certain components used in our products. While to date there has been suitable third party manufacturing capacity readily available at acceptable quality levels, in the future there may not be manufacturers that are able to meet our future volume or quality requirements at a price that is favorable to us. Any financial, operational, production or quality assurance difficulties experienced by these third party manufacturers that result in a reduction or interruption in supply to us could have a material adverse effect on our business, financial condition and results of operations.

If we are not able to obtain necessary licenses or distribution rights for third-party technology at acceptable prices, or at all, our products could become obsolete or we may not be able to deliver certain product offerings.

We have incorporated third-party licensed technology into our current products and our product lines. From time to time, we may be required to license additional technology from third parties to develop new products or product enhancements or to provide specific solutions. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. The inability to maintain or re-license any third-party licenses required in our current products or to obtain any new third-party licenses necessary to develop new products and product

enhancements or provide specific solutions could require us to obtain substitute technology of lower quality or performance standards or at greater cost. Such inabilities could delay or prevent us from making these products or enhancements or providing specific solutions, which could seriously harm the competitiveness of our products.

If we are unable to successfully compete in our marketplace, our financial condition and operating results may be adversely affected.

We currently compete against companies offering video software and /or server platforms. In the digital advertisement insertion market, we compete against suppliers of both analog tape-based and digital systems. In addition, a number of well-funded companies have been discussing broadband internet VOD services for home television viewing. If these products are developed, they may be more cost effective than our VOD solutions, which could result in cable system operators and telecommunications companies discontinuing purchases of our on demand products.

Due to the rapidly evolving markets in which we compete, additional competitors with significant market presence and financial resources, including computer hardware and software companies and television equipment manufacturers, may enter those markets, thereby further intensifying competition. Increased competition could result in price reductions, cancellations of purchase orders, losses of business with current customers to competitors, and loss of market share which would adversely affect our business, financial condition and results of operations. Many of our current and potential competitors have greater financial, selling and marketing, technical and other resources than we do. Moreover, our competitors may also foresee the course of market developments more accurately than we. Although we believe that we have certain technological and other advantages over our competitors, realizing and maintaining these advantages will require a continued high level of investment by us in research and product development, marketing and customer service and support. In the future we may not have sufficient resources to continue to make these investments or to make the technological advances necessary to compete successfully with our existing competitors or with new competitors.

If we are unable to compete effectively, our business, prospects, financial condition and operating results would be materially adversely affected because of the difference in our operating results from the assumptions on which our business model is based.

If we fail to respond to rapidly changing technologies related to digital video, our business, financial condition and results of operations would be materially adversely affected because the competitive advantage of our products and services relative to those of our competitors would decrease.

The markets for our products are characterized by rapidly changing technology, evolving industry standards and frequent new product introductions and enhancements. Future technological advances in the television and video industries may result in the availability of new products or services that could compete with the solutions provided by us or reduce the cost of existing products or services, any of which could enable our existing or potential customers to fulfill their video needs better and more cost efficiently than with our products. Our future success will depend on our ability to enhance our existing digital video products, including the development of new applications for our technology, and to develop and introduce new products to meet and adapt to changing customer requirements and emerging technologies. In the future, we may not be successful in enhancing our digital video products or developing, manufacturing and marketing new products which satisfy customer needs or achieve market acceptance. In addition, there may be services, products or technologies developed by others that render our products or technologies uncompetitive, unmarketable or obsolete, or announcements of currently planned or other new product offerings either by us or our competitors that cause customers to defer or fail to purchase our existing solutions.

Our financial condition and results of operations could be materially adversely affected by the performance of the companies in which we have made and may in the future make equity investments.

We have made non-controlling equity investments in complementary companies, including On Demand Deutschland GmbH & Co. KG and Minerva Networks, Inc., and we may in the future make additional investments in these and/or other companies. These investments may require additional capital and may not generate the expected rate of return

that we believed possible at the time of making the investment. This may adversely affect our financial condition or results of operations. Also, investments in development-stage companies may generate other than temporary declines in fair value of our investment that would result in impairment charges.

We may not fully realize the benefits of our acquisitions of eventIS Group B.V or VividLogic, Inc., and these and future acquisitions may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.

As part of our business strategy, we have acquired and may in the future seek to acquire or invest in new businesses, products or technologies that we believe could complement or expand our business, augment our market coverage, enhance our technical capabilities or otherwise offer growth opportunities. Acquisitions, including our acquisitions of eventIS Group B.V. and VividLogic, Inc. could create risks for us, including:

- difficulties in assimilation of acquired personnel, operations, technologies or products which may affect our ability to develop new products and services and compete in our rapidly changing marketplace due to a resulting decrease in the quality of work and innovation of our employees upon which our business is dependent; and
- adverse effects on our existing business relationships with suppliers and customers, which may be of particular importance to our business because we sell our products to a limited number of large customers, we purchase certain components used in manufacturing our products from sole suppliers and we use a limited number of third party manufacturers to manufacture our product.

In addition, if we consummate acquisitions through an exchange of our securities, our existing stockholders could suffer significant dilution. Acquisitions, even if successfully completed, may not generate any additional revenue or provide any benefit to our business.

We may make future acquisitions or enter into joint ventures that are not successful, which could seriously harm our business.

Historically, we have acquired technology or businesses to supplement and expand our product offerings. In the future, we could acquire additional products, technologies or businesses, or enter into joint venture arrangements, for the purpose of complementing or expanding our business as occurred with VividLogic Inc. in fiscal 2011, eventIS Group B.V. in fiscal 2010, Mobix Interactive Ltd. in fiscal 2009 and On Demand Deutschland GMBH in fiscal 2007. Negotiation of potential acquisitions or joint ventures and our integration of acquired products, technologies or businesses could divert management's time and resources. Future acquisitions could cause us to issue equity securities that would dilute existing stockholders, incur contingent liabilities, amortize intangible assets, or write off in-process research and development and other acquisition-related expenses that could have a material adverse affect on our business, results of operations, cash flow and financial condition. We may not be able to properly integrate acquired products, technologies or businesses with our existing products and operations, train, retain and motivate personnel from the acquired businesses, or combine potentially different corporate cultures. Failure to do so could deprive us of the intended benefits of those acquisitions. In addition, we may be required to write-off acquired research and development if further development of purchased technology becomes unfeasible, which may adversely affect our business, results of operations, cash flow and financial condition.

If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings.

Under accounting principles generally accepted in the United States, we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or other intangible assets may not be recoverable include declines in our stock price and market capitalization, or future cash flows projections. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on projections of future operating performance. We operate in highly competitive environments and projections of future operating results and cash flows may vary

significantly from actual results. We may be required to record a significant noncash charge to earnings in our financial statements during the period in which any impairment of our goodwill or other intangible assets is determined.



We may experience risks in our investments due to changes in the market, which could adversely affect the value or liquidity of our investments.

We maintain a portfolio of cash equivalents and short-term and long-term investments in a variety of securities which may include commercial paper, certificates of deposit, money market funds and government debt securities. These available-for-sale investments are subject to interest rate risk and may decline in value if market interest rates increase. These investments are subject to general credit, liquidity, market and interest rate risks. As a result, we may experience a reduction in value or loss of liquidity of our investments. In addition, should any investment cease paying or reduce the amount of interest paid to us, our interest income would suffer. These market risks associated with our investment portfolio may have a negative adverse effect on our results of operations, liquidity and financial condition.

The success of our business model could be influenced by changes in the regulatory environment, such as changes that either would limit capital expenditures by television, cable or telecommunications operators or reverse the trend towards deregulation in the industries in which we compete.

The telecommunications and television industries are subject to extensive regulation which may limit the growth of our business, both in the United States and other countries. The growth of our business internationally is dependent in part on deregulation of the telecommunications industry abroad similar to that which has occurred in the United States and the timing and magnitude of which is uncertain. Broadband system operators are subject to extensive government regulation by the Federal Communications Commission and other federal and state regulatory agencies. These regulations could have the effect of limiting capital expenditures by broadband system operators and thus could have a material adverse effect on our business, financial condition and results of operations. The enactment by federal, state or international governments of new laws or regulations, changes in the interpretation of existing regulations or a reversal of the trend toward deregulation in these industries could adversely affect our customers, and thereby materially adversely affect our business, financial condition and results of operations.

We may not be able to hire and retain highly skilled employees, particularly which could affect our ability to compete effectively because our business is technology-based.

Our success depends to a significant degree upon the continued contributions of our key personnel, many of whom would be difficult to replace. We believe that our future success will also depend in large part upon our ability to attract and retain highly skilled managerial, engineering, customer service, selling and marketing, finance, administrative and manufacturing personnel, as our business is technology-based. Because competition for these personnel is intense, we may not be able to attract and retain qualified personnel in the future. The loss of the services of any of the key personnel, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel, particularly software engineers and sales personnel could have a material adverse effect on our business, financial condition and results of operations because our business is technology-based.

We may have additional tax liabilities.

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our income tax provision, net income, or cash flows in the period or periods for which that determination is made.

In addition, we are subject to sales, use and similar taxes in many countries, jurisdictions and provinces, including those states in the United States where we maintain a physical presence or have a substantial nexus. These taxing regimes are complex. For example, in the United States, each state and local taxing authority has its own interpretation of what constitutes a sufficient physical presence or nexus to require the collection and remittance of these taxes. Similarly, each state and local taxing authority has its own rules regarding the applicability of sales tax by customer or product type.

System errors, failures, or interruptions could cause delays in shipments, require design modifications or replacements which may have a negative impact on our business and damage our reputation and customer relationships.

System errors or failures may adversely affect our business, financial condition and results of operations. Despite our testing and testing by current and potential customers, not all errors or failures may be found in our products or, if discovered, successfully corrected in a timely manner. Notwithstanding our efforts to the contrary, our products and business may be subject to unauthorized access which could also result in errors or failures in our products, or the dissemination of confidential information. These errors or failures could cause delays in product introductions and shipments, require design modifications that could adversely affect our competitive position or result in material liability to us. Further, some errors may not be detected until the systems are deployed. In such a case, we may have to undertake major replacement programs to correct the problem. Our reputation may also suffer if our customers view our products as unreliable or our systems as unsecure, whether based on actual or perceived errors or failures in our products or our systems.

Further, a defect, error or performance problem with our on-demand systems could cause our customers' VOD offerings to fail for a period of time or be degraded. Any such failure would cause customer service and public relations problems for our customers. As a result, any failure of our customers' systems caused by our technology, including the failure of third party technology incorporated therein or therewith, could result in delayed or lost revenue due to adverse customer reaction, negative publicity regarding us and our products and services and claims for substantial damages against us, regardless of our responsibility for such failure. Any claim could be expensive and require us to spend a significant amount of resources. In circumstances where third party technology incorporated with or in our systems includes a defect, error or performance problem or fails for any reason, we may have to replace such third party technology at our expense and be responsible to our customers for their corresponding claims. Such replacements or claims could be expensive and could require us to spend a significant amount of resources.

Our stock price may be volatile.

Historically, the market for technology stocks has been extremely volatile. Our common stock has experienced, and may continue to experience, substantial price volatility. The occurrence of any one or more of the factors noted above could cause the market price of our common stock to fluctuate. In the past couple of years, the stock market in general, and the NASDAQ Stock Market and technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of such companies. These broad market and industry factors may materially adversely affect the market price of our common stock, regardless of our actual operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such companies.

Any weaknesses identified in our system of internal controls by us and our independent registered public accounting firm pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 could have an adverse effect on our business.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that companies evaluate and report on their systems of internal control over financial reporting. In addition, our independent registered public accounting firm must report on its evaluation of those controls. In future periods, we may identify deficiencies, including as a result of the loss of the services of one or more of our key personnel, in our system of internal controls over financial reporting that may require remediation. There can be no assurances that any such future deficiencies identified may not be significant deficiencies or material weaknesses that would be required to be reported in future periods.

#### ITEM 1B. Unresolved Staff Comments

None



## ITEM 2. Properties

| Location                      | Lease/<br>Own | Principal Use   | Segment                       | Square Feet |
|-------------------------------|---------------|---|-------------------------------|-------------|
| Acton, Massachusetts          | Own           | Corporate Headquarters, video   | Software, Servers and Storage | 120,000     |
| Shanghai, China               | Lease         | Engineering   | Software, Servers and Storage | 38,000      |
| Manilla, Philippines          | Lease         | Engineering and Customer Services<br>software engineering and manufacturing | Software, Servers and Storage | 28,000      |
| Greenville, New Hampshire     | Own           | Video Storage engineering, logistics and services engineering               | Servers and Storage           | 24,000      |
| Fort Washington, Pennsylvania | Lease         | Software Development, digital video and interactive television              | Software                      | 14,000      |
| London, United Kingdom        | Own           | ODG corporate offices and video content processing services                 | Media Services                | 9,000       |
| Eindhoven, The Netherlands    | Lease         | eventIS corporate offices   | Software                      | 6,300       |

In addition, we also lease research and development and/or sales and support offices in Illinois, Nevada, California, France, Ireland, Singapore, Germany, Japan, India, Turkey, UK, Russia, Mexico, and China. We believe that existing facilities are adequate to meet our foreseeable requirements.

## ITEM 3. Legal Proceedings

On July 31, 2009, ARRIS Group, Inc. (“ARRIS”) filed a contempt motion in the U.S. District Court for the District of Delaware against SeaChange International relating to U.S. Patent No 5,805,804 (the “804 patent”), a patent in which ARRIS has an ownership interest. In its motion, ARRIS is seeking further patent royalties and the enforcement of the permanent injunction entered by the Court on April 6, 2006 against certain SeaChange products. On August 3, 2009, SeaChange filed a complaint seeking a declaratory judgment from the Court that its products do not infringe the ‘804 patent and asserting certain equitable defenses. Discovery and briefing on the ARRIS contempt motion are expected to be completed on April 18, 2011.

SeaChange changed the product that was the subject of the first patent lawsuit regarding the ‘804 patent to specifically avoid any further claims of alleged infringement under the ‘804 patent. In addition, on March 15, 2007 SeaChange petitioned the U.S. Patent and Trademark Office to re-examine the ‘804 patent in view of the claim construction that was given in the prior trial regarding the ‘804 patent. As a result of the re-examination, the patent examiner cancelled the first three claims of the ‘804 patent. SeaChange believes that ARRIS’s contempt motion is without merit, and that SeaChange's products do not infringe the ‘804 patent.

SeaChange enters into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require SeaChange to defend and/or indemnify the other party against

intellectual property infringement claims brought by a third party with respect to SeaChange's products. From time to time, SeaChange also indemnifies customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of SeaChange's products and services or resulting from the acts or omissions of SeaChange, its employees, authorized agents or subcontractors. For example, SeaChange has received requests from several of its customers for indemnification of patent litigation claims asserted by Acacia Media Technologies, USA Video Technology Corporation, Multimedia Patent Trust, Microsoft Corporation and VTran Media Technologies. Management performed an analysis of these requests, evaluating whether any potential losses were probable and estimable.

## PART II

## ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters

## Market Information

Our common stock (symbol, "SEAC") began trading on NASDAQ on November 5, 1996 and currently trades on the Nasdaq Global Select Market.

On April 1, 2011, the last reported sale price of our common stock on NASDAQ was \$9.93 per share and there were approximately 125 holders of record of our common stock. We believe that the number of beneficial holders of our common stock exceeds 7,149.

The following table sets forth the quarterly high and low closing sales prices per share reported on NASDAQ for our last two fiscal years ended January 31, 2011 and 2010.

|                           | Fiscal Year 2011 |         | Fiscal Year 2010 |         |
|---------------------------|------------------|---------|------------------|---------|
|                           | High             | Low     | High             | Low     |
| Three Month Period Ended: |                  |         |                  |         |
| First Quarter             | \$ 8.61          | \$ 6.45 | \$ 6.81          | \$ 4.32 |
| Second Quarter            | 9.48             | 7.45    | 9.23             | 6.06    |
| Third Quarter             | 9.17             | 7.08    | 9.85             | 6.77    |
| Fourth Quarter            | 9.04             | 7.90    | 6.97             | 5.50    |

## Dividend Policy

We have never declared or paid any cash dividends on our common stock, since inception, and do not expect to pay cash dividends on our common stock in the foreseeable future. We currently intend to retain all of our future earnings for use in operations and to finance the expansion of our business.

## Repurchase of our Equity Securities

On May 26, 2010, SeaChange's Board of Directors authorized the repurchase of up to \$20.0 million of its common stock, par value \$.01 per share, through a share repurchase program. As authorized by the program, shares may be purchased in the open market or through privately negotiated transactions in a manner consistent with applicable securities laws and regulations, including pursuant to a Rule 10b5-1 plan maintained by the Company. This share repurchase program does not obligate the Company to acquire any specific number of shares and may be suspended or discontinued at any time. All repurchases are expected to be funded from the Company's current cash and investment balances. The timing and amount of the shares to be repurchased will be based on market conditions and other factors, including price, corporate and regulatory requirements and alternative investment opportunities. The repurchase program terminates on January 31, 2012. There were no stock repurchases during the three months ended January 31, 2011. During the year ended January 31, 2011, the Company repurchased approximately 178,000 shares at a cost of \$1.4 million.

### STOCK PERFORMANCE GRAPH

The following graph compares the change in the cumulative total stockholder return on SeaChange's common stock during the period from the close of trading on January 31, 2006 through January 31, 2011, with the cumulative total return on the Center for Research in Securities Prices ("CRSP") Index for the Nasdaq Stock Market (U.S. Companies) and a SIC Code Index based on SeaChange's SIC Code. The comparison assumes \$100 was invested on January 31, 2006 in SeaChange's common stock at the \$8.32 closing price on January 31, 2006 and in each of the foregoing indices and assumes reinvestment of dividends, if any.

The following graph is not "soliciting material," is not deemed filed with the SEC and is not to be incorporated by reference in any filing of SeaChange under the Securities Act or the Exchange Act, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing. The stock price performance shown on the following graph is not necessarily indicative of future price performance. Information used on the graph was obtained from a third party provider, a source believed to be reliable, but SeaChange is not responsible for any errors or omissions in such information.

Notes:

- A. The lines represent monthly index levels derived from compounded daily returns that include all dividends.
- B. If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.
- C. The Index level for all series was set to 100 on January 31, 2006.



## ITEM 6. Selected Financial Data

The following consolidated selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The Company has reclassified certain prior period balances in fiscal 2007 and fiscal 2008 to conform to the current year presentation. These reclassifications have no impact on previously reported total assets, total liabilities, stockholders’ equity, results of operations or cash flows.

|   | Year ended January 31,                |                 |                 |                 |                    |
|---|---------------------------------------|-----------------|-----------------|-----------------|--------------------|
|   | 2011                                  | 2010            | 2009            | 2008            | 2007               |
|   | (in thousands, except per share data) |                 |                 |                 |                    |
| <b>Consolidated Statement of Operations</b>   |                                       |                 |                 |                 |                    |
| <b>Data:</b>  |                                       |                 |                 |                 |                    |
| <b>Revenues:</b>  |                                       |                 |                 |                 |                    |
| Products  | \$ 91,679                             | \$ 101,941      | \$ 117,372      | \$ 105,769      | \$ 95,000          |
| Services  | 125,048                               | 99,724          | 84,464          | 74,124          | 66,334             |
| <b>Total revenues</b>   | <b>216,727</b>                        | <b>201,665</b>  | <b>201,836</b>  | <b>179,893</b>  | <b>161,334</b>     |
| <b>Costs of revenues:</b>   |                                       |                 |                 |                 |                    |
| Products  | 35,527                                | 38,961          | 46,533          | 47,833          | 48,334             |
| Services  | 72,451                                | 59,451          | 52,007          | 46,368          | 37,189             |
| <b>Total cost of revenue</b>  | <b>107,978</b>                        | <b>98,412</b>   | <b>98,540</b>   | <b>94,201</b>   | <b>85,523</b>      |
| <b>Gross profit</b>   | <b>108,749</b>                        | <b>103,253</b>  | <b>103,296</b>  | <b>85,692</b>   | <b>75,811</b>      |
| <b>Operating expenses:</b>  |                                       |                 |                 |                 |                    |
| Research and development  | 48,403                                | 50,664          | 43,042          | 41,720          | 40,917             |
| Selling and marketing   | 24,506                                | 25,842          | 27,506          | 22,918          | 22,383             |
| General and administrative  | 24,328                                | 21,719          | 20,979          | 20,098          | 18,873             |
| Amortization of intangibles   | 3,359                                 | 2,826           | 1,575           | 2,952           | 5,664              |
| Restructuring   | 6,997                                 | -               | -               | 6,004           | -                  |
| <b>Total operating expenses</b>   | <b>107,593</b>                        | <b>101,051</b>  | <b>93,102</b>   | <b>93,692</b>   | <b>87,837</b>      |
| <b>Income (loss) from operations</b>  | <b>1,156</b>                          | <b>2,202</b>    | <b>10,194</b>   | <b>(8,000 )</b> | <b>(12,026 )</b>   |
| <b>Interest (expense) income, net</b>   | <b>(165 )</b>                         | <b>607</b>      | <b>2,050</b>    | <b>1,927</b>    | <b>1,355</b>       |
| <b>Other (expense), net</b>   | <b>(1,017 )</b>                       | <b>(462 )</b>   | <b>(925 )</b>   | <b>(43 )</b>    | <b>(470 )</b>      |
| <b>Gain on sale of investment in affiliates</b>   | <b>27,071</b>                         | <b>-</b>        | <b>-</b>        | <b>10,031</b>   | <b>-</b>           |
| <b>Income (loss) before income taxes and equity income (loss) in earnings of affiliates</b> | <b>27,045</b>                         | <b>2,347</b>    | <b>11,319</b>   | <b>3,915</b>    | <b>(11,141 )</b>   |
| <b>Income tax expense (benefit)</b>   | <b>(2,338 )</b>                       | <b>371</b>      | <b>575</b>      | <b>2,156</b>    | <b>(1,632 )</b>    |
| <b>Equity income (loss) in earnings of affiliates, net of tax</b>                           | <b>85</b>                             | <b>(653 )</b>   | <b>(770 )</b>   | <b>1,143</b>    | <b>1,272</b>       |
| <b>Net income (loss)</b>  | <b>\$ 29,468</b>                      | <b>\$ 1,323</b> | <b>\$ 9,974</b> | <b>\$ 2,902</b> | <b>\$ (8,237 )</b> |
| <b>Earnings (loss) per share:</b>   |                                       |                 |                 |                 |                    |
| Basic   | \$ 0.94                               | \$ 0.04         | \$ 0.32         | \$ 0.10         | \$ (0.29 )         |
| Diluted   | \$ 0.92                               | \$ 0.04         | \$ 0.32         | \$ 0.10         | \$ (0.29 )         |
| <b>Consolidated Balance Sheet Data (as of January 31):</b>                                  |                                       |                 |                 |                 |                    |
| Working capital   | \$ 92,628                             | \$ 60,887       | \$ 89,549       | \$ 88,344       | \$ 57,820          |
| Total assets  | 305,191                               | 267,147         | 233,983         | 217,896         | 199,296            |
| Deferred revenue  | 43,969                                | 46,793          | 32,974          | 19,103          | 21,806             |
| Long-term liabilities   | 27,057                                | 15,808          | 3,745           | 3,391           | 1,121              |

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|                            |         |         |         |         |         |
|----------------------------|---------|---------|---------|---------|---------|
| Total liabilities          | 96,049  | 89,225  | 61,747  | 52,494  | 42,876  |
| Total stockholders' equity | 209,142 | 177,922 | 172,236 | 165,402 | 156,420 |

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## ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis together with our consolidated financial statements, related notes and other financial information appearing elsewhere in this report. In addition to historical information, the following discussion and other parts of this report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to a number of factors including risks discussed in Item 1A. "Risk Factors," and elsewhere in this Annual Report on Form 10-K. These risks could cause our actual results to differ materially from any future performance suggested below.

### Overview

We are a global leader in the delivery of multi-screen video. Our products and services facilitate the aggregation, licensing, storage, management and distribution of video, television programming, and advertising content to cable system operators, telecommunications companies and broadcast television companies.

On September 1, 2009, the Company completed its acquisition of eventIS Group B.V. ("eventIS"). eventIS, based in Eindhoven, the Netherlands, provides video on demand ("VOD") and linear broadcast software and related services to cable television and telecommunications companies primarily in Europe. The Company acquired eventIS to expand its VOD solutions into the European market. The Company has made cash payments to date to the former shareholder of eventIS of \$38.7 million and issued 75,000 of restricted common shares which will vest in equal installments over three years beginning in fiscal 2012. The Company is obligated to make additional payments, each in an aggregate amount of \$2.8 million with \$1.7 million payable in cash and \$1.1 million payable by the issuance of restricted shares of SeaChange common stock on September 1, 2011 and 2012. For fiscal 2011, under the earn-out provisions of the share purchase agreement, \$340,000 was earned and will be paid to the former shareholder of eventIS during the Company's first quarter of fiscal 2012. If certain performance goals are met over each of the two years ending January 31, 2013, the Company will be obligated to make additional cash payments to the former shareholder of eventIS. Acquisition-related costs recognized included legal, accounting, valuation and other professional services totaling \$1.0 million for fiscal 2010. The transaction costs were expensed and recorded in general and administrative expenses in the Consolidated Statement of Operations.

On February 1, 2010, the Company completed its acquisition of VividLogic, Inc. ("VividLogic"). VividLogic, based in Fremont, California, provides in-home infrastructure software for high definition televisions, home gateways, and set-top boxes to cable television service providers, set-top box manufacturers and consumer electronics (CE) suppliers. The Company acquired VividLogic to expand its in home solutions. The Company made cash payments totaling \$21.5 million, of which \$1.2 million was deposited in escrow with respect to certain indemnification matters. In addition, the Company is obligated to make additional cash payments of \$1.0 million on February 1, 2012 and 2013, respectively. Under the earnout provisions of the purchase agreement, the Company will make an earn-out payment of \$257,000 for fiscal year 2011 and may be obligated to make future earn-out payments based on the operating results of VividLogic. Acquisition-related costs recognized include legal, accounting, valuation and other professional services of \$831,000 in fiscal 2011 and \$341,000 in fiscal 2010. The transaction costs were expensed and recorded in general and administrative expenses in the Consolidated Statement of Operations.

During fiscal 2011, the Company initiated actions to lower its cost structure as it strives to generate increased profitability. During fiscal 2011 pre-tax restructuring expenses charged to its income statement totaled approximately \$7.0 million related to the termination of approximately 110 employees, the write down of inventory, and the disposal of fixed assets. These actions included the restructuring of the Company's Servers and Storage business segment, completed in the fourth quarter of fiscal 2011.

The Company is managed and operated as three segments, Software, Servers and Storage, and Media Services. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company's Advertising, VOD, Middleware and Broadcast software solutions, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing and amortization of intangibles. The Software segment includes the results of eventIS from the date of the acquisition on September 1, 2009 and the results of VividLogic from the date of acquisition on February 1, 2010.

- Servers and Storage segment includes product revenues from VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.
- Media Services segment includes the operations of ODG which include content acquisition and preparation services for television and wireless service providers and related operating expenses.

Under this reporting structure, the Company further determined that there are significant functions, and therefore costs, that are considered corporate expenses and are not allocated to the reportable segments for the purposes of assessing performance and making operating decisions. These unallocated costs include general and administrative expenses, other than direct general and administrative expenses related to Media Services and Software, other income (expense), net, taxes and equity losses in earnings of affiliates, which are managed separately at the corporate level. The basis of the assumptions for all such revenues, costs and expenses includes significant judgments and estimations. There are no inter-segment revenues for the periods shown below. The Company does not separately track all assets by operating segments nor are the segments evaluated under this criterion

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

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

Factors that may impact the shipment of customer orders include:

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

In addition, many customers may delay or reduce capital expenditures. This, together with other factors, could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, excess and obsolete inventory, gross margin deterioration, slower adoption of new technologies, increased price competition and supplier difficulties. We believe that the recent global economic slowdown and the resulting slow recovery have caused certain customers to reduce or delay capital spending plans in fiscal 2010 and 2011 primarily in our Advertising and Broadcast products. In addition, we have experienced increased price-based competition from our competitors, which resulted in the reduction of the prices of some of our products, which reduced our revenues and adversely affected our gross margin.

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

Our operating results are significantly influenced by a number of factors, including the mix of products sold and services provided, pricing, costs of materials used in our products and the expansion of our operations during the fiscal year. We price our products and services based upon our costs and consideration of the prices of competitive products and services in the marketplace. The costs of our products primarily consist of the costs of components and subassemblies that have generally declined from product introduction to product maturity. As a result of the growth of our business, our operating expenses have historically increased in the areas of research and development, selling and

marketing and administration. In the current state of the economy, we currently expect that customers may still have limited capital spending budgets as we believe they are dependent on advertising revenues to fund their capital equipment purchases. Accordingly, we expect our financial results to vary from quarter to quarter and our historical financial results are not necessarily indicative of future performance. In light of the higher proportion of our international business, we expect movements in foreign exchange rates to have a greater impact on our operating results and the equity section of our balance sheet in the future.

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

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

#### Summary of Critical Accounting Policies; Significant Judgments and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. These items are regularly monitored and analyzed by management for changes in facts and circumstances, and material changes in these estimates could occur in the future. Changes in estimates are recorded in the period in which they become known. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from our estimates if past experience or other assumptions do not turn out to be substantially accurate.

We believe that the accounting policies described below are critical to understanding our business, results of operations and financial condition because they involve significant judgments and estimates used in the preparation of our consolidated financial statements. An accounting policy is deemed to be critical if it requires a judgment or accounting estimate to be made based on assumptions about matters that are highly uncertain, and if different estimates that could have been used, or if changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. Other significant accounting policies, primarily those with lower levels of uncertainty than those discussed below, are also critical to understanding our consolidated financial statements. The notes to our consolidated financial statements contain additional information related to our accounting policies and should be read in conjunction with this discussion.

**Principles of Consolidation.** The Company consolidates the financial statements of its wholly-owned subsidiaries and all inter-company accounts are eliminated in consolidation. SeaChange also holds minority investments in the capital stock of certain private companies having product offerings or customer relationships that have strategic importance. The Company evaluates its equity and debt investments and other contractual relationships with affiliate companies in order to determine whether the guidelines regarding the consolidation of variable interest entities (“VIE”) should be

applied in the financial statements. Consolidation guidelines address consolidation by business enterprises of variable interest entities that possess certain characteristics. A VIE is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary is required to consolidate the financial position and results of the VIE. The Company has concluded that it is not the primary beneficiary for any variable interest entities as of January 31, 2011.



The Company's investments in affiliates include investments accounted for under the cost method and the equity method of accounting. The investments that represent less than a 20% ownership interest of the common shares of the affiliate are carried at cost. Under the equity method of accounting, which generally applies to investments that represent 20% to 50% ownership of the common shares of the affiliate, SeaChange's proportionate ownership share of the earnings or losses of the affiliate are included in equity income (loss) in earnings of affiliates in the consolidated statement of operations.

We periodically review indicators of the fair value of our investments in affiliates in order to assess whether available facts or circumstances, both internally and externally, may suggest an other-than-temporary decline in the value of the investment. The carrying value of an investment in an affiliate may be affected by the affiliate's ability to obtain adequate funding and execute its business plans, general market conditions, industry considerations specific to the affiliate's business, and other factors. The inability of an affiliate to obtain future funding or successfully execute its business plan could adversely affect our equity earnings of the affiliate in the periods affected by those events. Future adverse changes in market conditions or poor operating results of the affiliates could result in equity losses or an inability to recover the carrying value of the investments in affiliates that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. We record an impairment charge when we believe an investment has experienced a decline in value that is other-than-temporary.

Revenue Recognition and Allowance for Doubtful Accounts. The accounting related to revenue recognition is complex and affected by interpretations of the rules and an understanding of industry practices. As a result, revenue recognition accounting rules require us to make significant judgments. Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when title and risk of loss has passed to the customer, there is evidence of an arrangement, 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 are 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 are 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. For contracts, where some level of profit is assured but the Company is only able to estimate ranges of amounts of total contract revenue and total contract cost, the Company uses the lowest probable level of profits in accounting for the contract revenues and costs. 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 inter-company profits associated with sales and services provided to affiliated companies is eliminated in consolidation in proportion to our equity ownership.

Our transactions frequently involve the sale of hardware, software, systems and services in multiple element arrangements. Revenues under multiple element arrangements are recorded based on the residual method of accounting. 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 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 required 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 vendor-specific objective evidence 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 with the exception of maintenance and technical support.

We recognize revenue for products and services only in those situations where collection from the customer is probable. The Company performs ongoing credit evaluations of customers' financial condition but generally does not require collateral. For some international customers, the Company may require an irrevocable letter of credit to be issued by the customer before the purchase order is accepted. The Company monitors payments from customers and assesses any collection issues. The Company maintains allowances for specific doubtful accounts and other risk categories of accounts based on estimates of losses resulting from the inability of the Company's customers to make required payments and records these allowances as a charge to general and administrative expenses. The Company bases its allowances for doubtful accounts on historical collections and write-off experience, current trends, credit assessments, and other analysis of specific customer situations. While such credit losses have historically been within our expectations and the allowances established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If the financial condition of our customers were to change, additional allowances may be required or established allowances may be considered unnecessary. Judgment is required in making these determinations and our failure to accurately estimate the losses for doubtful accounts and ensure that payments are received on a timely basis could have a material adverse effect on our business, financial condition and results of operations.

Service revenue from content processing provided to our customers is recognized when services are provided, based on contracted rates. Upfront fees received for services are recognized ratably over the period earned, whichever is the longer of the contract term or the estimated customer relationship.

Any taxes assessed by a governmental authority related to revenue-producing transactions (e.g. sales or value-added taxes) are reported on a net basis and excluded from revenues.

**Inventories and Reserves.** Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out (FIFO) method. Inventories consist primarily of components and subassemblies and finished products held for sale. All of SeaChange's hardware components are purchased from outside vendors. The value of inventories is reviewed quarterly to determine that the carrying value is stated at the lower of cost or net realizable value. SeaChange records charges to reduce inventory to its net realizable value when impairment is identified through the quarterly review process. The obsolescence evaluation is based upon assumptions and estimates about future demand and possible alternative uses and involves significant judgments. For the year ended January 31, 2011, we recorded \$3.0 million in inventory write-downs of which \$2.5 million was incurred as part of the first quarter restructuring. For the fiscal years ended January 31, 2010 and 2009, we recorded inventory write-downs of \$569,000 and \$1.0 million, respectively.

**Accounting for Business Combinations** In our business combinations, we are required to recognize the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions, especially at acquisition date with respect to intangible assets, estimated contingent consideration payments and pre-acquisition contingencies. Although we believe the assumptions and estimates we have made have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired company and are inherently uncertain. Examples of critical estimates in accounting for acquisitions include but are not limited to:

- The estimated fair value of the acquisition-related contingent consideration, which is calculated using a probability-weighted discounted cash flow model based upon the forecasted achievement of post acquisition bookings targets;

- The future expected cash flows from product sales, support agreements, consulting contracts, other customer contracts and acquired developed technologies and patents; and

ÿ the relevant discount rates.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results. Additionally, any change in the fair value of the acquisition-related contingent consideration subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the bookings that are expected to be achieved, will be recognized in earnings in the period of the estimated fair value change. A change in fair value of the acquisition-related contingent consideration could have a material effect on the statement of operations and financial position in the period of the change in estimate.

Goodwill. In connection with acquisitions of operating entities, we recognize the excess of the purchase price over the fair value of the net assets acquired as goodwill. Goodwill is not amortized, but is evaluated for impairment, at the reporting unit level, annually in our third quarter as of August 1. Goodwill of a reporting unit also is tested for impairment on an interim basis in addition to the annual evaluation if an event occurs or circumstances change which would more likely than not reduce the fair value of a reporting unit below its carrying amount. Changes in operating performance, market conditions and other factors may adversely impact estimates of expected future cash flows. Any impairment indicated by this analysis would be measured as the amount by which the carrying value exceeds estimated fair value based on forecasted cash flows, discounted at a rate commensurate with the risks involved.

Goodwill is evaluated at the reporting unit level, which is equivalent to our business segments. We have three reporting segments, the Software segment, Servers and Storage segment and Media Services segment. The goodwill balance as of January 31, 2011 is as follows:

|          | Goodwill       |                      |                   |           |
|----------|----------------|----------------------|-------------------|-----------|
|          | Software       | Servers<br>& Storage | Media<br>Services | Total     |
|          | (in thousands) |                      |                   |           |
| Goodwill | \$ 45,097      | \$ 754               | \$ 19,422         | \$ 65,273 |

On August 1, 2010, we performed our annual impairment testing of goodwill for each of the reporting units with goodwill balances. We first calculated the fair value of each reporting unit using a discounted cash flow methodology. We then performed “Step 1” and compared the fair value of each reporting unit of accounting to its carrying value as of August 1, 2010.

The process of evaluating goodwill for impairment requires several judgments and assumptions to be made to determine the fair value of the reporting units, including the method used to determine fair value, discount rates, expected levels of cash flows, revenues and earnings, and the selection of comparable companies used to develop market based assumptions. The Company may employ three generally accepted approaches for valuing businesses: the market approach, the income approach, and the asset-based (cost) approach to arrive at the fair value of each reporting unit. In calculating the fair value, we derived the standalone projected five year cash flows for all three reporting units. This process starts with the projected cash flows of each of the three reporting units and then the cash flows are discounted. The choice of which approach and methods to use in a particular situation depends on the facts and circumstances.

We determined that based on “Step 1” of our annual goodwill test, the reporting fair values of all three of our reporting units containing goodwill balances exceeded their carrying values. In aggregate, there was excess fair value over the carrying value of the net assets ranging from \$53-\$73 million. Below is a summary of the fair values ranges calculated by the company as of August 1, 2010 was as follows:

|                     | Premium<br>Ranges over<br>Carrying Value |
|---------------------|--|
| Software            | 143%-201%                                |
| Servers and Storage | 69%-111%                                 |
| Media Services      | 44%-62%                                  |

Key data points included in the market capitalization calculation were as follows:

- Shares outstanding as of August 1, 2010: 31.3 million; and
- \$8.96 closing price as of August 1, 2010.

Accordingly, as no impairment indicator existed as of August 1, 2010, our annual impairment date, and the implied fair value of goodwill did not exceed the carrying value of any of our three reporting units, we determined that goodwill was not at risk of failing “Step 1” and was appropriately stated as of August 1, 2010.

To validate our conclusions and determine the reasonableness of our annual impairment test, we performed the following:

- Reconciled our estimated enterprise value to market capitalization comparing the aggregate, calculated fair value of our reporting units to our market capitalization as of August 1, 2010, our annual impairment test date. As compared with the market capitalization value of \$280 million as of August 1, 2010, the aggregate carrying value was approximately \$200 million;

- Prepared a “reporting unit” fair value calculation using two different approaches;
- Reviewed the historical operating performance of each reporting unit for the current fiscal year;
- Performed a sensitivity analysis on key assumptions such as weighted-average cost of capital and terminal growth rates; and
- Reviewed market participant assumptions.

The Company used two generally accepted approaches to value its reporting segments. The Market approach provides value indications through a comparison with guideline public companies or guideline transactions. The valuation multiple is an expression of what investors believe to be a reasonable valuation relative to a measure of financial information such as revenues, earnings or cashflows. The Income approach provides value indications through an analysis of its projected earnings, discounted to present value. We employed a weighted-average cost of capital rate for each of our reporting units. The estimated weighted-average cost of capital was based on the risk-free interest rate and other factors such as equity risk premiums and the ratio of total debt to equity capital. In performing the annual impairment tests, we took steps to ensure appropriate and reasonable cash flow projections and assumptions were used. The discount rate used to estimate future cash flows was between 15% and 19% for each of the reporting units.

Our projections for the next five years included increased revenue and operating expenses, in line with the expected revenue growth over the next five years based on current market and economic conditions and our historical knowledge of the reporting units. Historical growth rates served as only one input to the projected future growth used in the goodwill impairment analysis. These historical growth rates were adjusted based on other inputs from management regarding anticipated customer contracts. The forecasts have incorporated any changes to the revenue and operating expenses resulting from the third quarter of fiscal 2011 restructuring plan. We projected growth for each reporting unit ranging from 6% to 9% annually for the Software and Services segment, a decline of 18% to growth of 9% for Servers and Storage segment, and growth from 28% to 88% annually for the Media Services segment. The higher projected growth for the Media Services segment is due to the recent contract wins by ODG and its recent year over year growth rate. We estimated the operating expenses based on a rate consistent with the current experience for of the each reporting units and estimated revenue growth over the next five years. The failure of any of our reporting units to execute as forecasted over the next five years could have an adverse affect on our annual impairment test. Future adverse changes in market conditions or poor operating results of the reporting unit could result in losses or an inability to recover the carrying value of the investments in reporting units, thereby possibly requiring an impairment charge in the future. We record an impairment charge when we believe an investment has experienced a decline in value that is other-than-temporary.

We also monitor economic, legal and other factors as a whole and for each reporting unit between annual impairment tests to ensure that there are no indicators that make it more likely than not that there has been a decline in the fair value of the reporting unit below its carrying value. Specifically, we monitor industry trends, our market capitalization, recent and forecasted financial performance of our reporting units and the timing and nature of any restructuring activities. We do not believe that there are any indicators of impairment as of January 31, 2011. If these estimates or the related assumptions change, we may be required to record non-cash impairment charges for these assets in the future.

During the fourth quarter of fiscal 2011, the Company evaluated the impairment analysis and updated for the change in its estimates from August 1, 2010 to January 31, 2011. While no impairment charges resulted from the analyses performed during the fourth quarter of fiscal 2011, impairment charges may occur in the future due to changes in projected revenue growth rates, projected operating margins or estimated discount rates, among other factors. Historical or projected revenues or cash flows may not be indicative of actual results in the future. Due to uncertain market conditions, it is possible that future impairment reviews may indicate additional impairments of goodwill and/or other intangible assets, which could result in charges that could be material to our results of operations and financial position.

Long –Lived Assets. SeaChange also evaluates property and equipment, investments, intangible assets 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, SeaChange evaluates 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 compares that value to the carrying value of the assets. SeaChange’s cash flow estimates contain management’s best estimates, using appropriate and customary assumptions and projections at the time.



Intangible assets consist of customer contracts, completed technology, in-process research and development, non-competition agreements, patents and trademarks and are respectively assigned to the operating segments. The intangible assets are amortized to cost of sales and operating expenses, as appropriate, on a straight-line or accelerated basis in order to reflect the period that the assets will be consumed. In-process research and development assets as of the acquisition date were recorded as indefinite-lived intangible assets and will be subject to impairment testing at least annually. The useful life of the intangible asset recognized will be reconsidered if and when an in-process research and development project is completed or abandoned.

SeaChange develops software for resale in markets that are subject to rapid technological change, new product development and changing customer needs. The time period during which software development costs can be capitalized from the point of reaching technological feasibility until the time of general product release is very short, and consequently, the amounts that could be capitalized are not material to the Company's financial position or results of operations. Software development costs relating to sales of software requiring significant modification or customization are charged to costs of product revenues.

Amortization expense of capitalized software is recorded over the period of economic consumption or the life of the agreement, whichever results in the higher expense, starting with the first shipment of the product to a customer. Amortization expense of capitalized software was \$8,000 and \$5,000 for the fiscal years ended January 31, 2011 and 2010, respectively.

Accounting for Income Taxes. As part of the process of preparing our financial statements, we are required to estimate our provision for income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, including assessing the risks associated with tax audits, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our balance sheet.

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards. We evaluate the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. We will record a valuation allowance if the likelihood of realization of the deferred tax assets in the future is reduced based on an evaluation of objective verifiable evidence. Significant management judgment is required in determining our income tax provision, our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. We have established a valuation allowance against our United States deferred tax assets due to indications that they may not be fully realized. The amount of the deferred tax asset considered realizable is subject to change based on future events, including generating sufficient pre-tax income in future periods. In the event that actual results differ from these estimates, our provision for income taxes could be materially impacted. SeaChange does not provide for U.S. federal and state income taxes on the undistributed earnings of its non-U.S. subsidiaries that are considered indefinitely reinvested in the operations outside the U.S.

Authoritative guidance as it relates to income tax liabilities states that the minimum threshold a tax position is required to meet before being recognized in the financial statements is "more likely than not" (i.e., a likelihood of occurrence greater than fifty percent). The recognition threshold is met when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination by the relevant taxing authority. Those tax positions failing to qualify for initial recognition are recognized in the first interim period in which they meet the more likely than not standard, or are resolved through negotiation or litigation with the taxing authority, or upon expiration of the statute of limitations. Derecognition of a tax position that was previously recognized occurs when an entity subsequently determines that a tax position no longer meets the more likely than not threshold of being sustained.

We file annual income tax returns in multiple taxing jurisdictions around the world. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, we believe that our reserves for income taxes reflect the most likely outcome. We adjust these reserves as well as the related interest and penalties, in light of changing facts and circumstances. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. The changes in estimate could have a material impact on our financial position and operating results. In addition, settlement of any particular position could have a material and adverse effect on our cash flows and financial position.

Share-based Compensation. We account for all employee and non-employee director stock-based compensation awards using the authoritative guidance regarding share based payments. We have continued to use the Black-Scholes pricing model as the most appropriate method for determining the estimated fair value of all applicable awards. Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the input of highly subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management estimated the volatility based on the historical volatility of our stock. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if circumstances change and we use different assumptions, our share-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be significantly different from what we have recorded in the current period. The estimated fair value of our stock-based options and performance-based restricted stock units, less expected forfeitures, is amortized over the awards' vesting period on a graded vesting basis, whereas the restricted stock units are amortized on a straight line basis.

Restructuring. During fiscal 2011, we recorded restructuring charges primarily related to the Servers and Storage segment consisting of employee severance, write down of inventory, and the disposal of fixed assets. Restructuring charges represent our best estimate of the associated liability at the date the charges are recognized. Adjustments for changes in assumptions are recorded as a component of operating expenses in the period they become known. Differences between actual and expected charges and changes in assumptions could have a material effect on our restructuring accrual as well as our consolidated results of operations.

Foreign Currency Translation. For subsidiaries where the U.S. dollar is designated as the functional currency of the entity, we translate that entity's monetary assets and liabilities denominated in local currencies into U.S. dollars (the functional and reporting currency) at current exchange rates, as of each balance sheet date. Non-monetary assets (e.g., inventories, property, plant, and equipment and intangible assets) and related income statement accounts (e.g., cost of sales, depreciation, amortization of intangible assets) are translated at historical exchange rates between the functional currency (the U.S. dollar) and the local currency. Revenue and other expense items are translated using average exchange rates during the fiscal period. Translation adjustments and transaction gains and losses on foreign currency transactions, and any unrealized gains and losses on short-term inter-company transactions are included in other income or expense, net.

For subsidiaries where the local currency is designated as the functional currency, we translate the subsidiaries' assets and liabilities into U.S. dollars (the reporting currency) at current exchange rates as of each balance sheet date. Revenue and expense items are translated using average exchange rates during the period. Cumulative translation adjustments are presented as a separate component of stockholders' equity. Exchange gains and losses on foreign currency transactions and unrealized gains and losses on short-term inter-company transactions are included in other income or expense, net.

The aggregate foreign exchange transaction losses included as other expense, net on the Consolidated Statement of Operations were \$1.1 million, \$572,000 and \$951,000 for the years ended January 31, 2011, 2010 and 2009, respectively.

Fiscal Year Ended January 31, 2011 Compared to the Fiscal Year Ended January 31, 2010

The following table sets forth summarized consolidated financial information for each of the two fiscal years ended January 31, 2011 and 2010.

|  | Year Ended<br>January 31, |            |
|--|---------------------------|------------|
|  | 2011                      | 2010       |
| (in thousands)   |                           |            |
| <b>Revenues:</b>   |                           |            |
| Products   | \$ 91,679                 | \$ 101,941 |
| Services   | 125,048                   | 99,724     |
| Total revenues   | 216,727                   | 201,665    |
| <b>Costs and expenses:</b>   |                           |            |
| Cost of product revenues   | 35,527                    | 38,961     |
| Cost of service revenues   | 72,451                    | 59,451     |
| Research and development   | 48,403                    | 50,664     |
| Selling and marketing  | 24,506                    | 25,842     |
| General and administrative   | 24,328                    | 21,719     |
| Amortization of intangibles  | 3,359                     | 2,826      |
| Restructuring  | 6,997                     | -          |
| Income from operations   | 1,156                     | 2,202      |
| Other (expense) income, net  | (1,182 )                  | 145        |
| Gain on sale of investment in affiliates                               | 27,071                    | -          |
| Income before income taxes and equity income in earnings of affiliates | 27,045                    | 2,347      |
| Income tax (benefit) expense   | (2,338 )                  | 371        |
| Equity gain (loss) in earnings of affiliates, net of tax               | 85                        | (653 )     |
| Net income   | \$ 29,468                 | \$ 1,323   |

#### Revenues

The following table summarizes information about the Company's reportable segments for each of the two fiscal years ended January 31, 2011 and 2010.

|  | Fiscal Year Ended<br>January 31, |            |        |
|--|----------------------------------|------------|--------|
|  | 2011                             | 2010       | %      |
| (in thousands, except for percentage data) |                                  |            |        |
| <b>Software revenues:</b>                  |                                  |            |        |
| Products                                   | \$ 73,626                        | \$ 66,968  | 10 %   |
| Services                                   | 82,984                           | 64,346     | 29 %   |
| Total Software revenues                    | \$ 156,610                       | \$ 131,314 | 19 %   |
| <b>Servers and Storage revenues:</b>       |                                  |            |        |
| Products                                   | \$ 18,053                        | \$ 34,974  | (48 )% |
| Services                                   | 14,033                           | 15,583     | (10 )% |
| Total Servers and Storage revenues         | \$ 32,086                        | \$ 50,557  | (37 )% |

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|                                    |                   |                   |          |          |
|------------------------------------|-------------------|-------------------|----------|----------|
| <b>Media Services Revenue:</b>     |                   |                   |          |          |
| Services                           | \$ 28,031         | \$ 19,794         | 42       | %        |
| <b>Total consolidated revenue:</b> |                   |                   |          |          |
| Products                           | \$ 91,679         | \$ 101,942        | (10)     | %        |
| Services                           | 125,048           | 99,723            | 25       | %        |
| <b>Total consolidated revenues</b> | <b>\$ 216,727</b> | <b>\$ 201,665</b> | <b>7</b> | <b>%</b> |

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**Product Revenue.** Product revenue decreased 10% to \$91.7 million in the fiscal year ended January 31, 2011 from \$101.9 million in the fiscal year ended January 31, 2010. Product revenues from the Software segment accounted for 80% and 66% of the total product revenues in the years ended January 31, 2011 and 2010, respectively. The Servers and Storage segment accounted for 20% and 34% of total product revenues in the fiscal years ended January 31, 2011 and 2010, respectively. The year over year decrease in Product revenues was due to lower VOD software license revenues and lower shipments of VOD servers to North American and Latin American service providers. The lower VOD Software licenses revenues was due to the Comcast software subscription agreement extension classification as services revenues for the period of February 2010 through May 2010. Unlike in prior periods, where software subscription agreements with Comcast provided for specified enhancements and therefore were classified as product revenues, the agreement extensions contained no specified enhancements. The new software subscription agreement signed with Comcast during the second quarter of fiscal 2011 was accounted for on a percentage of completion basis and was recorded as product revenues starting on May 21, 2010 since the new subscription agreement provides for specific enhancements. These decreases were partially offset by the inclusion of VividLogic product revenues and the inclusion of eventIS for a full year of revenues, while fiscal 2010 included only five months of eventIS revenues

**Service Revenue.** Service revenues increased 25% to \$125.0 million in the fiscal year ended January 31, 2011 from \$99.7 million in the fiscal year ended January 31, 2010. Service revenue for the Software segment accounted for 67% and 65% of the total services revenue in the fiscal years ended January 31, 2011 and 2010, respectively. Servers and Storage services revenue accounted for 11% and 16% of total services revenue in the fiscal year ended January 31, 2011 and 2010, respectively, while Media Services revenue accounted for 22% and 19% of total services revenue for the fiscal years ended January 31, 2011 and 2010, respectively. The increase in Service revenues year over year was due to increased revenues from Media Services resulting from recent contract wins late in the third quarter of fiscal 2010, and the inclusion of a full year of service revenues from our recent acquisitions of eventIS and VividLogic. In addition, fiscal 2011 service revenues included \$4.6 million of maintenance revenues resulting from a deactivation of VOD software and equipment by a U.S customer. The higher year over year service revenues also included the Comcast software subscription agreement extension which was classified as services revenues for the period of February 2010 through May 2010, as noted above. These increases were partially offset by lower Broadcast product maintenance and lower VOD professional services revenue due to lower VOD server revenues.

For the fiscal year ended January 31, 2011 and 2010, two customers each accounted for more than 10%, and collectively accounted for 34% and 39%, respectively, of our total revenues. Revenues from these customers were primarily in the Software and Servers and Storage segment. We believe that a significant amount of our revenues will continue to be derived from a limited number of customers.

International products and services revenues accounted for approximately 48% or \$103.7 million and 35% or \$71.6 million of total revenues in the fiscal years ended January 31, 2011 and 2010, respectively. We expect that international products and services revenues will remain a significant portion of our business in the future. A majority of our international sales are made in United States dollars (USD), and for the fiscal years 2011 and 2010, approximately 58% and 67%, respectively, of international revenues were transacted in USD.

**Software Revenue.** Revenues from our software segment increased 19% to \$156.6 million in the fiscal year ended January 31, 2011 from \$131.3 million in the fiscal year ended January 31, 2010. The year over year increase in software product revenues was primarily due to higher software licensing revenue from our Broadcast software products primarily from a large North American customer, and the inclusion of eventIS and VividLogic. The previous year only included five months of eventIS revenues.

The 29% increase in service revenue for the Software segment was primarily due to the Comcast software subscription agreement, which was accounted for as services revenues, as noted above, and the inclusion of service revenues from the recent acquisitions of eventIS and VividLogic. The previous year only included five months of

eventIS revenues. The increase also includes \$4.6 million of deferred maintenance revenue that was recognized in the fourth quarter of the fiscal year ended January 31, 2011 as a result of the deactivation of VOD equipment by a U.S customer.

Servers and Storage Revenue. Revenues from the Server and Storage segment decreased 37% to \$32.1 million for the fiscal year ended January 31, 2011 from \$50.6 for the fiscal year ended January 31, 2010. The decrease in servers and storage product revenues of 48% compared to the previous year was due primarily to decreased shipments of VOD servers compared to fiscal 2010, which included large shipments of VOD servers to two large North American customers. This decrease was partially offset by a large shipment of Broadcast servers to a customer in North America.

**Media Services Revenue.** Revenues from Media Services increased 42% to \$28.0 million in the year ended January 31, 2011 compared to \$19.8 million for the year ended January 31, 2010. The increase in revenue was due primarily to contract wins in Dubai and France in the fourth quarter of last year and increased content processing revenues from customers in Greece and Turkey.

**Product Gross Profit.** Costs of product revenues consist primarily of the cost of purchased material components and subassemblies, labor and overhead relating to the final assembly and testing of complete systems and related expenses, and labor and overhead costs related to software development contracts. The gross profit percentage for products decreased from 62% in the fiscal year ended January 31, 2010 to 61% in the fiscal year ended January 31, 2011. The year over year decrease in product gross profit percentages was due primarily to lower VOD software product margins.

**Services Gross Profit.** Cost of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support, software development, project management and costs associated with providing media services. The service gross profit percentage increased two points year over year due primarily to the inclusion of the Comcast software subscription agreement, extensions which carry higher margins than typical service revenues, and the maintenance revenues resulting from the deactivation of the VOD equipment noted above.

**Software Gross Profit.** Software segment gross margin was 56% and 61% in the years ended January 31, 2011 and 2010, respectively. The decrease in product gross profit percentages between years was primarily due to lower than normal margins for our VOD software products resulting from a significant product shipment during this year's first quarter resulting in a competitor displacement at a large North American customer and lower software subscription margins, partially offset by higher VividLogic product margins.

**Servers and Storage Gross Profit.** Servers and Storage segment gross margin of 50% in the year ended January 31, 2011 was ten points higher than in the year ended January 31, 2010 due to a more favorable mix of higher margin VOD server revenue as fiscal 2010 included a large shipment of low margin VOD servers to a large U.S customer.

**Media Services Gross Profit.** Media Services segment gross margin of 18% in the year ended January 31, 2011 was one point higher than in the year ended January 31, 2010 due to cost savings related to bringing in-house all content processing that was completed in the second half of last year offset by higher startup costs associated with new contract wins in South Africa and Serbia in the second half of fiscal 2011.

**Research and Development.** Research and development expenses consist primarily of the compensation of development personnel, depreciation of development and test equipment and an allocation of related facilities expenses. Research and development expenses were 22% and 25% of total revenues for the fiscal year ended January 31, 2011 and 2010, respectively, and decreased \$2.3 million from \$50.7 million to \$48.4 million year over year. The decrease year over year is primarily due to lower domestic headcount-related costs resulting from the second and third quarter restructuring offset by the inclusion of a full year of eventIS costs and increased Philippine headcount costs.

**Selling and Marketing.** Selling and marketing expenses consist primarily of compensation expenses, including sales commissions, travel expenses and certain promotional expenses. Selling and marketing expenses decreased 5% from \$25.8 million or 13% of total revenues in the fiscal year ended January 31, 2010 to \$24.5 million, or 11% of total revenues, in the fiscal year ended January 31, 2011. This decrease in total expenses is primarily due to lower headcount related costs offset by the inclusion of a full year of eventIS costs.

**General and Administrative.** General and administrative expenses consist primarily of the compensation of executive, finance, human resource and administrative personnel, legal and accounting services and an allocation of related



facilities expenses. In the fiscal year ended January 31, 2011, general and administrative expenses of \$24.3 million, or 11% of total revenues, increased 12% from \$21.7 million, or 11% of total revenues, in the fiscal year ended January 31, 2010. General and administrative expenses increased primarily due to transaction costs related to the VividLogic acquisition and higher legal and professional fees that were partially offset by lower corporate headcount-related costs.

Restructuring. During fiscal 2011, the Company initiated actions to lower its cost structure as it strives to improve its financial performance. For the year ended January 31, 2011, restructuring charges totaled \$7.0 million included severance costs for the termination of approximately 110 employees, a write down of inventory of \$2.5 million related to the decision to discontinue certain products within the Servers and Storage segment, and a \$1.3 million charge for the disposal of fixed assets as a direct result of the restructuring plan.

Amortization of Intangibles. Amortization expense consists of the amortization of acquired intangible assets which are operating expenses and not considered costs of revenues. Amortization of intangible assets increased from \$2.8 million in the fiscal year ended January 31, 2010 to \$3.4 million in the fiscal year ended January 31, 2011 which included a full year's impact of amortization expense for our eventIS and VividLogic intangible assets. Amortization is also based on the future economic value of the related intangible assets which is generally higher in the earlier years of the assets' lives.

An additional \$2.0 million and \$638,000 of amortization expense related to acquired technology was charged to cost of sales for the years ended January 31, 2011 and 2010, respectively.

Other income (expense). The table below provides detail regarding our other income (expense):

|                              | Fiscal Year ended<br>January 31, |        |
|------------------------------|----------------------------------|--------|
|                              | 2011                             | 2010   |
|                              | (in thousands)                   |        |
| Interest income              | \$ 307                           | \$ 763 |
| Interest expense             | (472 )                           | (156 ) |
| Foreign exchange (loss)      | (1,138 )                         | (572 ) |
| Acquisition related expenses | (330 )                           | -      |
| Miscellaneous income         | 451                              | 110    |
|                              | \$ (1,182 )                      | \$ 145 |

Interest. The decrease in interest income is primarily due to the lower prevailing interest rates earned on our marketable securities. Interest expense includes the change in present value for acquisition related contingencies. The increase in interest expense is due to a full year impact of changes in present value of acquisition-related contingencies for eventIS and VividLogic in fiscal 2011 compared to fiscal 2010.

Foreign exchange (loss). The increase in foreign exchange losses was a result of the change in rates between the USD and foreign currencies during fiscal 2011 compared to fiscal 2010. In light of the high proportion of our international businesses, we expect that the risk of any adverse movements in foreign currency exchange rates could have an impact on our results within the Consolidated Statements of Operations.

Acquisition related expenses. Acquisition related expenses included \$1.1 million in expense resulting from the write-off of the indemnification asset resulting from the settlement of the California tax audit related to the VividLogic acquisition, an \$870,000 gain resulting from an adjustment to acquisition related intangible assets for which the measurement period had ended and changes to the contingent consideration for earn-outs to the former shareholders of eventIS and VividLogic.

Gain from sale of investment in affiliates: Reflects the gain on the sale of the entire equity investments in Casa Systems of \$25.2 million and InSite One of \$1.9 million.

Equity Income (Loss) in Earnings of Affiliates. Equity income in earnings of affiliates was \$85,000 in the fiscal year ended January 31, 2011 compared with \$653,000 in equity loss in earnings of affiliates for fiscal year-ended January 31, 2010. The equity income (loss) in earnings of affiliates consists of our 50% ownership share of On Demand Deutschland GmbH & Co. KG, our German joint venture, under the equity method of accounting.

Income Tax Provision. Our effective tax rate for fiscal 2011 was a benefit of 9% and \$2.3 million compared to an effective tax rate expense of 16% and \$371,000 for the fiscal year ended January 31, 2010. The income tax benefit for fiscal 2011 was primarily due to a reduction of a portion of the valuation allowance against the Company's deferred tax assets due to the Company having met the "more likely than not" realization criteria on its U.S. deferred tax assets resulting from the gain related to the Company's equity investment in Casa Systems, Inc and the benefit of the reduction in deferred tax assets associated with the deferred tax liabilities from the acquisition of VividLogic. Previously, the Company maintained a full valuation allowance and will continue to monitor available information in determining whether there is sufficient evidence to consider releasing some or all of the remaining valuation allowance. The Company also recognized \$300,000 of tax benefits resulting from the expiration of the statute of limitations for uncertain tax positions and \$1.0 million of tax benefits resulting from the settlement of a California audit by the former shareholders of VividLogic. The statute of limitations varies by the various jurisdictions in which we operate. In any given year, the statute of limitations in certain jurisdictions may lapse without examination and any uncertain tax position taken in these years will result in a reduction of the liability for unrecognized tax benefits for that year. In addition, our subsidiary in the U.K recorded a tax benefit of \$540,000, resulting from a successful claim with the U.K. tax authorities for previously paid taxes from the transfer of intangible assets from the U.K to our German joint venture.

These tax benefits were offset by the tax expense resulting from the gain on the sale of Casa Systems, Inc and InSite One, Inc., and tax expense resulting from our profitable operations in foreign tax jurisdictions.

We will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If we determine that we can realize some portion or all of the net deferred tax assets, the valuation allowance would be reversed and a corresponding increase in net income would be recognized during the period.

In conjunction with the purchase price allocation for the acquisition of VividLogic, we recorded a liability for uncertain tax position in the amount of \$1.2 million. The Company has reached a settlement with the State of California regarding the previously disclosed state tax audit and has recorded a corresponding tax benefit of \$1.0 million. In connection with the settlement of this matter, a \$1.1 million indemnification asset was also written-off and recorded in other (income) expenses, net in the Statement of Operations.

Fiscal Year Ended January 31, 2010 Compared to the Fiscal Year Ended January 31, 2009

The following table sets forth summarized consolidated financial information for each of the two fiscal years ended January 31, 2010 and 2009.

|  | Year Ended<br>January 31, |            |
|--|---------------------------|------------|
|  | 2010                      | 2009       |
|  | (in thousands)            |            |
| <b>Revenues:</b>   |                           |            |
| Products   | \$ 101,941                | \$ 117,372 |
| Services   | 99,724                    | 84,464     |
| Total revenues   | 201,665                   | 201,836    |
| <b>Costs and expenses:</b>   |                           |            |
| Cost of product revenues   | 38,961                    | 46,533     |
| Cost of service revenues   | 59,451                    | 52,007     |
| Research and development   | 50,664                    | 43,042     |
| Selling and marketing  | 25,842                    | 27,506     |
| General and administrative   | 21,719                    | 20,979     |
| Amortization of intangibles  | 2,826                     | 1,575      |
| Income (loss) from operations  | 2,202                     | 10,194     |
| Other income, net  | 145                       | 1,125      |
| Income before income taxes and equity income in earnings of affiliates | 2,347                     | 11,319     |
| Income tax expense   | 371                       | 575        |
| Equity (loss) income in earnings of affiliates, net of tax             | (653 )                    | (770 )     |
| Net income   | \$ 1,323                  | \$ 9,974   |

## Revenues

The following table summarizes information about the Company's reportable segments for each of the two fiscal years ended January 31, 2010 and 2009.

|  | Fiscal Year Ended |            | %     |
|--|-------------------|------------|-------|
|  | January 31,       |            |       |
|  | 2010              | 2009       |       |
| (in thousands, except for percentage data) |                   |            |       |
| <b>Software revenues:</b>                  |                   |            |       |
| Products                                   | \$ 66,968         | \$ 78,397  | (15)% |
| Services                                   | 64,346            | 53,840     | 20%   |
| Total Software revenues                    | \$ 131,314        | \$ 132,237 | (1)%  |
| <b>Servers and Storage revenues:</b>       |                   |            |       |
| Products                                   | \$ 34,974         | \$ 38,975  | (10)% |
| Services                                   | 15,583            | 14,665     | 6%    |
| Total Servers and Storage revenues         | \$ 50,557         | \$ 53,640  | (6)%  |
| <b>Media Services Revenue:</b>             |                   |            |       |
| Services                                   | \$ 19,794         | \$ 15,959  | 24%   |
| <b>Total consolidated revenue:</b>         |                   |            |       |
| Products                                   | \$ 101,942        | \$ 117,372 | (13)% |
| Services                                   | 99,723            | 84,464     | 18%   |
| Total consolidated revenues                | \$ 201,665        | \$ 201,836 | 0%    |

**Product Revenue.** Product revenue decreased 13% to \$101.9 million in the fiscal year ended January 31, 2010 from \$117.4 million in the fiscal year ended January 31, 2009. Product revenues from the Software segment accounted for 66% and 67% of the total product revenues in the years ended January 31, 2010 and 2009, respectively. The Servers and Storage segment accounted for 34% and 33% of total product revenues in the fiscal years ended January 31, 2010 and 2009, respectively. The decrease in product revenues between years is primarily due to lower Advertising Insertion and Broadcast product revenues which was attributable to weaker advertising revenues for our customers resulting in reduced capital spending for these products.

**Service Revenue.** Service revenues increased 18% to \$99.7 million in the fiscal year ended January 31, 2010 from \$84.5 million in the fiscal year ended January 31, 2009. Service revenue for the Software segment accounted for 65% and 64% of the total services revenue in the fiscal years ended January 31, 2010 and 2009, respectively. Servers and Storage services revenue accounted for 16% and 17% of total services revenue in the fiscal year ended January 31, 2010 and 2009, respectively, while Media Services revenue accounted for 19% of total services revenue for the fiscal years ended January 31, 2010 and 2009. The increase in Services revenues was primarily in our Software segment and was due to increased VOD support maintenance and professional services and the inclusion of five months of eventIS for fiscal 2010, and is also due to higher contract revenues in our Media Services segment.

For the fiscal year ended January 31, 2010 and 2009, two customers each accounted for more than 10%, and collectively accounted for 39% and 43%, respectively, of our total revenues. Revenues from these customers were primarily in the Software and Servers and Storage segment.

International products and services revenues accounted for approximately 35% or \$71.6 million and 36% or \$72.7 million of total revenues in the fiscal years ended January 31, 2010 and 2009, respectively. A majority of our international sales are made in United States dollars (USD), and for the fiscal years 2010 and 2009, approximately 67% and 78%, of international revenues were transacted in USD.

Software Revenue. Revenues from our software segment decreased 1% to \$131.3 million in the fiscal year ended January 31, 2010 from \$132.2 million in the fiscal year ended January 31, 2009. The year over year decline in software product revenues was primarily due to significantly lower software licensing revenue from our Advertising Insertion products and our Broadcast software products due to the unfavorable advertising environment for our customers for those products as noted above. In addition, there were also two large nonrecurring orders during our fiscal 2009 for our VODlink and VOD hospitality software products. These decreases were partially offset by higher software licensing revenues of Axiom and higher VOD subscription revenue primarily from two large U.S customers. In addition we had higher shipments of our VOD AdPulse software products primarily to Virgin Media.

The 20% increase in service revenue for the Software segment was primarily due to higher VOD product maintenance revenues from a growing installed base of products, higher VOD software installation revenues and the inclusion of five months of eventIS for fiscal 2010.

**Servers and Storage Revenue.** Revenues from the Server and Storage segment decreased 6% to \$50.6 million for the fiscal year ended January 31, 2010 from \$53.6 for the fiscal year ended January 31, 2009. The decrease in servers and storage product revenues of 10% compared to the previous year was due primarily to lower order driven Broadcast server revenue partially offset by higher increased shipments of VOD servers primarily to two large U.S. service providers, a large customer in Latin America and several customers in China. The 6% year over year increase in services revenue in the Servers and Storage segment is due to increased installation revenue for VOD server products year over year.

**Media Services Revenue.** Revenues from Media Services increased 24% to \$19.8 million in the year ended January 31, 2010 compared to the year ended January 31, 2009. The increase in revenue was due primarily to a full year's impact of revenue from customers in Greece and Turkey for which we began to recognize revenue late in fiscal year 2009 and the recent contract wins during fiscal year with customers in France, Dubai and Cyprus.

**Product Gross Profit.** The gross profit percentage for products increased from 60% in the fiscal year ended January 31, 2009 to 62% in the fiscal year ended January 31, 2010. The year over year increase in product gross profit percentages between years was due mainly to higher margin VOD software products accounting for a greater portion of total product revenues combined with lower Broadcast server products revenues, which typically carry lower margins.

**Services Gross Profit.** The service gross profit percentage increased 2% year over year due primarily to the inclusion of eventIS for five months of fiscal 2010.

**Software Gross Profit.** Software segment gross margin was 61% and 58% in the years ended January 31, 2010 and 2009, respectively. The increase in product gross profit percentages between years is due mainly to a more favorable product mix of higher margin VOD software products and higher Software services maintenance revenue year over year with comparable headcount-related costs.

**Servers and Storage Gross Profit.** Servers and Storage segment gross margin of 40% in the year ended January 31, 2010 was six points lower than in the year ended January 31, 2009 due to increased shipments of lower margin VOD servers due to lower product pricing for a large U.S. customer and lower service margins as a result of higher VOD server headcount-related costs to service the larger installed base of products.

**Media Services Gross Profit.** Media Services segment gross margin of 17% in the year ended January 31, 2010 was two points higher than in the year ended January 31, 2009 due principally to absorbing all content processing in-house that was previously provided by a third party. This occurred during our second and third quarters of fiscal 2010.

**Research and Development.** Research and development expenses were 25% and 21% of total revenues for fiscal year ended January 31, 2010 and 2009, respectively, and increased \$7.6 million year over year. The increase year over year is primarily due to increased headcount costs related to the VOD and TV Navigator product lines, increased facilities-related expenses and five months of eventIS for fiscal 2010.

**Selling and Marketing.** Selling and marketing expenses decreased 6% from \$27.5 million or 14% of total revenues in the fiscal year ended January 31, 2009 to \$25.8 million, or 13% of total revenues, in the fiscal year ended January 31, 2010. This decrease in total expenses is primarily due to lower compensation and benefits of \$1.3 million, \$800,000 of lower external commission and \$300,000 in travel offset by the inclusion of five months of eventIS in fiscal 2010.



General and Administrative. In the fiscal year ended January 31, 2010, general and administrative expenses of \$21.7 million, or 11% of total revenues, increased 4% from \$21.0 million, or 10% of total revenues, in the fiscal year ended January 31, 2009. General and administrative expenses increased primarily due to acquisition-related costs of \$1.4 million and professional fees of \$400,000 offset by lower compensation expense and benefits of \$400,000 and bad debt expense of \$700,000.

Amortization of Intangibles. Amortization of intangible assets increased from \$1.6 million in the fiscal year ended January 31, 2009 to \$2.8 million in the fiscal year ended January 31, 2010 which included a full years impact of amortization expense for our Mobix intangible assets which were acquired in November 2008, and five months of amortization expense of eventIS intangible assets which were acquired on September 1, 2009. Amortization is also based on the future economic value of the related intangible assets which is generally higher in the earlier years of the assets' lives.

An additional \$638,000 and \$350,000 of amortization expense related to acquired technology was charged to cost of sales for the years ended January 31, 2010 and 2009, respectively.

Other income (expense). The table below provides detail regarding our other income (expense):

|                         | Fiscal Year ended<br>January 31, |          |
|-------------------------|----------------------------------|----------|
|                         | 2010                             | 2009     |
|                         | (in thousands)                   |          |
| Interest income         | \$ 763                           | \$ 2,107 |
| Interest expense        | (156 )                           | (57 )    |
| Foreign exchange (loss) | (572 )                           | (951 )   |
| Miscellaneous income    | 110                              | 26       |
|                         | \$ 145                           | \$ 1,125 |

Interest Income. Interest income, net was \$600,000 in the fiscal year ended January 31, 2010 and \$2.1 million in the fiscal year ended January 31, 2009. The decrease in interest income is primarily due to the lower cash balance in fiscal 2010 compared to fiscal 2009 due to our acquisitions of eventIS and Mobix, the purchase of our London facility and lower prevailing interest rates earned on our marketable securities.

Foreign exchange (loss). The decrease in foreign exchange losses was a result of the change in rates between the USD and foreign currencies during fiscal 2010 compared to fiscal 2009.

Equity Income (Loss) in Earnings of Affiliates. Equity loss in earnings of affiliates was \$653,000 in the fiscal year ended January 31, 2010 compared with \$770,000 in equity loss in earnings of affiliates for fiscal year ended January 31, 2009. The equity loss in earnings of affiliates consists of our 50% ownership share of On Demand Deutschland GmbH & Co. KG, our German joint venture, under the equity method of accounting.

Income Tax Provision. Our effective tax rate and income tax provision for fiscal 2010 was 16% and \$371,000 compared to an effective tax rate of 5% and \$600,000 for the fiscal year ended January 31, 2009. The difference between the underlying effective tax rate for the year ended January 31, 2010 and the federal statutory rate of 35% is primarily due to income tax expense on foreign source pre-tax income generated at our international subsidiaries which carry lower tax rates. In addition, the Company tax rate decreased in the U.S based on the benefit of releasing a portion of the valuation for the utilization of foreign tax credits and Federal research and development credits.

At January 31, 2010 and 2009, we provided a valuation allowance for the full amount of U.S. net deferred tax assets due to the uncertainty of realization of those assets.

## Non GAAP Measures

As part of our ongoing review of financial information related to our business, we regularly use non-GAAP measures, in particular adjusted non-GAAP earnings per share, as we believe they provide a meaningful insight into our business and trends. We also believe that these adjusted non-GAAP measures provide readers of our financial statements with useful information and insight with respect to the results of our business. However, the presentation of adjusted non-GAAP information is not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. Below are tables for fiscal 2011, 2010 and 2009 which detail and reconcile GAAP and adjusted non-GAAP earnings per share:

SeaChange International, Inc.  
Reconciliation of Selected GAAP Measures to Non-GAAP Measures - Unaudited  
(in thousands)

|  | Twelve months Ended<br>January 31, 2011 |            |           | Twelve months Ended<br>January 31, 2010 |            |           | Twelve months Ended<br>January 31, 2009 |            |           |
|--|---|------------|-----------|---|------------|-----------|---|------------|-----------|
|  | GAAP                                    | Adjustment | Non-GAAP  | GAAP                                    | Adjustment | Non-GAAP  | GAAP                                    | Adjustment | Non-GAAP  |
| Revenues                                     | \$216,727                               |            | \$216,727 | \$201,665                               | \$-        | \$201,665 | \$201,836                               | \$-        | \$201,836 |
| Deferred revenue-acquisition related         | -                                       | 3,876      | 3,876     | -                                       | 1,807      | 1,807     | -                                       | -          | -         |
| Deferred revenue-maintenance acceleration    | -                                       | (4,559 )   | (4,559 )  | -                                       | -          | -         | -                                       | -          | -         |
|  | 216,727                                 | (683 )     | 216,044   | 201,665                                 | 1,807      | 203,472   | 201,836                                 | -          | 201,836   |
| Operating expenses:                          | 107,593                                 |            | 107,593   | 101,051                                 | -          | 101,051   | 93,102                                  | -          | 93,102    |
| Stock-based compensation                     | -                                       | 2,957      | 2,957     | -                                       | 3,105      | 3,105     | -                                       | 3,954      | 3,954     |
| Amortization of intangible assets            | -                                       | 5,345      | 5,345     | -                                       | 3,465      | 3,465     | -                                       | 2,025      | 2,025     |
| Restructuring                                | -                                       | 6,997      | 6,997     | -                                       | -          | -         | -                                       | -          | -         |
| Acquisition related costs                    | -                                       | 831        | 831       | -                                       | 1,413      | 1,413     | -                                       | -          | -         |
|  | 107,593                                 | 16,130     | 91,463    | 101,051                                 | 7,983      | 93,068    | 93,102                                  | 5,979      | 87,123    |
| Income from operations                       | 1,156                                   | 15,447     | 16,603    | 2,202                                   | 9,790      | 11,992    | 10,194                                  | 5,979      | 16,173    |
| Other expenses, net                          | 1,182                                   | 738        | 444       | -                                       | -          | -         | -                                       | -          | -         |
| Income from sale of investment in affiliates | 27,071                                  | (27,071)   | -         | -                                       | -          | -         | -                                       | -          | -         |
| Income tax impact expense (benefit)          | (2,338 )                                | 4,865      | 2,527     | 371                                     | 3,106      | 3,477     | 575                                     | 2,073      | 2,648     |
| Net income                                   | \$29,468                                | \$(15,751) | \$13,717  | \$1,323                                 | \$6,684    | \$8,007   | \$9,974                                 | \$3,906    | \$13,880  |

|  |        |         |          |        |        |        |        |        |        |
|--|--------|---------|----------|--------|--------|--------|--------|--------|--------|
| Diluted income per share                           | \$0.92 | \$(0.49 | ) \$0.43 | \$0.04 | \$0.21 | \$0.25 | \$0.32 | \$0.12 | \$0.44 |
| Diluted weighted average common shares outstanding | 31,986 | 31,986  | 31,986   | 31,433 | 31,433 | 31,433 | 31,192 | 31,192 | 31,192 |

In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items mentioned below is useful in understanding trends and managing our operations. We believe it is useful for investors to understand the effects of these items on our total operating expenses.

Deferred revenue acquisition related: Business combination accounting rules require us to account for the fair value of customer contracts assumed in connection with our acquisitions. In connection with our acquisitions of eventIS Group B.V on September 1, 2009 and VividLogic Inc. on February 1, 2010, the book value of our deferred software revenue was reduced by approximately \$5.7 million in the adjustment to fair value. Because these customer contracts may take up to 18 months to complete, our GAAP revenues subsequent to these acquisitions do not reflect the full amount of software revenues on assumed customer contracts that would have otherwise been recorded by eventIS Group B.V. and VividLogic Inc. We believe this adjustment is useful to investors as a measure of the ongoing performance of our business because we have historically experienced high renewal rates on similar customer contracts, although we cannot be certain that customers will renew these contracts.

Deferred revenue-maintenance acceleration: We recognized previously deferred maintenance revenue due to a termination by a customer of our maintenance obligation for certain products previously purchased.

Stock-based compensation expenses: We have excluded the effect of stock-based compensation and stock-based payroll expenses from our non-GAAP operating expenses and net income measures. Although stock-based compensation is a key incentive offered to our employees, we continue to evaluate our business performance excluding stock-based compensation expenses. Stock-based compensation expenses will recur in future periods.

**Amortization of intangible assets:** We have excluded the effect of amortization of intangible assets from our non-GAAP operating expenses and net income measures. Amortization of intangibles is inconsistent in amount and frequency and is significantly affected by the timing and size of our acquisitions.

**Restructuring:** We incurred charges due to the restructuring of our business including severance charges, write down of inventory to net realizable value, and the disposal of fixed assets resulting from the restructuring, which we generally would not have otherwise incurred in the periods presented as part of our continuing operations.

**Acquisition related:** We incurred expenses in connection with our acquisition of eventIS Group B.V. and VividLogic Inc. during fiscal 2010 and 2011 which would not have otherwise occurred in the periods presented as part of our operating expenses.

**Other expenses, net:** Other expenses, net include adjustments to acquisition-related items that are required to be marked to fair value each reporting period, other items related to acquisitions for which the measurement period has ended, and settlement of indemnification assets.

**Gain from sale of investment in affiliates:** Reflects the gain on the sale of the entire equity investments in Casa Systems and InSite One.

**Income tax impact expense:** The non-GAAP income tax adjustment reflects the effective income tax rate used during the periods presented

#### Liquidity and Capital Resources

Historically, we have financed our operations and capital expenditures primarily with the proceeds from sales of our common stock and cash flows generated from operations. During fiscal 2011, cash and marketable securities increased by \$37.7 million from \$48.5 million at January 31, 2010 to \$86.2 million at January 31, 2011, largely due to the sale of our entire equity investment in Casa Systems, Inc. and by cash provided by operations. Working capital increased \$31.7 million to \$92.6 million at January 31, 2011 from \$60.9 million at January 31, 2010. We believe that existing funds combined with available borrowings under our revolving line of credit and cash provided by future operating activities are adequate to satisfy our working capital, potential acquisitions, capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

Our operating activities provided net cash of \$16.3 million. Cash provided by operating activities was the result of net income of \$29.5 million as well as non-cash charges of \$16.5 million which were primarily from depreciation and amortization of intangibles and stock-based based compensation. These amounts were partially offset by the gain on sale of investment in affiliates of \$27.1 million related to the Casa and InSite One divestitures.

Our investing activities provided \$18.1 million of cash primarily due to the proceeds from the Casa and InSite One divestitures of \$38.7 million offset by the acquisition payments related to eventIS and VividLogic of \$14.7 million, capital expenditures of \$3.8 million, and \$1.1 million of net sales and maturities of marketable securities during the fiscal year.

Our financing activities provided \$1.3 million primarily due to proceeds from the issuance of common stock for the exercise of employee stock options and the employee stock purchase plan of \$2.7 million which was partially offset by purchases of the Company's stock of \$1.4 million.

#### Debt Instruments and Related Covenants

The Company maintains a revolving line of credit with RBS Citizens (a subsidiary of the Royal Bank of Scotland Group plc) for \$20.0 million which expires on October 31, 2012. Loans made under this revolving line of credit bear interest at a rate per annum equal to the bank's prime rate. Borrowings under this line of credit are collateralized by substantially all of our assets. The loan agreement requires SeaChange to comply with certain financial covenants. As of January 31, 2011, we were in compliance with the financial covenants and there were no amounts outstanding under the revolving line of credit.

## Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

## Contractual Obligations

The following table reflects our current and contingent contractual obligations to make potential future payments as of January 31, 2011 (in thousands):

|                                  | Total     | Less than<br>one year<br>(in thousands) | One to three<br>years | Three to<br>five years | Over five<br>years |
|----------------------------------|-----------|---|-----------------------|------------------------|--------------------|
| Purchase obligations             | \$ 2,925  | \$ 2,925                                | \$ -                  | \$ -                   | \$ -               |
| Non-cancelable lease obligations | 6,503     | 2,943                                   | 2,145                 | 1,276                  | 139                |
| Studio content deals             | 12,304    | 5,907                                   | 6,397                 | -                      | -                  |
| Contingent consideration         | 14,410    | 3,179                                   | 11,231                | -                      | -                  |
| Total                            | \$ 36,142 | \$ 14,954                               | \$ 19,773             | \$ 1,276               | \$ 139             |

The purchase obligations include open, non-cancelable purchase commitments from our suppliers.

The Company has excluded from the table above uncertain tax liabilities as defined by authoritative guidance due to the uncertainty of the amount and period of payment. As of January 31, 2011, the Company has gross unrecognized tax benefits of \$7.3 million.

On February 27, 2007, ODG, a wholly-owned subsidiary of SeaChange, entered into an agreement with Tele-Munchen Fernseh GmbH & Co. Produktionsgesellschaft (TMG) to create a joint venture named On Demand Deutschland GmbH & Co. KG. The related Shareholder's Agreement requires ODG and TMG to provide cash contributions up to \$4.2 million upon the request of the joint venture's management and approval by the shareholders of the joint venture. To date, the Company has contributed \$1.6 million as required per the shareholders agreement.

Under the share purchase agreement with the former shareholder of eventIS on September 1, 2011 and 2012, the Company is obligated to make additional fixed payments, each in an aggregate amount of \$2.8 million with \$1.7 million payable in cash and \$1.1 million payable by the issuance of restricted shares of SeaChange common stock, which will vest in equal installments over three years starting on the first anniversary of the date of issuance. Under the earn-out provisions of the share purchase agreement a payment of \$340,000 for fiscal 2011 will be paid in the first quarter fiscal 2012. Additional earn-out payments may be earned over each of the next two years ended January 31, 2012 and 2013 if certain performance goals are met.

The Company is obligated to make fixed payments of \$1.0 million in cash on February 1, 2012 and 2013. In addition, under the share purchase agreement with the former shareholders of VividLogic the Company will make an earnout payment of \$257,000 in the first quarter of fiscal 2012. Additional earn-out payments may be earned over each of the next two years ended January 31, 2012 and 2013 if certain performance goals are met.

We are occasionally required to post letters of credit, issued by a financial institution, to secure certain sales contracts. Letters of credit generally authorize the financial institution to make a payment to the beneficiary upon the satisfaction of a certain event or the failure to satisfy an obligation. The letters of credit are generally posted for one-year terms and are usually automatically renewed upon maturity until such time as we have satisfied the commitment secured by the letter of credit. We are obligated to reimburse the issuer only if the beneficiary collects on the letter of credit. We

believe that it is unlikely we will be required to fund a claim under our outstanding letters of credit. As of January 31, 2011, the full amount of the letters of credit of \$1.5 million was supported by our credit facility.



#### Effects of Inflation

Our management believes that financial results have not been significantly impacted by inflation and price changes.

#### Impact of Recently Adopted Accounting Guidance

##### Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (“FASB”) issued an authoritative update to address the elimination of the concept of a qualifying special purpose entity and to replace the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity. Also, the new guidance requires an ongoing assessment of whether an entity is the primary beneficiary of a variable interest entity. The amended approach focuses on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, the update provides more timely and useful information about an enterprise’s involvement with a variable interest entity. The Company adopted this new guidance in the first quarter of fiscal year 2011. The adoption of this guidance did not have a material impact on our financial position or results of operations.

##### Fair Value Measurements

In January 2010, the FASB issued new guidance on the disclosures of fair value measurements. This new guidance amends the authoritative guidance for fair value measurements and disclosures by adding new disclosure requirements with respect to transfers in and out of Levels 1 and 2 fair value measurements, as well as by requiring gross basis disclosures for purchases, sales, issuances, and settlements included in the reconciliation of Level 3 fair value measurements. This new guidance also amends the authoritative guidance by providing clarifications to existing disclosure requirements. The new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company adopted this new guidance, including the guidance related to the disclosures about purchases, sales, issuances, and settlements in the roll forwards of activity in Level 3 fair value measurements, beginning in the first quarter of fiscal year 2011. The adoption of this guidance did not have a material impact on our financial position or results of operations.

##### Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

In July 2010, the FASB issued guidance requiring improved disclosures about the credit quality of a company's financing receivables and their associated credit reserves. The amendments in the update require more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. The objective of enhancing these disclosures is to improve financial statement users' understanding of the nature of an entity's credit risk associated with its financing receivables and the entity's assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The amendments in the update are effective for the first interim or annual reporting period ending on or after December 15, 2010. The Company adopted this new disclosure guidance for the period ended January 31, 2011. The adoption of this guidance did not have a material impact on our disclosures.

##### Recent Accounting Guidance Not Yet Effective

##### Revenue Recognition for Arrangements with Multiple Deliverables

In September 2009, the FASB amended the guidance for revenue recognition in multiple-element arrangements. It has been amended to remove from the scope of industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product's essential functionality. The guidance now requires an entity to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; and allocates revenue in an arrangement using estimated selling prices of deliverables for these products if a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price. The guidance also eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method for these products. The accounting changes summarized are effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. The Company is currently assessing the impact of these amendments on its accounting and reporting systems and processes; however, at this time the Company is unable to quantify the impact of their adoption on its financial statements or determine the timing and method of its adoption.

## ITEM 7A. 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 its 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.

Substantially all of our international product sales are payable in United States Dollars (USD) or in the case of our Media Services operations in the United Kingdom and eventIS in the Netherlands, payable in local currencies, providing a natural hedge for receipts and local payments. In light of the high proportion of our international businesses, we expect the risk of any adverse movements in foreign currency exchange rates could have an impact on our translated results within the Consolidated Statements of Operations. In addition, for the year ended January 31, 2011, the Company generated a foreign currency translation loss of \$1.1 million which was recorded as accumulated other comprehensive gain increasing the Company's equity section of the balance sheet over the prior year.

SeaChange does not enter into derivative financial instruments for trading purposes and does not currently have outstanding derivative financial instruments related to payment obligations of the company. While SeaChange does not anticipate that near-term changes in exchange rates will have a material impact on its operating results, financial position and liquidity, a sudden and significant change in the value of foreign currencies could harm the Company's operating results, financial position and liquidity.

The U.S. Dollar is the functional currency for a majority of our international subsidiaries. All foreign currency gains and losses are included in interest and other income, net, in the accompanying Consolidated Statements of Operations. In fiscal year 2011, the Company recorded approximately no gains or losses due to international subsidiary translations and \$1.1 million in losses due to cash settlements of revenues and expenses.

### Interest Rate Risk

Exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio of marketable debt securities of various issuers, types and maturities and to SeaChange's borrowings under its bank line of credit facility. The Company does not use derivative instruments in its investment portfolio, and its 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 nine months or less. There is risk that losses could be incurred if the Company were to sell any of its securities prior to stated maturity. Given the short maturities and investment grade quality of the portfolio holdings at January 31, 2011, a sharp rise in interest rates should not have a material adverse impact on the fair value of our investment portfolio. Additionally, our long term marketable investments, which are carried at the lower of cost or market, have fixed interest rates, and therefore are subject to changes in fair value. At January 31, 2011, we had \$7.3 million in short-term marketable securities and \$4.4 million in long-term marketable securities.

## ITEM 8. Financial Statements and Supplementary Data

See the consolidated financial statements fields as part of this Annual Report on Form 10-K as listed under Item 15 below.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

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ITEM 9A. Controls and Procedures

(A) Evaluation of Disclosure Controls and Procedures

We evaluated the effectiveness of our disclosure controls and procedures, as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”) Rule 13a-15(e), as of the end of the period covered by this Annual Report on Form 10-K. William C. Styslinger, III, our Chief Executive Officer, and Kevin M. Bisson, our Chief Financial Officer, participated in this evaluation. Based upon that evaluation, Messrs. Styslinger and Bisson concluded that our disclosure controls and procedures were effective as of the end of the period covered by the report.

(B) Report of Management on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of January 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on our assessment, management concluded that, as of January 31, 2011, our internal control over financial reporting was effective based on those criteria.

The effectiveness of our internal control over financial reporting as of January 31, 2011 has been audited by Grant Thornton LLP, our independent registered public accounting firm, as stated in their report which is included immediately below.

To the Board of Directors and Shareholders of SeaChange International, Inc.

We have audited SeaChange International, Inc. (a Delaware Corporation) and subsidiaries internal control over financial reporting as of January 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). SeaChange International Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on SeaChange International, Inc. and subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, SeaChange International, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of January 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of SeaChange International, Inc. and subsidiaries as of January 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended January 31, 2011 and our report dated April 14, 2011 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Boston, Massachusetts  
April 14, 2011

(C) Changes in Internal Control over Financial Reporting

As a result of the evaluation completed by management, and in which Messrs. Styslinger and Bisson participated, we have concluded that there were no changes during the fiscal quarter ended January 31, 2011 in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

Information concerning the directors of SeaChange is hereby incorporated by reference from the information contained under the heading “Election of Directors” in SeaChange’s definitive proxy statement related to SeaChange’s Annual Meeting of Stockholders to be held on or about July 20, 2011 which will be filed with the Commission within 120 days after the close of the fiscal year (the “Definitive Proxy Statement”).

Certain information concerning directors and executive officers of SeaChange is hereby incorporated by reference to the information contained under the headings “Information Concerning Executive Officers”, and “Section 16(a) Beneficial Ownership Reporting Compliance”, “Availability of Corporate Governance Documents” and “Audit Committee” in our Definitive Proxy Statement.

ITEM 11. Executive Compensation

Information concerning executive compensation is hereby incorporated by reference to the information contained under the headings “Compensation Discussion and Analysis” and “Compensation of Directors” in the Definitive Proxy Statement.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information concerning security ownership of certain beneficial owners and management is hereby incorporated by reference to the information contained under the headings “Securities Ownership of Certain Beneficial Owners and Management” and “Compensation Discussion and Analysis” in the Definitive Proxy Statement.

Equity Compensation Plan Information

The following table provides information about the common stock that may be issued upon the exercise of options, warrants and rights under all of SeaChange’s existing equity compensation plans as of January 31, 2011, including the Amended and Restated 2005 Equity Compensation and Incentive Plan, the Amended and Restated 1995 Stock Option Plan, and the 1996 Non-Employee Director Stock Option Plan.

| Plan category   | Number of securities to be issued upon exercise of outstanding options, warrants and rights<br>(a) | Weighted-average price of outstanding options, warrants and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|---|--|---|--|
| Equity compensation plans approved by security holders(1) | 2,745,254  | \$ 12.31  | 603,719 (2)  |

- (1) Consists of the Amended and Restated 2005 Equity Compensation and Incentive Plan, the Amended and Restated 1995 Stock Option Plan, and the 1996 Non-Employee Director Stock Option Plan.
- (2) As of January 31, 2011, there were 603,719 shares remaining available for issuance under the Amended and Restated 2005 Equity Compensation and Incentive Plan of which 87,995 RSUs are available.

ITEM 13. Certain Relationships and Related Transactions, and Director Independence

Information concerning certain relationships and related transactions is hereby incorporated by reference to the information contained under the heading “Certain Relationships and Related Transactions” and “Determination of Director Independence” in the Definitive Proxy Statement.

ITEM 14. Principal Accountant Fees and Services

Information concerning Principal accountant fees and services is hereby incorporated by reference to the information contained under the heading “Ratification of Appointment of Independent Registered Public Accounting Firm” in the Definitive Proxy Statement.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules.

(a)(1) INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

The following Consolidated Financial Statements of the Registrant are filed as part of this Annual Report on Form 10-K:

|  | Page |
|--|------|
| Report of Independent Registered Public Accounting Firm  | 58   |
| Consolidated Balance Sheet as of January 31, 2011 and 2010   | 59   |
| Consolidated Statement of Operations for the years ended January 31, 2011, 2010 and 2009   | 60   |
| Consolidated Statement of Stockholders' Equity and Comprehensive Income (Loss) for the years ended January 31, 2011, 2010 and 2009 | 61   |
| Consolidated Statement of Cash Flows for the years ended January 31, 2011, 2010 and 2009   | 62   |
| Notes to Consolidated Financial Statements   | 63   |

(a)(2) INDEX TO FINANCIAL STATEMENT SCHEDULE

The following Financial Statement Schedule of the Registrant is filed as part of this report:

|  | Page |
|--|------|
| Schedule II—Valuation and Qualifying Accounts and Reserves | 97   |

Schedules not listed above have been omitted because the information requested to be set forth therein is not applicable or is shown in the accompanying consolidated financial statements or notes thereto.

(a)(3) INDEX TO EXHIBITS

See attached Exhibit Index of this Annual Report on Form 10-K.

(b) EXHIBITS

The Company hereby files as part of this Form 10-K the Exhibits listed in Item 15 (a) (3) above. Exhibits which are incorporated herein by reference can be inspected and copied at the public reference facilities maintained by the Securities and Exchange Commission (the "Commission"), 450 Fifth Street, Room 1024, N.W., Washington, D.C. 20549. Copies of such material can also be obtained from the Public Reference Section of the Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates.

(c) FINANCIAL STATEMENT SCHEDULES

The Company hereby files as part of this Form 10-K the consolidated financial statements schedule listed in Item 15 (a) (2) above, which is attached hereto.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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: April 14, 2011

SEACHANGE INTERNATIONAL,  
INC.

By: /s/ William C.  
Styslinger, III  
William C. Styslinger, III  
Chief Executive Officer,  
Chairman of the Board  
and Director

POWER OF ATTORNEY AND SIGNATURES

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints William C. Styslinger, III and Kevin M. Bisson, jointly and severally, his attorney-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K and to file same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature  | Title(s)   | Date              |
|--|--|-------------------|
| /s/ William C. Styslinger, III<br>William C. Styslinger, III | Chief Executive Officer, Chairman<br>of the Board and Director (Principal<br>Executive Officer)  | April 14,<br>2011 |
| /s/ Kevin M. Bisson<br>Kevin M. Bisson                       | Chief Financial Officer, Senior Vice<br>President, Finance and Administration,<br>Treasurer and Secretary (Principal<br>Financial<br>and Accounting Officer) | April 14,<br>2011 |
| /s/ Mary Palermo Cotton<br>Mary Palermo Cotton               | Director   | April 14,<br>2011 |
| /s/ Thomas F. Olson  | Director   |                   |

|                     |          |                   |
|---------------------|----------|-------------------|
|                     |          | April 14,<br>2011 |
| Thomas F. Olson     |          |                   |
| /s/ carlo salvatori | Director | April 14,<br>2011 |
| Carlo Salvatori     |          |                   |
| /s/ Carmine Vona    | Director | April 14,<br>2011 |
| Carmine Vona        |          |                   |
| /s/ raghu rau       | Director | April 14,<br>2011 |
| Raghu Rau           |          |                   |
| /s/ peter feld      | Director | April 14,<br>2011 |
| Peter Feld          |          |                   |
| /s/ edward terino   | Director | April 14,<br>2011 |
| Edward Terino       |          |                   |

EXHIBIT INDEX

| Exhibit No. | Description  |
|-------------|--|
| 2.1         | Share Purchase Agreement relating to the sale and purchase of the whole issued and to be issued share capital of Mobix Interactive Capital, dated as of November 14, 2008, by and among On Demand Group Limited and the other parties set forth on the signature pages thereto (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K previously filed on November 25, 2008 with the Commission (File No. 000-21393) and incorporated herein by reference). |
| 2.2         | Agreement for the Entire Issued Share Capital of eventIS Group B.V. dated as of September 1, 2009 by and among Ventise Holding B.V., SeaChange B.V. and SeaChange International, Inc. (filed as Exhibit 2.1 to the Company's Quarterly Report on 10-Q previously filed on September 8, 2009 (File No. 000-21393) and incorporated herein by reference).  |
| 2.3         | Agreement and Plan of Merger, dated as of January 6, 2010, by and among SeaChange International, Inc., Vividlogic, Inc., Vulcan Acquisition, Inc. and Shiva Patibanda in the limited capacity of Stockholder Representative (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K previously filed on January 8, 2010 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 3.1         | Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).  |
| 3.2         | Certificate of Amendment, filed May 25, 2000 with the Secretary of State in the State of Delaware, to the Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 4.1 to the Company's Quarterly Report on 10-Q previously filed on December 15, 2000 with the Commission (Filed No. 000-21393) and incorporated herein by reference).  |
| 3.3         | Amended and Restated By-laws of the Company (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K previously filed on January 25, 2011 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 4.1         | Specimen certificate representing the Common Stock (filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).  |
| 4.2         | Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).  |
| 4.3         | Certificate of Amendment, filed May 25, 2000 with the Secretary of State in the State of Delaware, to the Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 4.2 to the Company's registration statement on Form S-3 previously filed on December 6, 2000 with the Commission (Filed No. 333-51386) and incorporated herein by reference).   |
| 10.1        |  |

Amended and Restated 2005 Equity Compensation and Incentive Plan (filed as Appendix A to the Company's Proxy Statement on Schedule 14A previously filed May 25, 2007 with the Commission (File No. 000-21393) and incorporated herein by reference).

- 10.2 Form of Restricted Stock Unit Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed December 14, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).



| Exhibit No. | Description  |
|-------------|--|
| 10.3        | Form of Incentive Stock Option Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 10.4        | Form of Non-Qualified Stock Option Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 10.5        | Amended and Restated 1995 Stock Option Plan (filed as Annex B to the Company's Proxy Statement on Form 14a previously filed on May 31, 2001 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.6        | Form of Incentive Stock Option Agreement pursuant to SeaChange's Amended and Restated 1995 Stock Option Plan (filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on October 6, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 10.7        | Form of Non-Qualified Stock Option Agreement pursuant to SeaChange's Amended and Restated 1995 Stock Option Plan (filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on October 6, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 10.8        | 1996 Non-Employee Director Stock Option Plan (filed as Exhibit 10.2 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).   |
| 10.9        | Loan and Security Agreement, dated as of October 22, 2001, by and between Citizens Bank of Massachusetts and the Company (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on December 13, 2001 with the Commission (File No. 000-21393) and incorporated herein by reference).   |
| 10.10       | Amendment No. 1, dated as of June 14, 2002, by and between the Company and Citizen's Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizen's Bank of Massachusetts (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on September 13, 2002 with the Commission (File No. 000-21393) and incorporated herein by reference). |
| 10.11       | Amendment No. 2, dated as of April 21, 2003, between the Company and Citizen's Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001 by and between the Company and Citizen's Bank of Massachusetts (filed as Exhibit 10.7 to the Company's Annual Report on Form 10-K previously filed on May 1, 2003 with the Commission (File No. 000-21393) and incorporated herein by reference).                  |
| 10.12       | Amendment No. 3, dated as of December 1, 2003, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001 by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.1 to   |

the Company's Quarterly Report on Form 10-Q filed on December 15, 2003 with the Commission (File No. 000-21393) and incorporated herein by reference).

- 10.13           Amendment No. 8, dated as of April 14, 2006, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).

| Exhibit No. | Description   |
|-------------|---|
| 10.14       | Amendment No. 12, dated as of August 17, 2007, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).    |
| 10.15       | Amendment No. 14, dated as of October 31, 2008, between the Company and RBS Citizens, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and RBS Citizens (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed December 8, 2008 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.16       | Amendment No.17, dated as of October 29, 2010, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on December 10, 2010 with the Commission (File No. 000-21393) and incorporated herein by reference). |
| 10.17       | License Agreement dated May 30, 1996 between Summit Software Systems, Inc. and the Company (filed as Exhibit 10.7 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).  |
| 10.18       | Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between the Company and Kevin Bisson (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed December 21, 2009 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.19       | Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between SeaChange and Steven M. Davi (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K previously filed December 21, 2009 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.20       | Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between the Company and Ira Goldfarb (filed as Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 21, 2009 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.21       | Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between SeaChange and Yvette Kanouff (filed as Exhibit 10.5 to the Company's Current Report on Form 8-K previously filed December 21, 2009 with the Commission (File No. 000-21393) and incorporated herein by reference).  |
| 10.22       | Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between the Company and William C. Styslinger, III (filed as Exhibit 10.7 to the Company's Current Report on Form 8-K previously filed December 21, 2009 with the Commission (File No. 000-21393) and incorporated herein by reference).  |

- 10.23           Amendment, dated as of June 1, 2010, by and between SeaChange International, Inc. and William C. Styslinger, III to the Amended and Restated Change-in-Control Severance Agreement, dated as of December 21, 2009, by and between SeaChange International, Inc. and William C. Styslinger, III (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed on June 1, 2010 with the Commission (File No. 000-21393) and incorporated herein by reference).
- 10.24           Executive Services Agreement, dated as of September 23, 2005, by and between On Demand Management Limited and Anthony Kelly (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K previously filed September 29, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).

| Exhibit No. | Description  |
|-------------|--|
| 10.25       | Settlement Agreement, dated as of June 3, 2010, by and among SeaChange International, Inc., Ramius Value and Opportunity Master Fund Ltd. and the other parties set forth on the signature pages thereto (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed on June 3, 2010 with the Commission (File No. 000-21393) and incorporated herein by reference). |
| 10.26       | Settlement Agreement, dated as of December 16, 2010, by and among SeaChange International, Inc., Ramius LLC and the other parties set forth on the signature pages thereto (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed on December 16, 2010 with the Commission (File No. 000-21393) and incorporated herein by reference).                          |
| 21.1*       | List of Subsidiaries of the Registrant.  |
| 23.1*       | Consent of Grant Thornton LLP.   |
| 24.1        | Power of Attorney (included on signature page).  |
| 31.1*       | Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2*       | Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*       | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2*       | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

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\* Provided herewith.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of SeaChange International, Inc.

We have audited the accompanying consolidated balance sheets of SeaChange International, Inc. (a Delaware corporation) and subsidiaries (collectively the “Company”) as of January 31, 2011 and 2010, and the related consolidated statements of operations stockholders’ equity and comprehensive income (loss), and cash flows for each of the three years in the period ended January 31, 2011. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15 (a) (2). These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SeaChange International, Inc. and subsidiaries as of January 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended January 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), SeaChange International, Inc. and subsidiaries internal control over financial reporting as of January 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 14, 2011 expressed an unqualified opinion thereon.

/s/ Grant Thornton LLP

Boston, Massachusetts  
April 14, 2011

SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEET  
(in thousands, except share data)

|  | January 31,<br>2011 | January 31,<br>2010 |
|--|---------------------|---------------------|
| <b>Assets</b>  |                     |                     |
| Current assets:  |                     |                     |
| Cash and cash equivalents  | \$73,145            | \$37,647            |
| Restricted cash  | 1,332               | 73                  |
| Marketable securities  | 7,340               | 2,114               |
| Accounts receivable, net of allowance for doubtful accounts of \$995 in 2011 and \$852 in 2010, respectively   | 48,843              | 50,337              |
| Unbilled receivables   | 5,644               | 3,941               |
| Inventories, net   | 14,393              | 17,830              |
| Prepaid expenses and other current assets  | 7,148               | 7,253               |
| Deferred tax assets  | 3,775               | 2,474               |
| <b>Total current assets</b>  | <b>161,620</b>      | <b>121,669</b>      |
| Property and equipment, net  | 36,381              | 39,682              |
| Marketable securities, long-term   | 4,379               | 8,688               |
| Investments in affiliates  | 2,913               | 13,697              |
| Intangible assets, net   | 30,306              | 26,264              |
| Goodwill   | 65,273              | 55,876              |
| Other assets   | 2,163               | 992                 |
| Deferred tax assets, long-term   | 2,156               | 279                 |
| <b>Total assets</b>  | <b>\$305,191</b>    | <b>\$267,147</b>    |
| <b>Liabilities and Stockholders' Equity</b>  |                     |                     |
| Current liabilities:   |                     |                     |
| Accounts payable   | \$11,249            | \$10,371            |
| Other accrued expenses   | 16,528              | 11,174              |
| Customer deposits  | 3,993               | 4,279               |
| Deferred revenues  | 37,039              | 34,158              |
| Deferred tax liabilities   | 183                 | 800                 |
| <b>Total current liabilities</b>   | <b>68,992</b>       | <b>60,782</b>       |
| Deferred revenue, long-term  | 6,930               | 12,635              |
| Other liabilities, long-term   | 11,231              | 6,574               |
| Distribution and losses in excess of investment  | 1,161               | 1,469               |
| Taxes payable, long-term   | 3,013               | 2,415               |
| Deferred tax liabilities, long-term  | 4,722               | 5,350               |
| <b>Total liabilities</b>   | <b>96,049</b>       | <b>89,225</b>       |
| <b>Commitments and contingencies (Note 9)</b>  |                     |                     |
| <b>Stockholders Equity:</b>  |                     |                     |
| Convertible preferred stock, \$0.01 par value, 5,000,000 shares authorized, none issued or outstanding   | —                   | —                   |
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 31,876,815 and 32,563,063 shares issued; 31,837,031 and 31,216,267 shares outstanding, respectively | 319                 | 326                 |
| Additional paid-in capital   | 207,121             | 211,504             |

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|  |            |            |
|--|------------|------------|
| Treasury stock, at cost 39,784 and 1,346,796 common shares, respectively | (1 )       | (8,757 )   |
| Accumulated income (deficit)   | 10,521     | (17,450 )  |
| Accumulated other comprehensive loss                                     | (8,818 )   | (7,701 )   |
| Total stockholders' equity   | 209,142    | 177,922    |
| Total liabilities and stockholders' equity                               | \$ 305,191 | \$ 267,147 |

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



SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF OPERATIONS  
(in thousands, except per share data)

|   | Fiscal Year ended January 31, |           |           |
|---|-------------------------------|-----------|-----------|
|   | 2011                          | 2010      | 2009      |
| <b>Revenues:</b>  |                               |           |           |
| Products  | \$91,679                      | \$101,941 | \$117,372 |
| Services  | 125,048                       | 99,724    | 84,464    |
| Total revenues  | 216,727                       | 201,665   | 201,836   |
| <b>Cost of revenues:</b>  |                               |           |           |
| Products  | 35,527                        | 38,961    | 46,533    |
| Services  | 72,451                        | 59,451    | 52,007    |
| Total cost of revenues  | 107,978                       | 98,412    | 98,540    |
| Gross profit  | 108,749                       | 103,253   | 103,296   |
| <b>Operating expenses:</b>  |                               |           |           |
| Research and development  | 48,403                        | 50,664    | 43,042    |
| Selling and marketing   | 24,506                        | 25,842    | 27,506    |
| General and administrative  | 24,328                        | 21,719    | 20,979    |
| Amortization of intangibles   | 3,359                         | 2,826     | 1,575     |
| Restructuring   | 6,997                         | -         | -         |
| Total operating expenses  | 107,593                       | 101,051   | 93,102    |
| Income from operations  | 1,156                         | 2,202     | 10,194    |
| Interest income   | 307                           | 763       | 2,107     |
| Interest expense  | (472 )                        | (156 )    | (57 )     |
| Other expense, net  | (1,017 )                      | (462 )    | (925 )    |
| Gain on sale of investment in affiliates                                      | 27,071                        | -         | -         |
| Income before income taxes and equity income (loss) in earnings of affiliates | 27,045                        | 2,347     | 11,319    |
| Income tax (benefit) expense  | (2,338 )                      | 371       | 575       |
| Equity income (loss) in earnings of affiliates, net of tax                    | 85                            | (653 )    | (770 )    |
| Net income  | \$29,468                      | \$1,323   | \$9,974   |
| <b>Earnings per share:</b>  |                               |           |           |
| Basic income per share  | \$0.94                        | \$0.04    | \$0.32    |
| Diluted income per share  | \$0.92                        | \$0.04    | \$0.32    |
| <b>Weighted average common shares outstanding:</b>                            |                               |           |           |
| Basic   | 31,434                        | 30,860    | 30,724    |
| Diluted   | 31,986                        | 31,433    | 31,192    |

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

SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME (LOSS)  
(in thousands, except per share data)

|  | Common Stock     |           | Additional paid-in capital | Accumulated Deficit | Accumulated other comprehensive income(loss) |                                     | Treasury Stock | Total Stockholders' Equity | Comprehensive income (loss) |          |
|--|------------------|-----------|----------------------------|---------------------|--|-------------------------------------|----------------|----------------------------|-----------------------------|----------|
|  | Number of shares | Par value |                            |                     | Cumulative translation adjustment            | Unrealized gain/loss on investments |                |                            |                             |          |
| Balance at January 31, 2008  | 29,944,095       | 299       | 191,627                    | (28,747)            | 1,787  | 436                                 | (39,784 )      | -                          | 165,402                     |          |
| Issuance of common stock pursuant to exercise of stock options               | 223,006          | 4         | 1,176                      | -                   | -  | -                                   | -              | -                          | 1,180                       |          |
| Issuance of common stock in connection with the employee stock purchase plan | 236,707          | 3         | 1,560                      | -                   | -  | -                                   | -              | -                          | 1,563                       |          |
| Issuance of common stock pursuant to vesting of restricted stock units       | 287,642          | 1         | -                          | -                   | -  | -                                   | -              | -                          | 1                           |          |
| Issuance of common stock pursuant to third earnout for ODG acquisition       | 1,131,388        | 11        | 8,094                      | -                   | -  | -                                   | -              | -                          | 8,105                       |          |
| Stock-based compensation expense   | -                | -         | 3,954                      | -                   | -  | -                                   | -              | -                          | 3,954                       |          |
| Purchase of treasury shares  | -                | -         | -                          | -                   | -  | -                                   | (833,597 )     | (5,989 )                   | (5,989 )                    |          |
| Change in fair value on marketable securities, net of tax                    | -                | -         | -                          | -                   | -  | 23                                  | -              | -                          | 23                          | \$23     |
| Translation adjustment   | -                | -         | -                          | -                   | (11,977)                                     | -                                   | -              | -                          | (11,977 )                   | (11,977) |

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|  |            |       |           |            |            |       |             |          |          |            |
|--|------------|-------|-----------|------------|------------|-------|-------------|----------|----------|------------|
| Net income   | -          | -     | -         | 9,974      | -          | -     | -           | -        | 9,974    | 9,974      |
| Comprehensive loss   |            |       |           |            |            |       |             |          |          | \$(1,980 ) |
| Balance at January 31, 2009  | 31,822,838 | 318   | 206,411   | (18,773)   | (10,190)   | 459   | (873,381 )  | (5,989 ) | 172,236  |            |
| Issuance of common stock pursuant to exercise of stock options               | 47,805     | 1     | 483       | -          | -          | -     | -           | -        | 484      |            |
| Issuance of common stock in connection with the employee stock purchase plan | 282,889    | 3     | 1,510     | -          | -          | -     | -           | -        | 1,513    |            |
| Issuance of common stock pursuant to vesting of restricted stock units       | 409,531    | 4     | (4 )      | -          | -          | -     | -           | -        | -        |            |
| Stock-based compensation expense   | -          | -     | 3,104     | -          | -          | -     | -           | -        | 3,104    |            |
| Purchase of treasury shares  |            |       |           |            | -          | -     | (473,415 )  | (2,768 ) | (2,768 ) |            |
| Change in fair value on marketable securities, net of tax                    | -          | -     | -         | -          | -          | (262) | -           | -        | (262 )   | \$(262 )   |
| Translation adjustment   | -          | -     | -         | -          | 2,292      | -     | -           | -        | 2,292    | 2,292      |
| Net income   | -          | -     | -         | 1,323      | -          | -     | -           | -        | 1,323    | 1,323      |
| Comprehensive income   |            |       |           |            |            |       |             |          |          | \$3,353    |
| Balance at January 31, 2010  | 32,563,063 | \$326 | \$211,504 | \$(17,450) | \$(7,898 ) | \$197 | (1,346,796) | (8,757 ) | 177,922  |            |
| Issuance of common stock pursuant to exercise of stock options               | 309,195    | 4     | 2,076     | -          | -          | -     | -           | -        | 2,080    |            |
| Issuance of common stock in connection                                       | 135,632    | 2     | 658       | -          | -          | -     | -           | -        | 660      |            |

|   |              |       |           |          |            |       |            |          |           |          |
|---|--------------|-------|-----------|----------|------------|-------|------------|----------|-----------|----------|
| with the<br>employee stock<br>purchase plan   |              |       |           |          |            |       |            |          |           |          |
| Issuance of<br>common stock<br>pursuant to<br>vesting of<br>restricted stock<br>units | 353,542      | 2     | (2 )      | -        | -          | -     | -          | -        | -         | -        |
| Stock-based<br>compensation<br>expense  | -            | -     | 1,564     | -        | -          | -     | -          | -        | -         | 1,564    |
| Purchase of<br>treasury shares  |              |       |           |          |            |       | (177,605 ) | (1,435 ) | (1,435 )  |          |
| Retirement of<br>shares   | (1,484,617 ) | (15 ) | (8,679 )  | (1,497 ) |            |       | 1,484,617  | 10,191   |           |          |
| Change in fair<br>value on<br>marketable<br>securities, net<br>of tax                 | -            | -     | -         | -        | -          | (77 ) | -          | -        | (77 )     | \$(77 )  |
| Translation<br>adjustment   | -            | -     | -         | -        | (1,040 )   | -     | -          | -        | (1,040 )  | (1,040 ) |
| Net income  | -            | -     | -         | 29,468   | -          | -     | -          | -        | 29,468    | 29,468   |
| Comprehensive<br>income   |              |       |           |          |            |       |            |          |           | \$28,351 |
| Balance at<br>January 31,<br>2011   | 31,876,815   | \$319 | \$207,121 | \$10,521 | \$(8,938 ) | \$120 | (39,784 )  | \$(1 )   | \$209,142 |          |

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

SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(in thousands)

|  | Year ended January 31, |           |           |
|--|------------------------|-----------|-----------|
|  | 2011                   | 2010      | 2009      |
| <b>Cash flows from operating activities:</b>   |                        |           |           |
| Net income   | \$29,468               | \$1,323   | \$9,974   |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                        |           |           |
| Depreciation   | 8,198                  | 7,995     | 7,216     |
| Amortization of intangibles and capitalized software                                     | 5,345                  | 3,461     | 2,025     |
| Loss on disposal of fixed assets   | 1,283                  | -         | -         |
| Loss on disposal of inventory  | 2,474                  | -         | -         |
| Inventory valuation charge   | 556                    | 585       | 1,085     |
| Provision for doubtful accounts receivable   | 2                      | 75        | 761       |
| Discounts earned and amortization of premiums on marketable securities                   | 62                     | 110       | 22        |
| Equity loss (income) in earnings of affiliates   | (65 )                  | 654       | 770       |
| Gain on sale of investment in affiliate  | (27,071 )              | -         | -         |
| Stock-based compensation expense   | 2,957                  | 3,105     | 3,954     |
| Deferred income taxes  | (7,074 )               | (1,210 )  | (124 )    |
| Excess tax benefit related to share based compensation expense                           | (4 )                   | (159 )    | -         |
| <b>Changes in operating assets and liabilities:</b>                                      |                        |           |           |
| Accounts receivable  | 3,689                  | (4,380 )  | (15,524 ) |
| Unbilled receivables   | (1,204 )               | 654       | 2,772     |
| Inventories  | (1,873 )               | (3,926 )  | (7,509 )  |
| Prepaid expenses and other assets  | 769                    | (3,657 )  | (1,508 )  |
| Accounts payable   | 664                    | (3,048 )  | 2,672     |
| Accrued expenses   | 3,442                  | (3,232 )  | 331       |
| Customer deposits  | (286 )                 | 2,313     | 707       |
| Deferred revenues  | (5,117 )               | 7,901     | 13,946    |
| Other  | 66                     | 35        | 92        |
| Net cash provided by operating activities  | 16,281                 | 8,599     | 21,662    |
| <b>Cash flows from investing activities:</b>   |                        |           |           |
| Purchases of property and equipment  | (3,772 )               | (8,355 )  | (12,948 ) |
| Proceeds from sale of property and equipment   | -                      | -         | -         |
| Purchases of marketable securities   | (8,382 )               | (43,402 ) | (57,063 ) |
| Proceeds from sale and maturity of marketable securities                                 | 7,325                  | 54,091    | 59,740    |
| Acquisition of businesses and payment of contingent consideration, net of cash acquired  | (14,661 )              | (35,019 ) | (3,204 )  |
| Investments in affiliates  | (1,107 )               | (1,824 )  | (43 )     |
| Capital distribution from investment in affiliate  | -                      | -         | -         |
| Proceeds from sale of investment in affiliate  | 38,717                 | -         | -         |
| (Deposit) release of restricted cash   | (55 )                  | 1,512     | (1,500 )  |
| Net cash provided by (used in) investing activities                                      | 18,065                 | (32,997 ) | (15,018 ) |
| <b>Cash flows from financing activities:</b>   |                        |           |           |
| Purchase of treasury stock   | (1,435 )               | (2,768 )  | (5,989 )  |
| Proceeds from issuance of common stock relating to the stock plans                       | 2,740                  | 1,838     | 2,743     |

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|  |          |           |          |
|--|----------|-----------|----------|
| Excess tax benefit related to share based compensation expense                 | 4        | 159       | -        |
| Net cash provided by (used in) financing activities                            | 1,309    | (771 )    | (3,246 ) |
| Effect of exchange rates on cash   | (157 )   | 358       | (4,299 ) |
| Net (decrease) increase in cash and cash equivalents                           | 35,498   | (24,811 ) | (901 )   |
| Cash and cash equivalents, beginning of period                                 | 37,647   | 62,458    | 63,359   |
| Cash and cash equivalents, end of period                                       | \$73,145 | \$37,647  | \$62,458 |
| Supplemental disclosure of cash flow information:                              |          |           |          |
| Income taxes paid  | \$3,174  | \$554     | \$1,267  |
| Interest paid  | -        | 41        | 38       |
| Supplemental disclosure of non-cash activities:                                |          |           |          |
| Transfer of items originally classified as inventories to equipment            | 2,283    | 2,841     | 3,488    |
| Issuance of equity for ODG contingent consideration                            | -        | -         | 8,105    |
| Conversion of accounts receivable to equity related to investment in affiliate | -        | -         | 332      |

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

SEACHANGE INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Business

SeaChange International, Inc. (“SeaChange” or “the Company”), headquartered in Acton, Massachusetts, is a global leader in the delivery of multi-screen video. Our products and services facilitate the aggregation, licensing, storage, management and distribution of video, television programming, and advertising content to cable system operators, telecommunications companies and broadcast television companies.

2. Summary of Significant Accounting Policies

Significant accounting policies followed in the preparation of the accompanying consolidated financial statements are as follows:

Use of Estimates

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates and judgments, including those related to revenue recognition, valuation of inventory and accounts receivable, valuation of investments and income taxes, stock-based compensation, goodwill, intangible assets and related amortization. The Company bases these estimates on historical and anticipated results and trends and on various other assumptions that the Company believes are reasonable under the circumstances, including assumptions as to future events. These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from management’s estimates.

Principles of Consolidation

The Company consolidates the financial statements of its wholly-owned subsidiaries and all intercompany accounts are eliminated in consolidation. SeaChange also holds minority investments in the capital stock of certain private companies having product offerings or customer relationships that have strategic importance. The Company evaluates its equity and debt investments and other contractual relationships with affiliate companies in order to determine whether the guidelines regarding the consolidation of variable interest entities (“VIE”) should be applied in the financial statements. Consolidation guidelines address consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The Company uses qualitative analysis to determine whether or not we are the primary beneficiary of a VIE (variable interest entity). The Company considers the rights and obligations conveyed by its implicit and explicit variable interest in each VIE and the relationship of these with the variable interests held by other parties to determine whether its variable interests will absorb a majority of a VIE’s expected losses, receive a majority of its expected residual returns, or both. If the company determines that its variable interests will absorb a majority of the VIE’s expected losses, receive a majority of its expected residual returns, or both, the Company consolidates the VIE as the primary beneficiary, and if not, it does not consolidate

The company has reviewed its interest in a joint venture in Germany, a partnership in Turkey and equity investment in Hightech ICT. BV, The primary beneficiary is required to consolidate the financial position and results of the VIE.

The Company has concluded that it is not the primary beneficiary for any variable interest entities during the fiscal year ended January 31, 2011. Accordingly, the Company uses the equity method to account for these investments.



## Equity Investments

The Company's investments in affiliates include investments accounted for under the cost method and the equity method of accounting. The investments that represent less than a 20% ownership interest of the common shares of the affiliate are carried at cost. Under the equity method of accounting, which generally applies to investments that represent 20% to 50% ownership of the common shares of the affiliate, SeaChange's proportionate ownership share of the earnings or losses of the affiliate are included in equity income in earnings of affiliates in equity income (loss) in earnings of affiliates in the consolidated statement of operations.

The Company periodically reviews indicators of the fair value of its investments in affiliates in order to assess whether available facts or circumstances, both internally and externally, may suggest an other than temporary decline in the value of the investment. The carrying value of an investment in an affiliate may be affected by the affiliate's ability to obtain adequate funding and execute its business plans, general market conditions, industry considerations specific to the affiliate's business, and other factors. The inability of an affiliate to obtain future funding or successfully execute its business plan could adversely affect the Company's equity earnings of the affiliate in the periods affected by those events. Future adverse changes in market conditions or poor operating results of the affiliates could result in equity losses or an inability to recover the carrying value of the investments in affiliates that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. The Company records an impairment charge when it believes an investment has experienced a decline in value that is other-than-temporary.

## Revenue Recognition

Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when title and risk of loss has passed to the customer, there is evidence of an arrangement, 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 are 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 are 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. 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. SeaChange's share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

SeaChange's transactions frequently involve the sales of hardware, software, systems and services in multiple element arrangements. Revenues under multiple element arrangements are recorded based on the residual method of accounting. 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 required 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 vendor-specific objective evidence 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 with the exception of maintenance and technical support.

Service revenue from content processing provided to the Company's customers is recognized when services are provided, based on contracted rates. Upfront fees received for services are recognized ratably over the period earned, whichever is the longer of the contract term or the estimated customer relationship.

Any taxes assessed by a governmental authority related to revenue-producing transactions (e.g. sales or value-added taxes) are reported on a net basis and excluded from revenues.

#### Concentration of Credit Risk and Major Customers

Financial instruments which potentially expose SeaChange to concentrations of credit risk include cash equivalents, investments in treasury bills, certificates of deposits and commercial paper, trade accounts receivable, accounts payable and accrued liabilities. The Company restricts its cash equivalents and investments in marketable securities to repurchase agreements with major banks and U.S. government and corporate securities which are subject to minimal credit and market risk.

For trade accounts receivable, SeaChange evaluates customers' financial condition, requires advance payments from certain of its customers and maintains reserves for potential credit losses. The Company performs ongoing credit evaluations of customers' financial condition but generally does not require collateral. For some international customers, SeaChange requires an irrevocable letter of credit to be issued by the customer before the purchase order is accepted. The Company monitors payments from customers and assesses any collection issues. The Company maintains allowances for specific doubtful accounts and other risk categories of accounts based on estimates of losses resulting from the inability of the Company's customers to make required payments and records these allowances as a charge to general and administrative expenses. SeaChange bases its allowances for doubtful accounts on historical collections and write-off experience, current trends, credit assessments, and other analysis of specific customer situations. At January 31, 2011 and 2010, SeaChange had an allowance for doubtful accounts of \$995,000 and \$852,000, respectively, to provide for potential credit losses. At January 31, 2011, three separate customers accounted for 17%, 12% and 10%, respectively, of SeaChange's gross accounts receivable balance. For the fiscal year ended January 31, 2011 and 2010, two customers each accounted for more than 10%, and collectively accounted for 34% and 39%, respectively, of our total revenues. Revenues from these customers were primarily in the Software and Servers and Storage segment.

#### Cash Equivalents and Marketable Securities

SeaChange accounts for investments in accordance with authoritative guidance that defines investment classifications. The Company determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date. SeaChange's investment portfolio consists of money market funds, corporate debt investments, asset-backed securities, government-sponsored enterprises, and state and municipal obligations. 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. SeaChange's 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 income or loss. The amortization of premiums and accretions of discounts to maturity are computed under the effective interest method and are included in interest income. Interest on securities is recorded as earned and is also included in interest income. Any realized gains or losses would be shown in the accompanying consolidated statements of operations in other income or expense.

The Company evaluates its investments on a regular basis to determine whether an other-than-temporary decline in fair value has occurred. This evaluation consists of a review of several factors, including, but not limited to: the length of time and extent that an investment has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; and the Company's intent and ability to hold an investment for a period of

time sufficient to allow for any anticipated recovery in fair value. Declines in value below cost for investments where it is considered probable that all contractual terms of the investment will be satisfied, is due primarily to changes in interest rates, and where the company has the intent and ability to hold the investment for a period of time sufficient to allow a market recovery, are not assumed to be other-than-temporary. Any other-than-temporary declines in fair value are recorded in earnings and a new cost basis for the investment is established.

### Inventory Valuation

Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out (FIFO) method. Inventories consist primarily of components and subassemblies and finished products held for sale. The values of inventories are reviewed quarterly to determine that the carrying value is stated at the lower of cost or net realizable value. SeaChange records charges to reduce inventory to its net realizable value when impairment is identified through the quarterly review process. The obsolescence evaluation is based upon assumptions and estimates about future demand, or possible alternative uses and involves significant judgments. For the year ended January 31, 2011, we recorded \$3.0 million in inventory write-downs of which \$2.5 million was incurred as part of the first quarter restructuring. For the fiscal years ended January 31, 2010 and 2009, we recorded inventory write-downs of \$569,000 and \$1.0 million, respectively.

### Property and Equipment

Property and equipment consists of land and buildings, office and computer equipment, leasehold improvements, demonstration equipment, deployed assets and spare components and assemblies used to service SeaChange's installed base.

Demonstration equipment consists of systems manufactured by SeaChange for use in marketing and selling activities. Property and equipment are recorded at cost and depreciated over their estimated useful lives. Leasehold improvements are amortized over the shorter of their estimated useful lives or the term of the respective leases using the straight-line method. Deployed assets consist of movie systems owned and manufactured by SeaChange that are installed in a hotel environment. Deployed assets are depreciated over the life of the related service agreements. Capitalized service and spare components are depreciated over the estimated useful lives using the straight-line method. Maintenance and repair costs are expensed as incurred. Upon retirement or sale, the cost of the assets disposed of, and the related accumulated depreciation, are removed from the accounts, and any resulting gain or loss is included in the determination of net income.

### Goodwill and Long-Lived Assets

The Company recognizes the excess of the purchase price over the fair value of the net tangible and intangible assets acquired as goodwill. At the time of acquisition, goodwill is assigned to the operating segment as the applicable reporting unit for the goodwill impairment review. Goodwill is not amortized, but is evaluated for impairment, at the reporting unit level, annually in the third fiscal quarter. Goodwill of a reporting unit also is 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, 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. The process of evaluating goodwill for impairment requires several judgments and assumptions to be made to determine the fair value of the reporting units, including the method used to determine fair value, discount rates, expected levels of cash flows, revenues and earnings, and the selection of comparable companies used to develop market based assumptions.

The Company accounts for business acquisitions in accordance with authoritative guidance which determines and records the fair values of assets acquired, liabilities, contractual contingencies and contingent consideration assumed as of the dates of acquisition. The purchase price allocation process requires management to make significant estimates and assumptions, especially at the acquisition date with respect to intangible assets and estimated contingent consideration payments.

SeaChange also evaluates property and equipment, intangible assets 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, SeaChange evaluates 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 compares that value to the carrying value of the assets. SeaChange's cash flow estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time.

Intangible assets consist of customer contracts, completed technology, in-process research and development, non-competition agreements, patents and trademarks and are respectively assigned to the operating segments. The intangible assets are amortized to cost of sales and operating expenses, as appropriate, on a straight-line or accelerated basis in order to reflect the period that the assets will be consumed. In-process research and development assets as of the acquisition date are recorded as indefinite-lived intangible assets and are subject to impairment testing at least annually. The useful life of the intangible asset recognized will be reconsidered if and when an in-process research and development project is completed or abandoned.

SeaChange develops software for resale in markets that are subject to rapid technological change, new product development and changing customer needs. The time period during which software development costs can be capitalized from the point of reaching technological feasibility until the time of general product release is very short, and consequently, the amounts that could be capitalized are not material to the Company's financial position or results of operations. Software development costs relating to sales of software requiring significant modification or customization are charged to costs of product revenues.

Amortization expense is recorded over the period of economic consumption or the life of the agreement, whichever results in the higher expense, starting with the first shipment of the product to a customer. Amortization expense charged to cost of sales was \$2.0 million, \$638,000 and \$100,000 for the fiscal years ended January 31, 2011, 2010 and 2009, respectively.

#### Income Taxes

Accounting for Income Taxes. As part of the process of preparing the Company's financial statements, the Company is required to estimate its provision for income taxes in each of the jurisdictions in which it operates. This process involves estimating its actual current tax exposure, including assessing the risks associated with tax audits, together with assessing temporary differences resulting from the different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the Company's balance sheet.

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards. The Company evaluates the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The Company will record a valuation allowance if the likelihood of realization of the deferred tax assets in the future is reduced based on an evaluation of objective verifiable evidence. Significant management judgment is required in determining its income tax provision, its deferred tax assets and liabilities and any valuation allowance recorded against its deferred tax assets. The Company has established a valuation allowance against its United States deferred tax assets due to indications that they may not be fully realized. The amount of the deferred tax asset considered realizable is subject to change based on future events, including generating sufficient pre-tax income in future periods. In the event that actual results differ from these estimates, the Company's provision for income taxes could be materially impacted. SeaChange does not provide for U.S. federal and state income taxes on the undistributed earnings of its non-U.S. subsidiaries that are considered indefinitely reinvested in the operations outside the U.S.

Authoritative guidance as it relates to income tax liabilities states that the minimum threshold a tax position is required to meet before being recognized in the financial statements is "more likely than not" (i.e., a likelihood of occurrence greater than fifty percent). The recognition threshold is met when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination by the relevant taxing authority. Those tax positions failing to qualify for initial recognition are recognized in the first interim period in which they meet the more likely than not standard, or are resolved through negotiation or litigation with the taxing

authority, or upon expiration of the statute of limitations. Derecognition of a tax position that was previously recognized occurs when an entity subsequently determines that a tax position no longer meets the more likely than not threshold of being sustained.



The Company files annual income tax returns in multiple taxing jurisdictions around the world. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company believes that its reserves for income taxes reflect the most likely outcome. The Company adjusts these reserves as well as the related interest and penalties, in light of changing facts and circumstances. If its estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when the Company determines the liabilities are no longer necessary. The changes in estimate could have a material impact on the Company's financial position and operating results. In addition, settlement of any particular position could have a material and adverse effect on the Company's cash flows and financial position.

#### Share-based Compensation.

The Company accounts for all employee and non-employee director stock-based compensation awards using the authoritative guidance regarding share-based payments. The Company has continued to use the Black-Scholes pricing model as the most appropriate method for determining the estimated fair value of all applicable awards. Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires the input of highly subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management estimated the volatility based on the historical volatility of the Company's stock. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management's judgment. As a result, if circumstances change and the Company uses different assumptions, the Company's share-based compensation expense could be materially different in the future. In addition, the Company is required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If the Company's actual forfeiture rate is materially different from its estimate, the share-based compensation expense could be significantly different from what it has recorded in the current period. The estimated fair value of SeaChange's stock-based options and performance-based restricted stock units, less expected forfeitures, is amortized over the awards' vesting period on a graded vesting basis, whereas the restricted stock units and Employee Stock Purchase Plan stock units are amortized on a straight line basis.

#### Restructuring

During fiscal 2011, the Company recorded restructuring charges primarily related to the Servers and Storage segment consisting of employee severance; write down of inventory, and the disposal of fixed assets. Restructuring charges represent our best estimate of the associated liability at the date the charges are recognized. Adjustments for changes in assumptions are recorded as a component of operating expenses in the period they become known. Differences between actual and expected charges and changes in assumptions could have a material effect on our restructuring accrual as well as our consolidated results of operations.

#### Foreign Currency Translation

For subsidiaries where the U.S. dollar is designated as the functional currency of the entity, the Company translates that entity's monetary assets and liabilities denominated in local currencies into U.S. dollars (the functional and reporting currency) at current exchange rates, as of each balance sheet date. Non-monetary assets (e.g., inventories, property, plant, and equipment and intangible assets) and related income statement accounts (e.g., cost of sales, depreciation, amortization of intangible assets) are translated at historical exchange rates between the functional currency (the U.S. dollar) and the local currency. Revenue and other expense items are translated using average exchange rates during the fiscal period. Translation adjustments and transactions gains and losses on foreign currency transactions, and any unrealized gains and losses on short-term inter-company transactions are included in other income or expense, net.

For subsidiaries where the local currency is designated as the functional currency, the Company translates its assets and liabilities into U.S. dollars (the reporting currency) at current exchange rates as of each balance sheet date. Revenue and expense items are translated using average exchange rates during the period. Cumulative translation adjustments are presented as a separate component of stockholders' equity. Exchange gains and losses on foreign currency transactions and unrealized gains and losses on short-term inter-company transactions are included in other income or expense, net.

The aggregate foreign exchange transaction losses included as other expense, net on the Consolidated Statement of Operations were \$1.1 million, \$572,000 and \$951,000 for the years ended January 31, 2011, 2010 and 2009, respectively.

### Comprehensive Income (Loss)

SeaChange presents accumulated other comprehensive income (loss) and total comprehensive income (loss) in the Statement of Stockholders' Equity. Total comprehensive income (loss) consists primarily of net income, cumulative translation adjustments and unrealized gains and losses on marketable securities, net of income tax.

### Forward Exchange Contracts not Designated as Hedging Instruments

SeaChange may enter into foreign currency forward exchange contracts ("forward exchange contracts") to manage its exposure to the foreign currency exchange risk related to the fixed deferred purchase price associated with the acquisition of eventIS Group B.V. The purpose of the Company's foreign currency risk management program is to reduce volatility in earnings caused by exchange rate fluctuation. The Company does not enter into derivative financial instruments for trading or speculative purposes. The Company does not designate these forward exchange contracts as hedging instruments, as such, they do not qualify for hedge accounting treatment. Therefore, the foreign currency forward contracts are recorded at fair value, with the gain or loss on these transactions recorded in the consolidated statements of operations within "other expense, net" in the period in which they occur. As of January 31, 2011, the Company had no outstanding foreign currency forward exchange contracts. The Company recorded approximately \$142,000 and \$87,000 of losses related to its foreign currency forward exchange contract during the years ended January 31, 2011 and 2010, respectively. The Company's foreign currency forward exchange contract is an over-the-counter instrument. There is an active market for these instruments, and therefore, they are classified as Level 1 in the fair value hierarchy.

### Advertising Costs

Advertising costs are charged to expense as incurred. Advertising costs were \$319,000, \$386,000 and \$340,000 for the years ended January 31, 2011, 2010 and 2009, respectively.

### Earnings Per Share

Earnings per share are presented in accordance with authoritative guidance, which requires the presentation of "basic" earnings per share and "diluted" earnings per share. Basic earnings per share is computed by dividing earnings available to common shareholders by the weighted-average shares of common stock outstanding during the period. For the purposes of calculating diluted earnings per share, the denominator includes both the weighted average number of shares of common stock outstanding during the period and the weighted average number of potential common stock, such as stock options, employee stock purchase plan, and restricted stock, calculated using the treasury stock method.

For the fiscal years ended January 31, 2011, 2010 and 2009 respectively, 2.5 million, 3.6 million and 3.7 million of common shares issuable upon the exercise of stock options are anti-dilutive and have been excluded from the diluted earnings per share computation as the exercise prices of these common shares were above the market price of the common stock for the periods indicated. Below is a summary of the shares used in calculating basic and diluted earnings per share for the periods indicated:

|  | Year ended January 31, |            |            |
|--|------------------------|------------|------------|
|  | 2011                   | 2010       | 2009       |
| Weighted average shares used in calculating earnings per share—Basic   | 31,434,398             | 30,860,194 | 30,724,301 |
| Dilutive common stock equivalents                                      | 551,404                | 573,174    | 468,174    |
| Weighted average shares used in calculating earnings per share—Diluted | 31,985,802             | 31,433,368 | 31,192,475 |



## Impact of Recently Adopted Accounting Guidance

### Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (“FASB”) issued an authoritative update to address the elimination of the concept of a qualifying special purpose entity and to replace the quantitative-based risks and rewards calculation for determining which enterprise has a controlling financial interest in a variable interest entity. Also, the new guidance requires an ongoing assessment of whether an entity is the primary beneficiary of a variable interest entity. The amended approach focuses on identifying which enterprise has the power to direct the activities of a variable interest entity and the obligation to absorb losses of the entity or the right to receive benefits from the entity. Additionally, the update provides more timely and useful information about an enterprise’s involvement with a variable interest entity. The Company adopted this new guidance in the first quarter of fiscal year 2011. The adoption of this guidance did not have a material impact on our financial position or results of operations.

### Fair Value Measurements

In January 2010, the FASB issued new guidance on the disclosures of fair value measurements. This new guidance amends the authoritative guidance for fair value measurements and disclosures by adding new disclosure requirements with respect to transfers in and out of Levels 1 and 2 fair value measurements, as well as by requiring gross basis disclosures for purchases, sales, issuances, and settlements included in the reconciliation of Level 3 fair value measurements. This new guidance also amends the authoritative guidance by providing clarifications to existing disclosure requirements. The new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company adopted this new guidance, including the guidance related to the disclosures about purchases, sales, issuances, and settlements in the roll forwards of activity in Level 3 fair value measurements, beginning in the first quarter of fiscal year 2011. The adoption of this guidance did not have a material impact on our financial position or results of operations.

### Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

In July 2010, the FASB issued guidance requiring improved disclosures about the credit quality of a company's financing receivables and their associated credit reserves. The amendments in the update require more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. The objective of enhancing these disclosures is to improve financial statement users' understanding of the nature of an entity's credit risk associated with its financing receivables and the entity's assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The amendments in the update are effective for the first interim or annual reporting period ending on or after December 15, 2010. The Company adopted this new disclosure guidance for the period ending January 31, 2011. The adoption of this guidance did not have a material impact on our disclosures.

### Recent Accounting Guidance Not Yet Effective

#### Revenue Recognition for Arrangements with Multiple Deliverables

In September 2009, the FASB amended the guidance for revenue recognition in multiple-element arrangements. It has been amended to remove from the scope of industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function

together to deliver the product's essential functionality. The guidance now requires an entity to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; and allocates revenue in an arrangement using estimated selling prices of deliverables for these products if a vendor does not have vendor-specific objective evidence ("VSOE") or third-party evidence of selling price. The guidance also eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method for these products. The accounting changes summarized are effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. The Company is currently assessing the impact of these amendments on its accounting and reporting systems and processes; however, at this time the Company is unable to quantify the impact of their adoption on its financial statements or determine the timing and method of its adoption.

### 3. Fair value of Assets and Liabilities

The applicable accounting guidance establishes a framework for measuring fair value and expands required disclosure about the fair value measurements of assets and liabilities. This guidance requires the Company 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 three-tier fair value hierarchy as described below.

The 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. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes three levels of inputs that may be used to measure fair value:

- 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 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. The Company primarily uses broker quotes for valuation of its short-term investments.

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.

The Company's financial assets and liabilities that are measured at fair value on a recurring basis as of January 31, 2011 are as follows:

|   | January 31,<br>2011 | Level 1          | Level 2<br>(in thousands) | Level 3     |
|---|---------------------|------------------|---------------------------|-------------|
| <b>Financial assets:</b>                  |                     |                  |                           |             |
| Cash                                      | \$ 66,539           | \$ 66,539        | -                         | -           |
| Cash equivalents                          | 6,606               | 6,606            | -                         | -           |
| Available for sale marketable securities: |                     |                  |                           |             |
| Current marketable securities:            |                     |                  |                           |             |
| U.S. government agency issues             | 7,340               | 4,605            | 2,735                     | -           |
| Non-current marketable securities:        |                     |                  |                           |             |
| U.S. government agency issues             | 4,379               | 3,358            | 1,021                     | -           |
| <b>Total</b>                              | <b>\$ 84,864</b>    | <b>\$ 81,108</b> | <b>\$ 3,756</b>           | <b>\$ -</b> |
| <b>Other liabilities:</b>                 |                     |                  |                           |             |
| Acquisition-related consideration         | \$ 14,410           | \$ -             | \$ -                      | \$ 14,410   |

The Company's financial assets and liabilities that are measured at fair value on a recurring basis as of January 31, 2010 are as follows:





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|   | January 31,<br>2010 | Fair Value Measurements Using |             |             |
|---|---------------------|-------------------------------|-------------|-------------|
|   |                     | Level 1                       | Level 2     | Level 3     |
| (in thousands)                            |                     |                               |             |             |
| <b>Financial assets:</b>                  |                     |                               |             |             |
| Cash                                      | \$ 32,725           | \$ 32,725                     | -           | -           |
| Cash equivalents                          | 4,922               | 4,922                         | -           | -           |
| Available for sale marketable securities: |                     |                               |             |             |
| <b>Current marketable securities:</b>     |                     |                               |             |             |
| U.S. government agency issues             | 2,114               | 2,114                         | -           | -           |
| <b>Non-current marketable securities:</b> |                     |                               |             |             |
| U.S. government agency issues             | 8,688               | 8,688                         | -           | -           |
| <b>Total</b>                              | <b>\$ 48,449</b>    | <b>\$ 48,449</b>              | <b>\$ -</b> | <b>\$ -</b> |
| Forward exchange contract                 | \$ 1,664            | \$ 1,664                      | \$ -        | \$ -        |
| <b>Other liabilities:</b>                 |                     |                               |             |             |
| Acquisition-related consideration         | \$ 9,514            | \$ -                          | \$ -        | \$ 9,514    |

The following tables set forth a reconciliation of assets and liabilities transferred from Level 1 to Level 2. Investments were transferred from Level 1 to Level 2 when there was no active market price quoted within five business days of January 31, 2011:

|                                    | Level 1<br>Marketable<br>Securities<br>Year Ended<br>January 31<br>2011 | Level 2<br>Marketable<br>Securities<br>Year Ended<br>January 31<br>2011 |
|------------------------------------|---|---|
| Beginning balance                  | \$ 10,802   | \$ -  |
| Purchases                          | 5,897   | 2,485   |
| Sales                              | (7,325 )  | -   |
| Transfers from Level 1             | (1,271 )  | 1,271   |
| Amortization and unrealized losses | (140 )  | -   |
| Ending balance                     | \$ 7,963  | \$ 3,756  |

The following tables set forth a reconciliation of assets and liabilities measured at fair value on a recurring basis with the use of significant unobservable inputs (Level 3):

|   | Level 3<br>Marketable Securities<br>Year Ended January 31 |          |
|---|---|----------|
|   | 2011  | 2010     |
| Beginning balance                       | \$ -  | \$ 1,000 |
| Sales                                   | -   | (950 )   |
| Realized loss recorded in other expense | -   | (50 )    |
| Ending balance                          | \$ -  | \$ -     |



|                               | Level 3<br>Accrued Contingent<br>Consideration<br>Year Ended<br>January 31<br>2011 |          |
|-------------------------------|--|----------|
| Beginning balance             | \$   | 9,514    |
| VividLogic, Inc. acquisition  |  | 8,388    |
| Settlement of working capital |  | 1,056    |
| Contingency payments          |  | (4,751 ) |
| Change in fair value          |  | 293      |
| Translation adjustment        |  | (90 )    |
| Ending balance                | \$   | 14,410   |

The Company relies on mark to market valuations to record the fair value of the Company's available for sale security assets which are measured under a Level 1 input. These assets are publicly traded equity securities for which market prices are readily observable and recorded. At January 31, 2011, the Company had \$7.3 million in short-term marketable securities and \$4.4 million in long-term marketable securities.

The Company determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date. SeaChange's investment portfolio consists of money market funds, corporate debt investments, asset-backed securities, government-sponsored enterprises, and state and municipal obligations. 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. SeaChange's 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 income or loss. The amortization of premiums and accretions of discounts to maturity are computed under the effective interest method and is included in interest income. Interest on securities is recorded as earned and is also included in interest income. Any realized gains or losses would be shown in the accompanying consolidated statements of operations in other expense, net.

The following is a summary of available-for-sale securities, including the cost basis, aggregate fair value and gross unrealized gains and losses, for cash equivalents, short-and long-term marketable securities portfolio as of January 31, 2011 and 2010:

|  | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|--|----------------|------------------------------|-------------------------------|-------------------------|
|  | (in thousands) |                              |                               |                         |
| <b>January 31, 2011:</b>                         |                |                              |                               |                         |
| Cash   | \$ 66,539      | \$ -                         | \$ -                          | \$ 66,539               |
| Cash equivalents                                 | 6,606          | -                            | -                             | 6,606                   |
| Cash and cash equivalents                        | 73,145         | -                            | -                             | 73,145                  |
| US government agency issues                      | 7,245          | 95                           | -                             | 7,340                   |
| Marketable securities—short-term                 | 7,245          | 95                           | -                             | 7,340                   |
| US government agency issues                      | 4,308          | 71                           | -                             | 4,379                   |
| Corporate debt securities                        | -              | -                            | -                             | -                       |
| Marketable securities—long-term                  | 4,308          | 71                           | -                             | 4,379                   |
| Total cash equivalents and marketable securities | \$ 84,698      | \$ 166                       | \$ -                          | \$ 84,864               |
| <b>January 31, 2010:</b>                         |                |                              |                               |                         |
| Cash   | \$ 32,725      | \$ -                         | \$ -                          | \$ 32,725               |
| Cash equivalents                                 | 4,922          | -                            | -                             | 4,922                   |
| Cash and cash equivalents                        | 37,647         | -                            | -                             | 37,647                  |
| US government agency issues                      | 2,023          | 91                           | -                             | 2,114                   |
| Marketable securities—short-term                 | 2,023          | 91                           | -                             | 2,114                   |
| US government agency issues                      | 8,276          | 161                          | -                             | 8,437                   |
| Corporate debt securities                        | 250            | 1                            | -                             | 251                     |
| Marketable securities—long-term                  | 8,526          | 162                          | -                             | 8,688                   |
| Total cash equivalents and marketable securities | \$ 48,196      | \$ 253                       | \$ -                          | \$ 48,449               |

During the years ended January 31, 2011, 2010 and 2009, available-for-sale securities were sold for total proceeds of \$519,000, \$11.6 million, and \$8.0 million, respectively. The gross realized gains and losses for fiscal years 2011, 2010 and 2009 were immaterial. For purposes of determining gross realized gains and losses, the cost of securities sold is based on specific identification.

Contractual maturities of available-for-sale debt securities at January 31, 2011 are as follows (in thousands):

|                                     | Estimated<br>Fair Value |
|-------------------------------------|-------------------------|
| Maturity of one year or less        | \$ 7,340                |
| Maturity between one and five years | 4,379                   |
| Total                               | \$ 11,719               |

The Company concluded that there were no declines in investments recorded as of January 31, 2011, 2010 and 2009 and the Company does not have any investments in a gross unrealized loss position as of January 31, 2011 and 2010. The unrealized holding (losses) gains, net of tax, on available-for-sale securities in the amount of (\$77,000), \$262,000

and \$23,000 for the years ended January 31, 2011, 2010 and 2009, respectively, have been included in stockholders' equity as a component of accumulated other comprehensive income or loss.

### 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 and marketable securities at January 31, 2011 and 2010 was \$84.9 million and \$48.4 million, respectively.

### Restricted Cash

Pursuant to certain lease agreements and share purchase agreements, we are required to maintain cash reserves, classified as restricted cash. Current restricted cash totaled \$1.3 million and \$73,000 at January 31, 2011 and 2010, respectively.

### Foreign Currency Exchange Risk

The Company may enter into a foreign exchange forward contract denominated in Euros to hedge against a portion of the foreign currency exchange risk associated with the acquisition of eventIS Group B.V. for the fixed deferred purchase price. The purpose of the Company's foreign currency risk management program is to reduce volatility in earnings caused by exchange rate fluctuations. Authoritative guidance requires companies to recognize all of the derivative financial instruments as either assets or liabilities at fair value in the consolidated balance sheets based upon quoted market prices for comparable instruments. The Company's derivative instrument have not met the criteria for hedge accounting within authoritative guidance. Therefore, the foreign currency forward contracts have been recorded at fair value, with the gain or loss on these transactions recorded in the consolidated statements of operations within "interest and other income, net" in the period in which they occur. The Company does not use derivative financial instruments for trading or speculative purposes. As of January 31, 2011, the Company had no outstanding foreign currency forward exchange contracts. During the year ended January 31, 2011, the Company recorded approximately \$142,000 of losses related to its foreign currency forward exchange contract. Typically, any losses or gains on the forward exchange contracts are offset by re-measurement losses or gains on the underlying balances denominated in non-functional currencies. The Company's foreign currency exchange contract is an over-the-counter instrument.

### Acquisition-Related Consideration

We determined the fair value of the acquisition-related consideration in connection with the acquisition of eventIS Group BV in September 2009 using a probability-weighted discounted cash flow model. This fair value measurement is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Any change in the fair value of the acquisition-related consideration for the deferred fixed purchase price and earnout payments subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the performance goals, will be recognized in earnings in the period the estimated fair value changes. The fair value of the acquisition-related consideration to be distributed directly to the eventIS and VividLogic selling shareholder is \$14.4 million.

### 4. Consolidated Balance Sheet Detail

Inventories consist of the following:

|                           | Year ended January 31, |           |
|---------------------------|------------------------|-----------|
|                           | 2011                   | 2010      |
|                           | (in thousands)         |           |
| Components and assemblies | \$ 8,158               | \$ 11,316 |

|                        |           |           |
|------------------------|-----------|-----------|
| Finished products      | 6,235     | 6,514     |
| Total inventories, net | \$ 14,393 | \$ 17,830 |

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Property and equipment, net consist of the following:

|   | Estimated<br>useful<br>life (years) | Year ended January 31,<br>2011                      2010<br>(in thousands) |           |
|---|-------------------------------------|--|-----------|
| Land  |                                     | \$ 4,285   | \$ 4,295  |
| Buildings   | 20                                  | 13,586   | 13,364    |
| Office furniture and equipment                              | 5                                   | 3,117  | 2,867     |
| Computer equipment, software and demonstration<br>equipment | 3                                   | 67,606   | 65,815    |
| Deployed assets   | 2-7                                 | 3,280  | 3,280     |
| Service and spare components                                | 5                                   | 8,912  | 8,731     |
| Leasehold improvements                                      | 1-7                                 | 3,383  | 2,629     |
| Automobiles and trucks                                      | 5                                   | 211  | 211       |
| Construction in progress                                    |                                     | 298  | 1,048     |
|   |                                     | 104,678  | 102,240   |
| Less - Accumulated depreciation and amortization            |                                     | (68,297 )  | (62,558 ) |
| Total property and equipment, net                           |                                     | \$ 36,381  | \$ 39,682 |

Depreciation and amortization expense of fixed assets was \$8.2 million, \$8.0 million and \$7.2 million for the years ended January 31, 2011, 2010 and 2009, respectively.

Other accrued expenses consist of the following:

|                                      | Year ended January 31,<br>2011                      2010<br>(in thousands) |           |
|--------------------------------------|--|-----------|
| Acquisition-related consideration    | \$ 3,179   | \$ 2,941  |
| Accrued compensation and commissions | 3,864  | 3,051     |
| Employee benefits                    | 668  | 585       |
| Accrued other                        | 8,817  | 4,597     |
| Total other accrued expenses         | \$ 16,528  | \$ 11,174 |

## 5. Investments in Affiliates

SeaChange periodically reviews indicators of the fair value of its investments in affiliate companies in order to assess whether available facts or circumstances, both internally and externally, may suggest an other than temporary decline in the fair value of the investment. There were no indications of other than temporary declines in the fair value of investments in affiliates as of January 31, 2011 and 2010, respectively. The Company's investments in affiliates under the cost method of accounting are as follows:

|               | Year ended January 31,<br>2011                      2010<br>(in thousands) |          |
|---------------|--|----------|
| Casa          | \$ -   | \$ 8,897 |
| Minerva       | 1,000  | 1,000    |
| Insite One    | -  | 2,748    |
| Visible World | 552  | 552      |



|                                 |          |           |
|---------------------------------|----------|-----------|
| Other investments               | 1,361    | 500       |
| Total investments in affiliates | \$ 2,913 | \$ 13,697 |

Casa Systems. On April 26, 2010, the Company sold its entire equity investment in Casa Systems, Inc., a Massachusetts company that specializes in video-on-demand products for the telecommunications and television markets, for \$34.1 million realizing a pre-tax profit of \$25.2 million. For fiscal 2011, 2010 and 2009, SeaChange purchased \$0, \$52,000 and \$98,000, respectively, of equipment from Casa Systems.

Minerva. SeaChange owns 1.3 million shares of preferred stock representing 2.8% of the total capital stock of Minerva Networks, Inc. ("Minerva"), a California based company specializing in software products for the telecommunications and television markets. The preferred shares are convertible to 1.3 million shares of common stock under certain conditions as defined in the Stock Purchase Agreement. SeaChange accounts for this investment under the cost method of accounting.

InSite One. In Q4 of FY11, SeaChange sold its entire equity investment in InSite One for \$4.6 million in cash realizing a pre-tax profit of \$1.9 million. For fiscal years 2011, 2010 and 2009 SeaChange recognized revenues of \$14,000, \$31,000 and \$164,000, respectively, from InSite One.

Visible World. SeaChange owns less than 5% of the common and preferred stock of Visible World and is accounting for this investment under the cost method of accounting. In fiscal 2004, SeaChange and Visible World signed a revised Marketing Agreement in which SeaChange agreed to receive warrants to purchase 2.8 million shares of preferred stock of Visible World in lieu of future royalties that would have been earned by SeaChange relating to revenue earned by Visible World in accordance with an agreement between Visible World and Comcast Cable Corporation ("Comcast"). The warrants vested over the five year term of the agreement between Visible World and Comcast and ended in fiscal year 2009. SeaChange estimated the fair value of these warrants to be \$223,000 and included the amount in investments in affiliates with an offsetting amount included in deferred revenue. SeaChange recognized the deferred revenue over a five year period, the term of the agreement ending in fiscal year 2009. For fiscal years 2011, 2010 and 2009, SeaChange recognized revenues of approximately \$532,000, \$641,000 and \$703,000 respectively, from Visible World.

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

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

expected five year life of the customer contracts and recorded as a gain and an increase in the investment in the joint venture. ODG recorded an income tax provision during fiscal 2008 of \$1.1 million for the taxable gain recognized by ODG related to the \$2.6 million contribution of customer contracts and content licenses to and the reimbursement of previously paid costs from the joint venture.

ODG entered into a Service Agreement with the joint venture whereby ODG provides content aggregation, distribution, marketing and administration services to the joint venture under an arm's length fee structure. For the years ended January 31, 2011, 2010 and 2009, ODG recorded revenues of \$1.9 million, \$1.8 million, and \$1.5, respectively, related to the Service Agreement. ODG's share of profits from this agreement in proportion to its equity ownership interest is eliminated in consolidation.

The Shareholder's Agreement requires both ODG and TMG to provide cash contributions up to \$4.2 million upon the request of the joint venture's management and approval by the shareholders of the joint venture. Through the year ended January 31, 2011, ODG and TMG each made additional cash contributions of \$1.6 million to the joint venture.

ODG recorded its proportionate share of the joint venture's losses of \$36,000 for the fiscal year ended January 31, 2011 and losses for the fiscal years ended January 31, 2010 and 2009 of \$653,000 and \$770,000, respectively. Due to the capital distribution and ODG's share of the joint venture's net loss exceeding the book value of its investment in the joint venture, the investment is recorded as a long-term liability of \$1.2 million and \$1.5 million at January 31, 2011 and 2010, respectively.

## 6. Acquisitions

### eventIS Group B.V.

On September 1, 2009, the Company acquired the entire share capital of eventIS Group B.V. ("eventIS") based in Eindhoven, the Netherlands, which provides video on demand and linear broadcast software and related services to cable television and telecommunications companies primarily in Europe. The results of eventIS's operations have been included in the consolidated financial statements since the acquisition date. The Company acquired eventIS to expand its VOD solutions into the European market.

### Fair Value of Consideration Transferred

The Company has made cash payments to the former shareholder of eventIS under the eventIS Share Purchase Agreement of \$36.7 million plus \$2.2 million based on an estimated working capital adjustment in accordance with the eventIS Share Purchase Agreement.

On September 1, 2010, the Company paid approximately \$1.8 million and issued 75,018 shares (approximate value \$615,000) of restricted stock that will vest annually over three years. The former shareholders of eventIS elected to receive the balance of the Restricted Stock consideration due in cash in the amount of approximately \$410,000, which will be paid out in equal installments on September 1, 2011, 2012, and 2013. The Company is obligated to make additional fixed payments on September 1, 2011 and 2012, each in an aggregate amount of \$2.8 million with \$1.7 million payable in cash and \$1.1 million payable by the issuance of restricted shares of SeaChange common stock, which will vest in equal installments over three years starting on the first anniversary of the date of issuance. Under the earn-out provisions of the share purchase agreement a payment of \$340,000 for fiscal 2011 will be paid in the first quarter fiscal 2012. Additional earn-out payments may be earned over each of the next two years ended January 31, 2012 and 2013 if certain performance goals are met.

### Allocation of Consideration Transferred

The identifiable assets acquired and liabilities assumed in the eventIS acquisition were recognized and measured as of the acquisition date, September 1, 2009, based on their estimated fair values. The excess of the acquisition date fair value of consideration transferred over the fair value of the net tangible assets and intangible assets acquired was recorded as goodwill.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the eventIS acquisition date.

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## Consideration:

|  | (in<br>thousands) |
|--|-------------------|
| Payment of cash to eventIS shareholders    | \$ 36,631         |
| Acquisition-related deferred consideration | 10,098            |
| Total acquisition-date fair value          | \$ 46,729         |

|  | (in<br>thousands) |
|--|-------------------|
| Cash and cash equivalents              | \$ 4,374          |
| Accounts receivable                    | 4,237             |
| Inventory                              | 98                |
| Other tangible assets                  | 695               |
| Intangible assets                      | 23,833            |
| Total identifiable assets acquired     | 33,237            |
| Accounts payable and other liabilities | (2,069 )          |
| Deferred taxes                         | (4,495 )          |
| Deferred revenue                       | (6,207 )          |
| Total liabilities assumed              | (12,771 )         |
| Goodwill                               | 26,263            |
| Net assets acquired                    | \$ 46,729         |

## Intangible Assets

In determining the fair value of the intangible assets, the Company considered, among other factors, the intended use of acquired assets, analyses of historical financial performance and estimates of future performance of eventIS's products. The fair values of identified intangible assets were calculated using an income approach based on estimates and assumptions provided by eventIS's and the Company's management. The rates utilized to discount net cash flows to their present values were based on a weighted average cost of capital of 17%. This discount rate was determined after consideration of the rate of return on debt capital and equity that typical investors would require in an investment in companies similar in size and operating in similar markets as eventIS. The following table sets forth the components of identified intangible assets associated with the eventIS acquisition and their estimated useful lives:

|                                     | Useful life | Fair Value<br>(in thousands) |
|-------------------------------------|-------------|------------------------------|
| Existing technology                 | 3-9 years   | \$ 6,748                     |
| In process research and development | indefinite  | 574                          |
| Non-compete agreements              | 3 years     | 2,153                        |
| Customer contracts                  | 10 years    | 13,927                       |
| Trademarks                          | 4 years     | 431                          |
| Total intangible assets             |             | \$ 23,833                    |

SeaChange determined the useful life of intangible assets based on the expected future cash flows associated with the respective asset. Existing technology is comprised of products that have reached technological feasibility and are part of eventIS's product line. In-process research and development assets as of the acquisition date of \$574,000 were recorded as indefinite-lived intangible assets and will be subject to impairment testing at least annually. The useful life of the intangible asset recognized will be reconsidered if and when in-process research and development projects are completed or abandoned. Customer contracts represent the underlying relationships and agreements with eventIS's installed customer base. Trademarks represent the fair value of the brand and name recognition associated with the

marketing of eventIS's products and services. Non-compete agreements represent the fair value of the non-compete with the former shareholders and key employees and will be amortized over the term of the agreement. Amortization of existing technology is included in cost of product revenue, and amortization expense for customer relationships and trademarks is included in operating expenses.

## Goodwill

Of the total eventIS purchase price of \$46.7 million, \$26.3 million was allocated to goodwill. Goodwill represents the excess of the purchase price of an acquired business over the fair value of the underlying net tangible and intangible assets. SeaChange determined that the goodwill included the value of the eventIS work force and expected synergies in global sales and marketing, especially within the European market, and in the deployment of VOD systems. SeaChange considers the acquired business an addition to the Company's Software reporting segment. The Company made this determination based upon the financial information provided and reviewed by our Chief Executive Officer (the chief operating decision maker) and the similar economic characteristics to our other products in our Software segment. None of the goodwill associated with the eventIS acquisition is deductible for income tax purposes.

## Deferred Revenue

In connection with the allocation of consideration transferred, SeaChange recorded the fair value of the customer contract obligations assumed from eventIS. The fair value of the customer contract obligations was determined using a cost build-up approach. The cost build-up approach determines fair value by estimating the costs relating to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that SeaChange would be required to pay a third party to assume the service obligations. The costs to fulfill the service obligations were based on the historical direct costs and indirect costs related to eventIS's contracts with its customers. Direct costs include personnel directly engaged in providing service and support activities, while indirect costs consist of estimated general and administrative expenses based on normalized levels as a percentage of revenue. Profit associated with selling efforts was excluded because eventIS had concluded the selling efforts on the service contracts prior to the date of the Company's acquisition. The research and development costs associated with the customer contracts have been included in the fair value determination, as these costs were deemed to represent a legal obligation to the customers at the time of acquisition. SeaChange recorded \$6.2 million of deferred revenue to reflect the fair value of eventIS's service obligations assumed.

## Acquisition-related Consideration

A liability was recognized for the acquisition date fair value of the acquisition-related consideration for the deferred fixed purchase price, and the estimated earnout payments and working capital adjustments. Any change in the fair value of the acquisition-related consideration subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the meeting of performance goals, will be recognized in earnings in the period the estimated fair value changes. The fair value estimate is based on the probability weighted bookings to be achieved over the earnout period. A change in fair value of the acquisition-related consideration could have a material effect on the statement of operations and financial position in the period of the change in estimate.

The fair value of the acquisition-related consideration to be distributed directly to the eventIS selling shareholder was estimated by the Company at the acquisition date to be \$10.1 million on September 1, 2009.

## VividLogic, Inc.

On February 1, 2010, the Company completed its acquisition of VividLogic, Inc. ("VividLogic"). VividLogic, based in Fremont, California provides in-home infrastructure software for high definition televisions, home gateways, and set-top boxes to cable television service providers, set-top box manufacturers and consumer electronics (CE) suppliers. The Company acquired VividLogic to expand its in-home solutions. The results of VividLogic's operations have been included in the consolidated financial statements since the acquisition date.

## Fair Value of Consideration Transferred



The Company has made cash payments totaling \$18.5 million. In addition, \$3.0 million was paid on February 1, 2011.

The Company is obligated to make additional fixed payments of \$1.0 million in cash on February 1, 2012 and 2013. In addition, under the share purchase agreement with the former shareholders of VividLogic the Company will make an earnout payment of \$257,000 in the first quarter of fiscal 2012. Additional earn-out payments may be earned over each of the next two years ended January 31, 2012 and 2013 if certain performance goals are met.

## Allocation of Consideration Transferred

The identifiable assets acquired and liabilities assumed in the VividLogic acquisition were recognized and measured as of the acquisition date, February 1, 2010, based on their estimated fair values. The excess of the acquisition date fair value of consideration transferred over the estimated fair value of the net tangible assets and intangible assets acquired was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the VividLogic acquisition date.

|  | February 1, 2010<br>(in thousands) |
|--|------------------------------------|
| Payment of cash to VividLogic shareholders | \$ 15,470                          |
| Acquisition-related deferred consideration | 8,388                              |
| Total acquisition-date fair value          | \$ 23,858                          |
| Cash and cash equivalents                  | \$ 5,932                           |
| Accounts receivable                        | 2,917                              |
| Other assets                               | 1,739                              |
| Deferred tax assets                        | 1,250                              |
| Intangible assets                          | 9,900                              |
| Total identifiable assets acquired         | 21,738                             |
| Accounts payable and other liabilities     | (1,740 )                           |
| Deferred tax liabilities                   | (3,665 )                           |
| Deferred revenue                           | (2,500 )                           |
| Total liabilities assumed                  | (7,905 )                           |
| Goodwill                                   | 10,025                             |
| Net assets acquired                        | \$ 23,858                          |

## Intangible Assets

In determining the fair value of the intangible assets, the Company considered, among other factors, the intended use of acquired assets, analyses of historical financial performance, and estimates of future performance of VividLogic's products. The fair values of identified intangible assets were calculated using an income approach based on estimates and assumptions provided by VividLogic's and the Company's management. The following table sets forth the components of identified intangible assets associated with the VividLogic acquisition and their estimated useful lives:

|                         | Useful life | Fair Value<br>(in thousands) |
|-------------------------|-------------|------------------------------|
| Existing technology     | 5-9 years   | \$ 2,200                     |
| Non-compete agreements  | 5 years     | 700                          |
| Customer contracts      | 9 years     | 6,200                        |
| Trade name              | indefinite  | 200                          |
| Backlog                 | 1 year      | 600                          |
| Total intangible assets |             | \$ 9,900                     |



SeaChange determined the useful life of intangible assets based on the expected future cash flows associated with the respective asset. Existing technology is comprised of products that have reached technological feasibility and are part of VividLogic's product line. Non-compete agreements represent the fair value of the non-compete with the former shareholders and key employees and will be amortized over the respective terms of the agreements. Customer contracts represent the underlying relationships and agreements with VividLogic's installed customer base. Trade name represents the value of the VividLogic name. Backlog represents the discounted value of the orders received from customers but unfulfilled. Amortization of existing technology is included in cost of product revenue, and amortization expense for customer relationships, non-compete and backlog are included in operating expenses. The weighted average life of the remaining amortization expense is approximately eight years.

#### Goodwill

Of the total VividLogic purchase price of \$23.9 million, \$10.0 million was allocated to goodwill. Goodwill represents the excess of the purchase price of an acquired business over the fair value of the underlying net tangible and intangible assets. SeaChange determined that the goodwill included the value of VividLogic's work force and expected synergies in global sales and marketing. SeaChange considers the acquired business an addition to the Company's Software reporting segment. The Company made this determination based upon the financial information provided and reviewed by our Chief Executive Officer (the chief operating decision maker) and the similar economic characteristics to our other products in our Software segment. None of the goodwill associated with the VividLogic acquisition is deductible for income tax purposes.

#### Deferred Revenue

In connection with the allocation of consideration transferred, SeaChange recorded the fair value of the customer contract obligations assumed from VividLogic. The fair value of the customer contract obligations was determined using a cost build-up approach. The cost build-up approach determines fair value by estimating the costs relating to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that SeaChange would be required to pay a third party to assume the service obligations. The estimated costs to fulfill the service obligations were based on the historical direct costs and indirect costs related to VividLogic's contracts with its customers. Direct costs include personnel directly engaged in providing service and support activities, while indirect costs consist of estimated general and administrative expenses based on normalized levels as a percentage of revenue. Profit associated with selling efforts was excluded because VividLogic had concluded the selling efforts on the service contracts prior to the date of the Company's acquisition. The research and development costs associated with the customer contracts have been included in the fair value determination, as these costs were deemed to represent a legal obligation to the customers at the time of acquisition. SeaChange recorded \$2.5 million of deferred revenue as of the acquisition date to reflect the fair value of VividLogic's service obligations assumed.

#### Acquisition-related Consideration

A liability was recognized for the acquisition date fair value of the acquisition-related consideration for the deferred fixed purchase price, the estimated earnout payments and working capital adjustments. Any change in the fair value of the acquisition-related consideration subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the meeting of performance goals, will be recognized in earnings in the period the estimated fair value changes. The fair value estimate for the earnout payment was estimated at \$700,000 and is based on the probability weighted bookings to be achieved over the earnout period. A change in fair value of the acquisition-related consideration could have a material effect on the statement of operations and financial position in the period of the change in estimate. The fair value of the acquisition-related consideration to be distributed directly to the VividLogic shareholders was estimated by the Company at the acquisition date to be \$8.4 million.

#### Acquisition-related Costs

SeaChange recorded transaction costs such as legal, accounting, valuation and other professional services of \$831,000 for the year ended January 31, 2011 and \$341,000 for the year ended January 31, 2010. The transaction costs were expensed and recorded in general and administrative expenses in the Consolidated Statement of Operations. During the year ended January 31, 2011, the Company recorded \$204,000 of interest expense in the Consolidated Statement of Operations for the change in fair value of the acquisition-related contingencies.

## 7. Goodwill and Intangible Assets

At January 31, 2011 and 2010, the Company had goodwill of \$65.3 million and \$55.9 million, respectively. The change in the carrying amount of goodwill for the years ended January 31, 2011 and 2010 are as follows:

|                                   | Software | Servers &<br>Storage | Media Services | Total    |
|-----------------------------------|----------|----------------------|----------------|----------|
| Balance at January 31, 2009       | \$10,162 | \$754                | \$ 16,506      | \$27,422 |
| Mobix consideration payments      | -        | -                    | 2,478          | \$2,478  |
| Revaluation of Mobix intangibles  | -        | -                    | (1,387 )       | (1,387 ) |
| eventIS acquisition               | 26,263   | -                    | -              | 26,263   |
| Cumulative translation adjustment | (889 )   | -                    | 1,989          | 1,100    |
| Balance at January 31, 2010       | 35,536   | 754                  | 19,586         | 55,876   |
| VividLogic acquisition            | 10,025   | -                    | -              | 10,025   |
| Cumulative translation adjustment | (464 )   | -                    | (164 )         | (628 )   |
| Balance at January 31, 2011       | \$45,097 | \$754                | \$ 19,422      | \$65,273 |

As of August 1, 2010, SeaChange reviewed the recoverability of goodwill associated with its three reporting units, Software, Servers and Storage and Media Services, and determined that there was no goodwill impairment. During the fourth quarter of fiscal 2011, the Company evaluated the impairment analysis and updated for the change in its estimates from August 1, 2010 to January 31, 2011. While no impairment charges resulted from the analyses performed during the fourth quarter of fiscal 2011, impairment charges may occur in the future due to changes in projected revenue growth rates, projected operating margins or estimated discount rates, among other factors. The Company's projections used to evaluate goodwill as of August 1, 2010 have included changes to revenue and operating expense resulting from the restructuring plan that occurred during the third quarter of fiscal 2011. (see Note 8)

At January 31, 2011 and 2010, the Company had recorded net intangible assets of \$30.3 million and \$26.3 million respectively, consisting of patents, customer contracts, non-compete agreements, completed technology, in-process research and development and trademarks.

Intangible assets, net, consisted of the following:

|  | Weighted average<br>remaining life<br>(Years) | January 31, 2011 |   |           | January 31, 2010 |   |           |
|--|---|------------------|---|-----------|------------------|---|-----------|
|  |   | Gross            | Accumulated<br>Amortization<br>(in thousands) | Net       | Gross            | Accumulated<br>Amortization<br>(in thousands) | Net       |
| <b>Finite-lived intangible assets:</b> |   |                  |   |           |                  |   |           |
| Customer contracts                     | 7.2   | \$ 34,576        | \$ (14,291 )                                  | \$ 20,285 | \$ 28,643        | \$ (11,984 )                                  | \$ 16,659 |
| Non-compete agreements                 | 2.0   | 2,742            | (1,104 )                                      | 1,638     | 2,487            | (290 )  | 2,197     |
| Completed technology                   | 5.1   | 11,976           | (4,775 )                                      | 7,201     | 9,904            | (3,250 )                                      | 6,654     |
| Trademarks and other                   | 0.8   | 2,384            | (1,946 )                                      | 438       | 1,391            | (1,191 )                                      | 200       |

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|  |          |           |             |           |           |             |           |
|--|----------|-----------|-------------|-----------|-----------|-------------|-----------|
| Total finite-lived intangible assets   |          | \$ 51,678 | \$ (22,116) | \$ 29,562 | \$ 42,425 | \$ (16,715) | \$ 25,710 |
| Infinite-lived intangible assets:      |          |           |             |           |           |             |           |
| Trade names                            | Infinite | \$ 200    | \$ -        | \$ 200    | \$ -      | \$ -        | \$ -      |
| In-process research and development    | Infinite | 544       | -           | 544       | 554       | -           | 554       |
| Total infinite-lived intangible assets |          | \$ 744    | \$ -        | \$ 744    | \$ 554    | \$ -        | \$ 554    |
| Total intangible assets                |          | \$ 52,422 | \$ (22,116) | \$ 30,306 | \$ 42,979 | \$ (16,715) | \$ 26,264 |

Estimated useful lives and the amortization basis for the intangible assets are as follows:

|                        | Estimated Useful Life and Amortization Basis      |
|------------------------|---|
| Customer contracts     | 1 - 8 years using economic consumption life basis |
| Non compete agreements | 2 - 3 years economic life of the agreement        |
| Completed technology   | 4 - 6 years using economic consumption life basis |
| Trademarks and other   | 5 years using economic consumption life basis     |
| In-process R & D       | indefinite life                                   |
| Trade names            | indefinite life                                   |

Amortization expense for intangible assets was \$5.4 million, \$3.5 million and \$2.0 million for the years ended January 31, 2011, 2010 and 2009, respectively. In the years ended January 31, 2011, 2010 and 2009, \$2.0 million, \$638,000, and \$450,000, respectively, were charged to cost of product revenues. In the years ended January 31, 2011, 2010 and 2009, \$3.4 million, \$2.8 million and \$1.6 million, respectively, were charged to operating expense. The total amortization expense for each of the next five fiscal years is as follows:

|                            | Amortization Expense<br>(in thousands) |
|----------------------------|--|
| Fiscal 2012                | \$ 4,892                               |
| Fiscal 2013                | 4,570                                  |
| Fiscal 2014                | 3,654                                  |
| Fiscal 2015                | 3,507                                  |
| Fiscal 2016 and thereafter | 12,939                                 |
| Total Future Amortization  | \$ 29,562                              |

Actual amounts may change from such estimated amounts due to fluctuations in foreign currency exchange rates, additional intangible asset acquisitions, potential impairment, accelerated amortization, or other events.

## 8. Restructuring

During the fiscal year ended January 31, 2011, the Company lowered its cost structure as it strives to improve its financial performance. The fiscal year ended January 31, 2011 included restructuring charges to its income statement totaling \$7.0 million for severance costs related to the termination of 110 employees, a write down of inventory of \$2.5 million related to the decision to discontinue certain products within the Servers and Storage segment, and a charge for the disposal of fixed assets totaling \$1.3 million as a direct result of the restructuring plan.

The severance amounts reported as a component of accrued liabilities on the Balance Sheet as of January 31, 2011 were as follows:

| (in thousands)                         | Severance |
|--|-----------|
| Accrual balance as of January 31, 2010 | \$ -      |
| Amount charged to expense              | 3,241     |
| Severance costs paid                   | (2,833 )  |
| Accrual balance as of January 31, 2011 | \$ 408    |



9. Lines of Credit

The Company maintains a revolving line of credit with RBS Citizens (a subsidiary of the Royal Bank of Scotland Group plc) for \$20.0 million which expires on October 31, 2012. Loans made under this revolving line of credit bear interest at a rate per annum equal to the bank's prime rate. Borrowings under this line of credit are collateralized by substantially all of the Company's assets. The loan agreement requires SeaChange to comply with certain financial covenants. As of January 31, 2011, we were in compliance with the financial covenants and there were no amounts outstanding under the revolving line of credit.

We are occasionally required to post letters of credit, issued by a financial institution, to secure certain sales contracts. Letters of credit generally authorize the financial institution to make a payment to the beneficiary upon the satisfaction of a certain event or the failure to satisfy an obligation. The letters of credit are generally posted for one-year terms and are usually automatically renewed upon maturity until such time as we have satisfied the commitment secured by the letter of credit. We are obligated to reimburse the issuer only if the beneficiary collects on the letter of credit. We believe that it is unlikely we will be required to fund a claim under our outstanding letters of credit. As of January 31, 2011 the full amount of the letters of credit of \$1.5 million was supported by our credit facility.

## 10. Commitments and Contingencies

SeaChange leases certain of its operating facilities, automobiles and office equipment under non-cancelable operating leases, which expire at various dates through 2015. Rental expense under operating leases was \$3.2 million, \$2.6 million and \$3.7 million for the years ended January 31, 2011, 2010 and 2009, respectively. Future commitments under minimum lease payments as of January 31, 2011 are as follows:

|                                    | Operating<br>Leases<br>(in<br>thousands) |
|------------------------------------|--|
| Fiscal Year ended January 31, 2012 | \$ 2,943                                 |
| 2013                               | 1,359                                    |
| 2014                               | 787                                      |
| 2015                               | 726                                      |
| 2016 and thereafter                | 688                                      |
| Minimum lease payments             | \$ 6,503                                 |

SeaChange has non-cancelable purchase commitments for its inventories of approximately \$2.9 million at January 31, 2011 and studio content commitments of \$12.3 million at January 31, 2011.

### ARRIS Litigation

On July 31, 2009, ARRIS Group, Inc. (“ARRIS”) filed a contempt motion in the U.S. District Court for the District of Delaware against SeaChange International relating to U.S. Patent No 5,805,804 (the “804 patent”), a patent in which ARRIS has an ownership interest. In its motion, ARRIS is seeking further patent royalties and the enforcement of the permanent injunction entered by the Court on April 6, 2006 against certain SeaChange products. On August 3, 2009, SeaChange filed a complaint seeking a declaratory judgment from the Court that its products do not infringe the ‘804 patent and asserting certain equitable defenses. Discovery and briefing on the ARRIS contempt motion are expected to be completed on April 18, 2011. SeaChange changed the product that was the subject of the first patent lawsuit regarding the ‘804 patent to specifically avoid any further claims of alleged infringement under the ‘804 patent. In addition, on March 15, 2007 SeaChange petitioned the U.S. Patent and Trademark Office to re-examine the ‘804 patent in view of the claim construction that was given in the prior trial regarding the ‘804 patent. As a result of the re-examination, the patent examiner cancelled the first three claims of the ‘804 patent. SeaChange believes that ARRIS’s contempt motion is without merit, and that SeaChange’s products do not infringe the ‘804 patent.

### Guarantees, Indemnification and Warranties

SeaChange provides indemnification, to the extent permitted by law, to its officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee, or agent is or was serving at SeaChange’s request in such capacity. With respect to acquisitions, SeaChange provides indemnification to

or assumes indemnification obligations for the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' bylaws and charter. As a matter of practice, SeaChange has maintained directors' and officers' liability insurance including coverage for directors and officers of acquired companies.

SeaChange enters into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require SeaChange to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to SeaChange's products. From time to time, SeaChange also indemnifies customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of SeaChange's products and services or resulting from the acts or omissions of SeaChange, its employees, authorized agents or subcontractors. For example, SeaChange has received requests from several of its customers for indemnification of patent litigation claims asserted by Acacia Media Technologies, USA Video Technology Corporation and VTran Media Technologies. Management performed an analysis of these requests under authoritative guidance regarding accounting for contingencies.

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

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

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

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

## 11. Stockholders' Equity

### Stock Authorization

The Board of Directors is authorized to issue from time to time up to an aggregate of 5,000,000 shares of preferred stock, in one or more series. Each such series of preferred stock shall have the number of shares, designations, preferences, voting powers, qualifications and special or relative rights or privileges to be determined by the Board of Directors, including dividend rights, voting rights, redemption rights and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights.



### Stock Repurchase Program

On March 11, 2009, the Board of Directors authorized the repurchase of up to \$20 million of its common stock through a share repurchase program, which expired on January 31, 2010. During fiscal 2010, 473,415 shares of our common stock were purchased for \$2.8 million at an average price of \$5.85 as part of this repurchase program.

On May 26, 2010, SeaChange's Board of Directors authorized the repurchase of up to \$20.0 million of its common stock, par value \$.01 per share, through a share repurchase program. The repurchase program will terminate on January 31, 2012. During the year ended January 31, 2011, the Company repurchased approximately 178,000 shares at a cost of \$1.4 million at an average purchase price \$8.05. During fiscal 2011, there were 1,484,617 treasury shares retired.

### 12. Segment Information

The Company is managed and operated as three segments; Software, Servers and Storage, and Media Services, as segments defined by authoritative guidance. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company's Advertising, VOD, Middleware and Broadcast software solutions, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing and amortization of intangibles. The Software segment includes the results of eventIS Group B.V. as of September 1, 2009 and VividLogic as of February 1, 2010.
- Servers and Storage segment includes product revenues from the VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.
- Media Services segment includes the operations of ODG, including Mobix Interactive, activities which include content acquisition and preparation services for television and wireless service providers and related operating expenses.

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

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

The following summarizes the income (loss) from operations by reportable operating segment:

|                                      | Year ended January 31, |           |           |
|--------------------------------------|------------------------|-----------|-----------|
|                                      | 2011<br>(in thousands) | 2010      | 2009      |
| <b>Software</b>                      |                        |           |           |
| Revenue:                             |                        |           |           |
| Products                             | \$ 73,626              | \$ 66,968 | \$ 78,397 |
| Services                             | 82,984                 | 64,346    | 53,840    |
| Total revenue                        | 156,610                | 131,314   | 132,237   |
| Gross profit                         | 87,992                 | 79,543    | 76,087    |
| Operating expenses:                  |                        |           |           |
| Research and development             | 38,286                 | 39,592    | 33,373    |
| Selling and marketing                | 17,807                 | 16,624    | 16,417    |
| General and administrative           | 1,465                  | 502       | -         |
| Amortization of intangibles          | 3,073                  | 2,246     | 1,456     |
| Restructuring                        | 905                    | -         | -         |
| Total operating expenses             | 61,536                 | 58,964    | 51,246    |
| Income from operations               | \$ 26,456              | \$ 20,579 | \$ 24,841 |
| <b>Servers and Storage</b>           |                        |           |           |
| Revenue:                             |                        |           |           |
| Products                             | \$ 18,053              | \$ 34,974 | \$ 38,975 |
| Services                             | 14,033                 | 15,583    | 14,665    |
| Total revenue                        | 32,086                 | 50,557    | 53,640    |
| Gross profit                         | 15,966                 | 20,426    | 24,865    |
| Operating expenses:                  |                        |           |           |
| Research and development             | 10,117                 | 11,072    | 9,669     |
| Selling and marketing                | 6,699                  | 9,218     | 11,025    |
| Restructuring                        | 5,180                  | -         | -         |
| Total operating expenses             | 21,996                 | 20,290    | 20,694    |
| (Loss) income from operations        | \$ (6,030 )            | \$ 136    | \$ 4,171  |
| <b>Media Services</b>                |                        |           |           |
| Service revenue                      | \$ 28,031              | \$ 19,794 | \$ 15,959 |
| Gross profit                         | 4,791                  | 3,284     | 2,344     |
| Operating expenses:                  |                        |           |           |
| Selling and marketing                | -                      | -         | 64        |
| General and administrative           | 4,026                  | 3,015     | 3,049     |
| Amortization of intangibles          | 286                    | 580       | 119       |
| Total operating expenses             | 4,312                  | 3,595     | 3,232     |
| Income (loss) from operations        | \$ 479                 | \$ (311 ) | \$ (888 ) |
| <b>Unallocated Corporate</b>         |                        |           |           |
| Operating expenses:                  |                        |           |           |
| General and administrative           | \$ 18,837              | \$ 18,202 | \$ 17,930 |
| Restructuring                        | 912                    | -         | -         |
| Total unallocated corporate expenses | \$ 19,749              | \$ 18,202 | \$ 17,930 |

|                                     |          |          |           |
|-------------------------------------|----------|----------|-----------|
| Consolidated income from operations | \$ 1,156 | \$ 2,202 | \$ 10,194 |
|-------------------------------------|----------|----------|-----------|



The following summarizes revenues by customers' geographic locations. Certain reclassifications have been made to conform prior period amounts to current period presentation, including the reclassification of revenue originated in Canada from Latin American to North American revenue:

|   | 2011                               |      | Year ended January 31, |      |            |      | 2009   |   |
|---|------------------------------------|------|------------------------|------|------------|------|--------|---|
|   | Amount                             | %    | Amount                 | %    | Amount     | %    | Amount | % |
|   | (in thousands, except percentages) |      |                        |      |            |      |        |   |
| <b>Revenues by customers' geographic locations:</b> |                                    |      |                        |      |            |      |        |   |
| North America                                       | \$ 123,252                         | 57 % | \$ 133,947             | 66 % | \$ 139,457 | 69 % |        |   |
| Europe and Middle East                              | 67,543                             | 31 % | 45,787                 | 23 % | 44,059     | 22 % |        |   |
| Asia Pacific and other international locations      | 11,026                             | 5 %  | 8,456                  | 4 %  | 14,165     | 7 %  |        |   |
| Latin America                                       | 14,906                             | 7 %  | 13,475                 | 7 %  | 4,155      | 2 %  |        |   |
| Total revenues                                      | \$ 216,727                         |      | \$ 201,665             |      | \$ 201,836 |      |        |   |

Total revenues for the United States for the years ended January 31, 2011, 2010, and 2009, were \$113.0 million, \$130.1 million, and \$130.2 million, respectively.

The following summarizes fixed assets, net by geographic locations:

|   | 2011                               |      | Year ended January 31, |      | 2010   |   |
|---|------------------------------------|------|------------------------|------|--------|---|
|   | Amount                             | %    | Amount                 | %    | Amount | % |
|   | (in thousands, except percentages) |      |                        |      |        |   |
| <b>Fixed assets, net by geographic locations:</b> |                                    |      |                        |      |        |   |
| North America                                     | \$ 20,507                          | 57 % | \$ 24,058              | 61 % |        |   |
| United Kingdom                                    | 10,250                             | 28 % | 10,700                 | 27 % |        |   |
| Europe (excluding UK) and Middle East             | 865                                | 2 %  | 580                    | 1 %  |        |   |
| Asia Pacific and other international locations    | 4,759                              | 13 % | 4,344                  | 11 % |        |   |
| Total   | \$ 36,381                          |      | \$ 39,682              |      |        |   |

### 13. Stock-Based Compensation and Stock Incentive Plans

SeaChange uses on a modified prospective basis, the provisions of the authoritative guidance which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options, restricted stock units and, prior to its termination, employee stock purchases related to the Employee Stock Purchase Plan ("ESPP") based on estimated fair values. The fair value of SeaChange's stock-based options and performance-based restricted stock units, less expected forfeitures, is amortized over the awards' vesting period on a graded vesting basis, whereas the restricted stock units and Employee Stock Purchase Plan stock units are amortized on a straight line basis. SeaChange has applied the provisions of authoritative guidance allowing the use of a "simplified" method, in developing an estimate of the expected term of "plain vanilla" share options.

Stock-based compensation includes expense charges for all stock-based awards to employees and directors. Such awards include option grants, restricted stock unit awards, and, prior to its termination, shares expected to be purchased under an employee stock purchase plan. The estimated fair value of SeaChange's stock-based options and

performance-based restricted stock units, less expected forfeitures, is amortized over the awards' vesting period on a graded vesting basis, whereas the restricted stock units and ESPP stock units are amortized on a straight line basis.

The effect of recording stock-based compensation was as follows:

|  | 2011     | Year ended January 31, |          |
|--|----------|------------------------|----------|
|  |          | 2010                   | 2009     |
|  |          | (in thousands)         |          |
| Stock-based compensation expense by type of award: |          |                        |          |
| Stock options                                      | \$ (60 ) | \$ 94                  | \$ 304   |
| Restricted stock units                             | 766      | 639                    | 996      |
| Performance-based restricted stock units           | 2,107    | 1,628                  | 2,061    |
| Employee stock purchase plan                       | 144      | 744                    | 593      |
| Total stock-based compensation                     | \$ 2,957 | \$ 3,105               | \$ 3,954 |

Since additional option grants and restricted stock unit awards are expected to be made each year and options and awards vest over several years, the effects of applying authoritative guidance for recording stock-based compensation for the year ended January 31, 2011 are not indicative of future amounts.

#### Determining Fair Value

SeaChange records the fair value of stock options, including rights granted under the ESPP prior to its termination, using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price, the expected option term, the risk-free interest rate over the option's expected term, the expected annual dividend yield and the expected stock price volatility. The expected option term was determined using the "simplified" method for "plain vanilla" options. The expected stock price volatility was established using a blended volatility, which is an average of the historical volatility of SeaChange's common stock over a period of time equal to the expected term of the stock option, and the average volatility of SeaChange's common stock over the most recent one-year and two-year periods.

The fair value of stock options granted was estimated at the date of grant using the following assumptions:

|                                | Year ended January 31, |      |           |
|--------------------------------|------------------------|------|-----------|
|                                | 2011                   | 2010 | 2009      |
| Expected term (in years)       | 4-5                    | 4-5  | 4-5       |
| Expected volatility (range)    | 51%-53%                | 61%  | 52%-56%   |
| Weighted average volatility    | 53%                    | 61%  | 52%       |
| Risk-free interest rate        | 1.5%-1.6%              | 12%  | 2.6%-2.9% |
| Weighted average interest rate | 1.6%                   | 1.2% | 2.9%      |
| Expected dividend yield        | 0%                     | 0%   | 0%        |

The fair value of ESPP stock granted was estimated at the date of grant using following assumptions:

|  | Year ended January 31, |      |      |
|--|------------------------|------|------|
|  | 2011                   | 2010 | 2009 |
|  | 0.5                    | 0.5  | 0.5  |

|                                |     |   |     |   |     |   |
|--------------------------------|-----|---|-----|---|-----|---|
| Expected term (in years)       |     |   |     |   |     |   |
| Weighted average volatility    | 48  | % | 71  | % | 61  | % |
| Weighted average interest rate | 0.1 | % | 0.3 | % | 2.8 | % |
| Expected dividend yield        | 0   | % | 0   | % | 0   | % |

## Stock Option Plans

## Amended and Restated 2005 Equity Compensation and Incentive Plan

The Amended and Restated 2005 Equity Compensation and Incentive Plan (the “2005 Plan”) provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units, and “other” non-stock option awards as determined by the plan administrator for the purchase of up to an aggregate of 2,800,000 shares of SeaChange’s common stock by officers, employees, consultants and directors of SeaChange. The Company may satisfy awards upon the exercise of stock options or restricted stock units with either newly issued shares. The Board of Directors is responsible for the administration of the 2005 Plan and determining the term of each award, award exercise price, number of shares for which each award is granted and the rate at which each award is exercisable. As of January 31, 2011, there were 603,719 shares available for future grant of which 87,995 RSUs were available.

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 (not less than 110% for an incentive stock option granted to a 10% or more stockholder). Incentive stock options may be granted only to those employees of SeaChange to the extent that the fair value of the options granted that become exercisable during any one calendar year plus previously granted incentive stock options that become exercisable in that period is less than \$100,000. Restricted stock units and other equity-based non-stock option awards may be granted to any officer, employee, director or consultant at a purchase price per share as determined by the Board of Directors. Awards granted under the 2005 Plan generally vest over three years and expire seven years from the date of the grant (five years for incentive stock options granted to holders of more than 10% of SeaChange’s voting stock).

The following table summarizes the stock option activity (excluding restricted stock units):

|  | Year ended January 31, |                                 |            |                                 |            |                                 |
|--|------------------------|---------------------------------|------------|---------------------------------|------------|---------------------------------|
|  | 2011                   |                                 | 2010       |                                 | 2009       |                                 |
|  | Shares                 | Weighted average exercise price | Shares     | Weighted average exercise price | Shares     | Weighted average exercise price |
| Outstanding at beginning of period                     | 3,934,973              | \$ 15.41                        | 4,228,237  | \$ 15.43                        | 4,884,205  | \$ 14.99                        |
| Granted  | 15,000                 | 8.77                            | 60,000     | 6.23                            | 13,500     | 8.71                            |
| Exercised  | (309,195 )             | 6.71                            | (47,805 )  | 6.79                            | (223,006 ) | 5.29                            |
| Forfeited/expired/cancelled                            | (1,258,604)            | 23.30                           | (305,459 ) | 15.38                           | (446,462 ) | 15.51                           |
| Outstanding at end of period                           | 2,382,174              | \$ 12.31                        | 3,934,973  | \$ 15.41                        | 4,228,237  | \$ 15.43                        |
| Options exercisable at end of period                   | 2,367,176              | \$ 12.33                        | 3,865,221  | \$ 15.56                        | 4,169,492  | \$ 15.53                        |
| Weighted average remaining contractual term (in years) |                        | 1.95                            |            | 3.38                            |            | 4.06                            |

The weighted-average fair valuation at grant date of stock options granted during the years ended January 31, 2011, 2010 and 2009, was \$3.70, \$3.21, and \$3.52, respectively. As of January 31, 2011, the unrecognized stock-based compensation related to the unvested stock options was \$38,000 net of estimated forfeitures. Total unrecognized compensation cost will be adjusted for any future changes in estimated changes in forfeitures. This cost will be recognized over an estimated weighted average amortization period of seventeen months.

The total intrinsic value of options exercised during the years ended January 31, 2011, 2010 and 2009 was approximately \$473,000, \$60,000 and \$576,000, respectively, with intrinsic value defined as the difference between the market price on the date of exercise and the grant date price.

The cash received from employees as a result of employee stock option exercises during fiscal years 2011, 2010 and 2009 was \$2.1 million, \$324,000, and \$1.2 million, respectively.

The following table summarizes information about employee and director stock options outstanding and exercisable as of January 31, 2011:

|                          | Options Outstanding |  |                                 | Options Exercisable |                                 |
|--------------------------|---------------------|--|---------------------------------|---------------------|---------------------------------|
|                          | Number outstanding  | Weighted average remaining contractual terms (years) | Weighted average exercise price | Number exercisable  | Weighted average exercise price |
| Range of exercise prices |                     |  |                                 |                     |                                 |
| \$ 5.85 to 6.88          | 380,743             | 1.44   | \$ 6.53                         | 380,743             | \$ 6.53                         |
| 6.93 to 8.38             | 242,829             | 2.47   | 7.34                            | 242,829             | 7.34                            |
| 8.41 to 10.72            | 322,471             | 2.40   | 10.12                           | 307,471             | 10.18                           |
| 11.35 to 13.24           | 291,517             | 1.98   | 12.56                           | 291,517             | 12.56                           |
| 13.31 to 13.66           | 39,338              | 1.12   | 13.44                           | 39,338              | 13.44                           |
| 13.76 to 13.76           | 253,732             | 1.14   | 13.76                           | 253,732             | 13.76                           |
| 14.47 to 15.59           | 360,513             | 2.37   | 15.02                           | 360,513             | 15.02                           |
| 15.62 to 17.39           | 367,921             | 2.36   | 16.55                           | 367,921             | 16.55                           |
| 17.56 to 29.25           | 117,112             | 0.67   | 20.61                           | 117,112             | 20.61                           |
| 32.48 to 32.48           | 6,000               | 0.93   | 32.48                           | 6,000               | 32.48                           |
|                          | 2,382,176           | 1.95   | \$ 12.31                        | 2,367,176           | \$ 12.33                        |

#### Restricted Stock Units

Pursuant to the 2005 Plan, SeaChange may grant restricted stock units that entitle the recipient to acquire shares of SeaChange's common stock. Awards of restricted stock units vest in equal increments on each of the first three anniversaries of the grant of the award. Stock-based compensation expense associated with the restricted stock units is charged for the market value of the Company's stock on the date of grant, assuming nominal forfeitures, and is amortized over the awards' vesting period on a straight-line basis for awards with only a service condition and graded vesting basis for awards that include both a performance and service condition. As of January 31, 2011 there were 87,995 RSUs available to be granted. For fiscal 2011, approximately 465,446 RSUs were earned by the Company executive officers under the Company's fiscal 2011 performance based plan. These RSUs were not awarded due to the Company not having sufficient RSUs available within the 2005 Plan to satisfy the RSUs earned. The Company recorded a liability totaling \$1.5 million on the Consolidated Balance Sheet as of January 31, 2011 for the estimated fair value of the awards. The awards will be re-measured quarterly until the increase in RSUs is approved by the shareholders. These shares will be awarded subject to shareholder approval at the Company's annual meeting on July 20, 2011.

The following table summarizes the restricted stock unit activity:

|                                  | Year ended January 31, |  |         |  |         |  |
|----------------------------------|------------------------|--|---------|--|---------|--|
|                                  | 2011                   |  | 2010    |  | 2009    |  |
|                                  | Shares                 | Weighted average grant date fair value | Shares  | Weighted average grant date fair value | Shares  | Weighted average grant date fair value |
| Nonvested at beginning of period | 572,489                | \$ 7.94                                | 458,674 | \$ 8.99                                | 230,508 | \$ 8.99                                |

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|                             |           |         |           |         |           |         |
|-----------------------------|-----------|---------|-----------|---------|-----------|---------|
| Awarded                     | 223,020   | 8.12    | 523,346   | 6.45    | 519,814   | 7.30    |
| Vested                      | (353,542) | 8.15    | (409,531) | 7.22    | (287,648) | 6.40    |
| Forfeited/expired/cancelled | (78,889 ) | 7.20    | -         | -       | (4,000 )  | 6.93    |
| Nonvested at end of period  | 363,078   | \$ 8.00 | 572,489   | \$ 7.94 | 458,674   | \$ 8.72 |

As of January 31, 2011 the unrecognized stock-based compensation related to the unvested restricted stock units was \$4.2 million. This cost will be recognized over an estimated weighted average amortization period of 1.8 years.

#### Employee Stock Purchase Plan

In September 1996, SeaChange's Board of Directors adopted and the stockholders approved an employee stock purchase plan (the "ESPP"), effective January 1, 1997 as amended July 16, 2008, which provides for the issuance of a maximum of 2.2 million shares of common stock to participating employees who meet eligibility requirements. The Plan was terminated on May 31, 2010. Employees who would immediately after the purchase own 5% or more of the total combined voting power or value of SeaChange's stock and directors who are not employees of SeaChange may not participate in the ESPP. The purchase price of the stock is 85% of the lesser of the average market price of the common stock on the first or last business day of each six-month plan period. During the fiscal years ended January 31, 2011, 2010 and 2009, shares of common stock were issued under the Stock Purchase Plan were 135,632, 282,889 and 236,707, respectively. The cash received from employees as a result of the ESPP during fiscal 2011, 2010 and 2009 was \$660,000, \$1.5 million, and \$1.6 million, respectively.



## 14. Income Taxes

The components of income before income taxes are as follows:

|                | 2011      | Year ended January 31, |           |
|----------------|-----------|------------------------|-----------|
|                |           | 2010                   | 2009      |
| (in thousands) |           |                        |           |
| Domestic       | \$ 18,718 | \$ (2,719 )            | \$ 2,840  |
| Foreign        | 8,327     | 5,066                  | 8,479     |
|                | \$ 27,045 | \$ 2,347               | \$ 11,319 |

The components of the income tax benefit (expense) are as follows:

|                  | 2011        | Year ended January 31, |           |
|------------------|-------------|------------------------|-----------|
|                  |             | 2010                   | 2009      |
| (in thousands)   |             |                        |           |
| <b>Current:</b>  |             |                        |           |
| Federal          | \$ (2,546 ) | \$ (271 )              | \$ 296    |
| State            | (188 )      | 32                     | (80 )     |
| Foreign          | (887 )      | (1,214 )               | (915 )    |
|                  | (3,621 )    | (1,453 )               | (699 )    |
| <b>Deferred:</b> |             |                        |           |
| Federal          | 4,677       | -                      | -         |
| State            | 137         | -                      | -         |
| Foreign          | 1,145       | 1,082                  | 124       |
|                  | 5,959       | 1,082                  | 124       |
|                  | \$ 2,338    | \$ (371 )              | \$ (575 ) |

The income tax benefit (expense) computed using the federal statutory income tax rate differs from SeaChange's effective tax rate primarily due to the following:

|   | 2011        | Year ended January 31, |             |
|---|-------------|------------------------|-------------|
|   |             | 2010                   | 2009        |
| (in thousands)                            |             |                        |             |
| Statutory U.S. federal tax rate           | \$ (9,471 ) | \$ (861 )              | \$ (3,962 ) |
| State taxes, net of federal tax benefit   | (33 )       | 29                     | 52          |
| Losses not benefitted                     | 7,967       | (1,157 )               | 527         |
| Non-deductible stock compensation expense | 79          | (133 )                 | (255 )      |
| Other                                     | 462         | (126 )                 | (35 )       |
| Research and development tax credits      | 117         | 130                    | 650         |
| Foreign tax rate differential             | 3,217       | 1,747                  | 2,448       |
|   | \$ 2,338    | \$ (371 )              | \$ (575 )   |

SeaChange's effective tax rate was 9%, 16%, and 5% in the years ended January 31, 2011, 2010 and 2009, respectively.

The components of deferred income taxes are as follows:

|  | Year ended January 31, |             |
|--|------------------------|-------------|
|  | 2011                   | 2010        |
|  | (in thousands)         |             |
| Deferred tax assets:                       |                        |             |
| Accruals and reserves                      | \$ 2,593               | \$ 3,041    |
| Deferred revenue                           | 6,478                  | 4,395       |
| Stock-based compensation expense           | 1,277                  | 1,933       |
| U.S. federal and state tax credits         | 1,586                  | 4,297       |
| Net operating loss carryforwards           | 3,403                  | 3,291       |
| Property and equipment                     | 30                     | -           |
| Other                                      | 15                     | (28 )       |
| Deferred tax assets                        | 15,382                 | 16,929      |
| Less: Valuation allowance                  | (6,985 )               | (14,903 )   |
| Net deferred tax assets                    | 8,397                  | 2,026       |
| Deferred tax liabilities:                  |                        |             |
| Property and equipment                     | -                      | 313         |
| Intangible assets                          | 7,371                  | 5,110       |
| Other                                      | -                      | -           |
| Deferred tax liabilities                   | 7,371                  | 5,423       |
| Total net deferred tax assets(liabilities) | \$ 1,026               | \$ (3,397 ) |

At January 31, 2011, SeaChange had federal, state and foreign net operating loss carryforwards of \$1.2 million, \$13.5 million and \$10.2 million respectively, which can be used to offset future tax liabilities and expire at various dates beginning in fiscal 2016. Utilization of these net operating loss carryforwards may be limited pursuant to provisions of the respective local jurisdiction. At January 31, 2011, SeaChange had federal and state research and development credit carryforwards of approximately \$216,000 and \$994,000, respectively, and state investment tax credit carryforwards of \$111,000. The federal credit carryforwards will expire at various dates beginning in fiscal 2012, if not utilized. Certain state credit carryforwards will expire at various dates beginning in fiscal 2012, while certain other state credit carryforwards may be carried forward indefinitely. Utilization of these credit carryforwards may be limited pursuant to provisions of the respective local jurisdiction. SeaChange also has alternative minimum tax credit carryforwards of \$652,000 which is available to reduce future federal regular income taxes over an indefinite period.

For the year ended January 31, 2011, the Company has a valuation allowance of \$7.0 million. During the year the Company released \$ 7.9 million of the valuation allowance against the Company's deferred tax assets in the U.S. due to the Company having met the "more than likely than not" realization criteria. The Company met this criteria as a result of the gains related to the Company's equity investments in Casa Systems, Inc. and InSite One, as well as the benefit of the reduction in deferred tax assets associated with the deferred tax liabilities from the acquisition of VividLogic, Inc. Previously, the Company maintained a full valuation allowance and will continue to monitor available information in determining whether there is sufficient evidence to consider releasing some or all of the remaining valuation allowance

At January 31, 2011, the Company has indefinitely reinvested \$45.4 million of the cumulative undistributed earnings of certain foreign subsidiaries. Approximately \$35.3 million of such earnings would be subject to U.S. taxes if repatriated to the U.S. Through January 31, 2011, the Company has not provided deferred income taxes on the

undistributed earnings of its foreign subsidiaries because such earnings are considered to be indefinitely reinvested outside the U.S. Non-US income taxes are, however, provided on those foreign subsidiaries' undistributed earnings. Determination of the potential deferred income tax liability on these undistributed earnings is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

For the year ended January 31, 2011, the Company recognized an additional tax expense for unrecognized tax benefits of \$404,000. None of the amounts included in the balance of unrecognized tax benefits at January 31, 2011 of \$7.3 million are related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. The Company recognizes accrued interest and penalties related to uncertain tax positions in income tax expense. A reconciliation of the beginning and ending balance of the total amounts of gross unrecognized tax benefits, excluding interest of \$708,000 is as follows (in thousands):

|  | Year ended January 31, |          |
|--|------------------------|----------|
|  | 2011                   | 2010     |
|  | (in thousands)         |          |
| Balance of gross unrecognized tax benefits, beginning of period  | \$ 6,985               | \$ 6,404 |
| Increases due to acquisitions  | 1,200                  | -        |
| Gross amounts of increases in unrecognized tax benefits as a result of tax positions taken in the current period | 404                    | 521      |
| Decrease due to expiration of statute of limitation  | (188 )                 | -        |
| Decrease due to settlement   | (1,094 )               | -        |
| Effect of currency translation   | (24 )                  | 60       |
| Balance of gross unrecognized tax benefits, end of period  | \$ 7,283               | \$ 6,985 |

The Company and its subsidiaries file income tax returns in U.S. federal jurisdiction, various state jurisdictions, and various foreign jurisdictions. The Company is no longer subject to U.S. federal examinations before 2007. However, the taxing authorities 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.

#### 15. Employee Benefit Plan

SeaChange sponsors a 401(k) retirement savings plan (the "Plan"). Participation in the Plan is available to full-time employees who meet eligibility requirements. Eligible employees may contribute up to 25% of their annual salary, subject to certain limitations. SeaChange matched contributions up to 50% of the first 6% of compensation. During the fiscal years ended January 31, 2011, 2010 and 2009, SeaChange contributed \$1.3 million, \$1.4 million and \$802,000, respectively. The Company also contributes to various retirement plans in its international subsidiaries, of which the amounts will vary, according to the local plans specific to each foreign location.

#### 16. Related Party

On September 1, 2009, SeaChange completed its acquisition of eventIS from a holding company in which Erwin van Dommelen, elected President of SeaChange Software in March 2010, has a 31.5% interest. On closing the transaction, SeaChange made cash payments to the holding company totaling \$37.0 million and issued \$1.1 million of restricted shares. SeaChange is obligated to make additional fixed payments to the holding company of deferred purchase price under the eventIS share purchase agreement, each such payment to be in an aggregate amount of \$2.8 million with \$1.7 million payable in cash and \$1.1 million payable by the issuance of restricted shares of SeaChange common stock, which will vest in equal installments over three years starting on the first anniversary date of the purchase agreement for three years. At the option of the former shareholder of eventIS, up to forty percent of each payment otherwise to be made in restricted stock may be payable in cash on the vesting dates of the restricted shares. On September 1, 2010, the Company paid \$1.8 million and issued 75,000 shares (approximate value \$615,000) of restricted stock that will vest annually over three years. The remaining \$410,000 will be paid out in equal installments on September 1, 2011, 2012, and 2013. Under the earn-out provisions of the share purchase agreement a payment of \$340,000 for fiscal 2011 will be paid in the first quarter fiscal 2012. Additional earn-out payments may be earned over each of the next two years ended January 31, 2012 and 2013 if certain performance goals are met.



## 17. Quarterly Results of Operations—Unaudited

The following table sets forth certain unaudited quarterly results of operations for the fiscal years ended January 31, 2011 and 2010. In the opinion of management, this information has been prepared on the same basis as the audited consolidated financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the quarterly information when read in conjunction with the audited consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. The quarterly operating results are not necessarily indicative of future results of operations.

|                                      | Three months ended |                  |                     |                     |                   |                  |                     |                     |
|--------------------------------------|--------------------|------------------|---------------------|---------------------|-------------------|------------------|---------------------|---------------------|
|                                      | April 30,<br>2009  | July 31,<br>2009 | October 31,<br>2009 | January 31,<br>2010 | April 30,<br>2010 | July 31,<br>2010 | October 31,<br>2010 | January 31,<br>2011 |
| Revenue                              | \$48,876           | \$46,507         | \$ 53,290           | \$ 52,992           | \$54,589          | \$51,636         | \$ 49,135           | \$ 61,367           |
| Gross profit                         | 25,018             | 23,714           | 27,557              | 26,964              | 27,378            | 24,859           | 23,241              | 33,271              |
| Operating expenses                   | 23,714             | 24,204           | 26,977              | 26,156              | 31,929            | 24,634           | 26,648              | 24,382              |
| Net income (loss)                    | 998                | (376 )           | 657                 | 44                  | 20,298            | 3,534            | (5,215 )            | 10,851              |
| Earnings (loss) per<br>share-Basic   | 0.03               | (0.01 )          | 0.02                | -                   | 0.66              | 0.11             | (0.17 )             | 0.34                |
| Earnings (loss) per<br>share-Diluted | 0.03               | (0.01 )          | 0.02                | -                   | 0.64              | 0.11             | (0.17 )             | 0.34                |

Schedule II  
SEACHANGE INTERNATIONAL, INC.  
VALUATION OF QUALIFYING ACCOUNTS AND RESERVES

Years ended January 31, 2011, 2010 and 2009

|   | Balance at<br>beginning of<br>period | Charged to<br>costs and<br>expenses | Deductions<br>and write-offs<br>(in thousands) | Other<br>Adjustments | Balance at<br>end of<br>period |
|---|--------------------------------------|-------------------------------------|--|----------------------|--------------------------------|
| <b>Accounts Receivable Allowance:</b>           |                                      |                                     |  |                      |                                |
| Year ended January 31, 2011                     | \$852                                | \$147                               | \$ (4 )  | \$ -                 | \$995                          |
| Year ended January 31, 2010                     | 853                                  | 75                                  | (76 )  | -                    | 852                            |
| Year ended January 31, 2009                     | 663                                  | 670                                 | (480 )   | -                    | 853                            |
|   | Balance at<br>beginning of<br>period | Additions                           | Deletions<br>(in thousands)                    | Adjustments          | Balance at<br>end of<br>period |
| <b>Deferred Tax Assets Valuation Allowance:</b> |                                      |                                     |  |                      |                                |
| Year ended January 31, 2011                     | \$14,903                             | \$-                                 | \$(7,918 )                                     | \$ -                 | \$6,985                        |
| Year ended January 31, 2010                     | 15,692                               | -                                   | (789 )   | -                    | 14,903                         |
| Year ended January 31, 2009                     | 13,319                               | 2,373                               | -  | -                    | 15,692                         |