

SEACHANGE INTERNATIONAL INC

Form 10-Q

December 08, 2016

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended October 31, 2016**

**OR**

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

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

**Commission File Number: 0-21393**

**SEACHANGE INTERNATIONAL, INC.**

**(Exact name of registrant as specified in its charter)**

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

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

**50 Nagog Park, Acton, MA 01720**

**(Address of principal executive offices, including zip code)**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares outstanding of the registrant's Common Stock on December 5, 2016 was 35,207,057.

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**SEACHANGE INTERNATIONAL, INC.**

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**PART I. FINANCIAL INFORMATION**

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**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements****SEACHANGE INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEETS***(Amounts in thousands, except share data)*

|  | <b>October 31,<br/>2016<br/>(Unaudited)</b> | <b>January 31,<br/>2016</b> |
|--|---|-----------------------------|
| <b>Assets</b>  |   |                             |
| Current assets:  |   |                             |
| Cash and cash equivalents  | \$ 27,484                                   | \$ 58,733                   |
| Restricted cash  | 108   | 82                          |
| Marketable securities  | 4,256                                       | 1,504                       |
| Accounts and other receivables, net of allowance for doubtful accounts of \$340 and \$415 at October 31, 2016 and January 31, 2016, respectively | 25,020                                      | 26,331                      |
| Unbilled receivables   | 7,913                                       | 10,680                      |
| Inventories, net   | 998   | 1,682                       |
| Assets held for sale   | 235   |                             |
| Prepaid expenses and other current assets  | 3,374                                       | 3,827                       |
| <b>Total current assets</b>  | <b>69,388</b>                               | <b>102,839</b>              |
| Property and equipment, net  | 12,089                                      | 14,129                      |
| Marketable securities, long-term   | 6,014                                       | 10,764                      |
| Investments in affiliates  | 2,500                                       | 2,500                       |
| Intangible assets, net   | 5,385                                       | 4,126                       |
| Goodwill   | 45,689                                      | 40,175                      |
| Other assets   | 2,422                                       | 3,136                       |
| <b>Total assets</b>  | <b>\$ 143,487</b>                           | <b>\$ 177,669</b>           |
| <b>Liabilities and Stockholders Equity</b>   |   |                             |
| Current liabilities:   |   |                             |
| Accounts payable   | \$ 4,535                                    | \$ 6,132                    |
| Deferred stock consideration   |   | 3,205                       |
| Deferred revenues  | 11,230                                      | 16,201                      |
| Other accrued expenses   | 12,923                                      | 17,414                      |
| <b>Total current liabilities</b>   | <b>28,688</b>                               | <b>42,952</b>               |
| Deferred revenue, long-term  | 2,404                                       | 1,209                       |
| Deferred tax liabilities, long-term  | 15,224                                      |                             |

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|   |            |            |
|---|------------|------------|
| Taxes payable, long-term  | 1,369      | 1,389      |
| Other liabilities, long-term  | 1,255      | 1,101      |
| Total liabilities   | 48,940     | 46,651     |
| Commitments and contingencies (Note 7)  |            |            |
| Stockholders' equity:   |            |            |
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 35,247,547 shares issued and 35,207,057 outstanding at October 31, 2016, and 33,818,777 shares issued and 33,778,871 outstanding at January 31, 2016 | 352        | 338        |
| Additional paid-in capital  | 235,873    | 228,164    |
| Treasury stock, at cost; 40,490 and 39,906 common shares at October 31, 2016 and January 31, 2016, respectively   | (5)        | (2)        |
| Accumulated loss  | (134,742)  | (90,869)   |
| Accumulated other comprehensive loss  | (6,931)    | (6,613)    |
| Total stockholders' equity  | 94,547     | 131,018    |
| Total liabilities and stockholders' equity  | \$ 143,487 | \$ 177,669 |

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

**Table of Contents****SEACHANGE INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS***(Unaudited, amounts in thousands, except per share data)*

|   | <b>Three Months<br/>Ended<br/>October 31,</b> |                 | <b>Nine Months Ended<br/>October 31,</b> |                 |
|---|---|-----------------|--|-----------------|
|   | <b>2016</b>                                   | <b>2015</b>     | <b>2016</b>                              | <b>2015</b>     |
| <b>Revenues:</b>  |   |                 |  |                 |
| Products  | \$ 3,746                                      | \$ 6,195        | \$ 10,481                                | \$ 16,314       |
| Services  | 16,215  | 22,552          | 49,502                                   | 63,481          |
| <b>Total revenues</b>   | <b>19,961</b>                                 | <b>28,747</b>   | <b>59,983</b>                            | <b>79,795</b>   |
| <b>Cost of revenues:</b>  |   |                 |  |                 |
| Products  | 1,824   | 1,528           | 4,506                                    | 4,766           |
| Services  | 8,036   | 10,963          | 27,982                                   | 33,829          |
| Provision for loss contract   |   | 9,162           |  | 9,162           |
| Amortization of intangible assets   | 315   | 184             | 947                                      | 557             |
| Stock-based compensation expense  | (26)  | 33              | 131                                      | 61              |
| <b>Total cost of revenues</b>   | <b>10,149</b>                                 | <b>21,870</b>   | <b>33,566</b>                            | <b>48,375</b>   |
| <b>Gross profit</b>   | <b>9,812</b>                                  | <b>6,877</b>    | <b>26,417</b>                            | <b>31,420</b>   |
| <b>Operating expenses:</b>  |   |                 |  |                 |
| Research and development  | 7,325   | 8,273           | 23,751                                   | 26,176          |
| Selling and marketing   | 3,422   | 3,965           | 10,841                                   | 11,263          |
| General and administrative  | 3,673   | 3,648           | 11,579                                   | 11,446          |
| Amortization of intangible assets   | 540   | 1,038           | 1,572                                    | 3,003           |
| Stock-based compensation expense  | 791   | 1,104           | 1,685                                    | 2,943           |
| Earn-outs and change in fair value of earn-outs                             |   | 492             | 249                                      | 1,475           |
| Professional fees - other   | 24  | 1               | 328                                      | 145             |
| Severance and other restructuring costs                                     | 2,373   | 197             | 5,991                                    | 1,026           |
| Loss on impairment of long-lived assets                                     | 99  |                 | 99                                       |                 |
| <b>Total operating expenses</b>   | <b>18,247</b>                                 | <b>18,718</b>   | <b>56,095</b>                            | <b>57,477</b>   |
| <b>Loss from operations</b>   | <b>(8,435)</b>                                | <b>(11,841)</b> | <b>(29,678)</b>                          | <b>(26,057)</b> |
| <b>Other (expenses) income, net</b>   | <b>(67)</b>                                   | <b>38</b>       | <b>220</b>                               | <b>(390)</b>    |
| <b>Loss before income taxes and equity income in earnings of affiliates</b> | <b>(8,502)</b>                                | <b>(11,803)</b> | <b>(29,458)</b>                          | <b>(26,447)</b> |
| <b>Income tax (benefit) provision</b>                                       | <b>(420)</b>                                  | <b>(1,228)</b>  | <b>14,415</b>                            | <b>(1,003)</b>  |
| <b>Equity income in earnings of affiliates, net of tax</b>                  |   | <b>10</b>       |  | <b>27</b>       |

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|  |            |             |             |             |
|--|------------|-------------|-------------|-------------|
| Net loss                                       | \$ (8,082) | \$ (10,565) | \$ (43,873) | \$ (25,417) |
| Net loss                                       | \$ (8,082) | \$ (10,565) | \$ (43,873) | \$ (25,417) |
| Other comprehensive (loss) income, net of tax: |            |             |             |             |
| Foreign currency translation adjustment        | (619)      | 114         | (316)       | (510)       |
| Unrealized loss on marketable securities       | (20)       | (7)         | (2)         | (22)        |
| Comprehensive loss                             | \$ (8,721) | \$ (10,458) | \$ (44,191) | \$ (25,949) |
| Net loss per share:                            |            |             |             |             |
| Basic  | \$ (0.23)  | \$ (0.31)   | \$ (1.26)   | \$ (0.76)   |
| Diluted  | \$ (0.23)  | \$ (0.31)   | \$ (1.26)   | \$ (0.76)   |
| Weighted average common shares outstanding:    |            |             |             |             |
| Basic  | 35,186     | 33,636      | 34,889      | 33,440      |
| Diluted  | 35,186     | 33,636      | 34,889      | 33,440      |

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

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## SEACHANGE INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

*(Unaudited, amounts in thousands)*

|   | <b>Nine Months Ended<br/>October 31,</b> |                 |
|---|--|-----------------|
|   | <b>2016</b>                              | <b>2015</b>     |
| <b>Cash flows from operating activities:</b>                                  |  |                 |
| Net loss  | \$ (43,873)                              | \$ (25,417)     |
| Adjustments to reconcile net loss to net cash used in operating activities:   |  |                 |
| Depreciation and amortization of property and equipment                       | 2,289                                    | 2,554           |
| Provision for loss contract   |  | 9,162           |
| Provision for inventory obsolescence  | 318                                      | 65              |
| Amortization of intangible assets   | 2,519                                    | 3,560           |
| Fair value of acquisition-related contingent consideration                    | 249                                      | 1,475           |
| Stock-based compensation expense  | 1,816                                    | 3,004           |
| Deferred income taxes   | 14,649                                   | (960)           |
| Other   | 113                                      | 61              |
| Changes in operating assets and liabilities, excluding impact of acquisition: |  |                 |
| Accounts receivable   | 1,987                                    | 895             |
| Unbilled receivables  | 2,913                                    | (5,743)         |
| Inventories   | 338                                      | (1,207)         |
| Prepaid expenses and other assets   | 428                                      | (158)           |
| Accounts payable  | (2,102)                                  | 718             |
| Accrued expenses  | (4,942)                                  | (4,056)         |
| Deferred revenues   | (3,864)                                  | (2,770)         |
| Other   | 173                                      | (625)           |
| <b>Total cash used in operating activities</b>                                | <b>(26,989)</b>                          | <b>(19,442)</b> |
| <b>Cash flows from investing activities:</b>                                  |  |                 |
| Purchases of property and equipment   | (521)                                    | (1,140)         |
| Investment in capitalized software  |  | (2,030)         |
| Purchases of marketable securities  | (2,252)                                  | (3,005)         |
| Proceeds from sale and maturity of marketable securities                      | 4,249                                    | 4,503           |
| Cash paid for acquisition of business, net of cash acquired                   | (5,243)                                  | (11,686)        |
| Other investing activities  | 2  | 453             |
| <b>Total cash used in investing activities</b>                                | <b>(3,765)</b>                           | <b>(12,905)</b> |
| <b>Cash flows from financing activities:</b>                                  |  |                 |
| Proceeds from issuance of common stock  | 64                                       | 88              |
| Other financing activities  | (4)                                      |                 |



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|   |           |           |
|---|-----------|-----------|
| Total cash provided by financing activities                                   | 60        | 88        |
| Effect of exchange rate changes on cash                                       | (555)     | 270       |
| Net decrease in cash and cash equivalents                                     | (31,249)  | (31,989)  |
| Cash and cash equivalents, beginning of period                                | 58,733    | 90,019    |
| Cash and cash equivalents, end of period                                      | \$ 27,484 | \$ 58,030 |
| Supplemental disclosure of cash flow information:                             |           |           |
| Income taxes paid   | \$ 120    | \$ 495    |
| Supplemental disclosure of non-cash investing and financing activities:       |           |           |
| Fair value of common stock issued for acquisition of DCC Labs                 | \$ 2,640  | \$        |
| Fair value of common stock issued for deferred stock consideration obligation | \$ 3,454  | \$ 1,753  |
| Fair value of common stock issued for acquisition of TLL LLC                  | \$        | \$ 3,025  |
| Asset group classified as held for sale                                       | \$ 235    | \$        |
| Transfer of items originally classified as inventories to equipment           | \$ 24     | \$ 342    |

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

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**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Nature of Business and Basis of Presentation**

**The Company**

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

**Basis of Presentation**

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries ( SeaChange or the Company ) and are prepared in accordance with U.S. generally accepted accounting principles ( U.S. GAAP ) for interim financial reports as well as rules and regulations of the Securities and Exchange Commission ( SEC ). All intercompany transactions and balances have been eliminated. Certain information and footnote disclosures normally included in financial statements prepared under U.S. GAAP have been condensed or omitted pursuant to such regulations. However, we believe that the disclosures are adequate to make the information presented not misleading. In the opinion of management, the accompanying financial statements include all adjustments, consisting of only normal recurring items, necessary to present a fair presentation of the consolidated financial statements for the periods shown. These consolidated financial statements should be read in conjunction with our most recently audited financial statements and related footnotes included in our Annual Report on Form 10-K ( Form 10-K ) as filed with the SEC. The balance sheet data as of January 31, 2016 that is included in this Quarterly Report on Form 10-Q ( Form 10-Q ) was derived from our audited financial statements. We have reclassified certain amounts previously reported in our financial statements to conform to current presentation.

The preparation of these financial statements in conformity with U.S. GAAP, requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Interim results are not necessarily indicative of the operating results for the full fiscal year or any future periods and actual results may differ from our estimates. During the three and nine months ended October 31, 2016, there have been no material changes to our significant accounting policies that were described in our fiscal 2016 Form 10-K, as filed with the SEC.

**2. Significant Accounting Policies**

***Revenue Recognition***

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

persuasive evidence of an arrangement exists;

delivery has occurred, and title and risk of loss have passed to the customer;

fees are fixed or determinable; and

collection of the related receivable is considered probable.

Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities is deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support agreements is recognized ratably over the period of the related agreements. Revenue from software development contracts that include significant modification or customization, including software product enhancements, is recognized based on the percentage of completion contract accounting method using labor efforts expended in relation to estimates of total labor efforts to complete the contract. The percentage of completion method requires that adjustments or re-evaluations to estimated project revenues and costs be recognized on a project-to-date cumulative basis, as changes to the estimates are identified. Revisions to project estimates are made as additional information becomes known, including information that becomes available subsequent to the date of the consolidated financial statements up through the date such consolidated financial statements are filed with the SEC. If the final estimated profit

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to complete a long-term contract indicates a loss, a provision is recorded immediately for the total loss anticipated. Accounting for contract amendments and customer change orders are included in contract accounting when executed. Revenue from shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues. Our share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

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

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

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

Under the revenue recognition rules for tangible products as amended by ASU 2009-13, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting. The selling price used for each deliverable is based upon VSOE if available, third-party evidence ( TPE ) if VSOE is not available, and best estimate of selling price

( **BESP** ) if neither **VSOE** nor **TPE** are available. **TPE** is the price of the Company's, or any competitor's, largely interchangeable products or services in stand-alone sales to similarly situated customers. **BESP** is the price at which we would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors.

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

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

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

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

## ***Impairment of Assets***

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

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

In the second quarter of fiscal 2017, we determined there to be triggering events that might possibly indicate that the carrying amount of our long-lived assets may not be recoverable. These triggering events included a sustained decrease in share price during the period and our current-period operating loss combined with a history of operating losses. As a result, we were required to test for the recoverability of our long-lived assets to determine whether an impairment loss should have been recognized as mentioned above. We determined that the estimated undiscounted

future cash flows over the remaining useful life of the long-lived assets exceeded the carrying value. Therefore, the assets were deemed recoverable and no impairment loss was recognized on long-lived assets as of July 31, 2016.

In the third quarter of fiscal 2017, in conjunction with the annual impairment analysis of goodwill, we determined that there were indications that the carrying amount of our long-lived assets may not be recoverable. As a result, we were required to test for the recoverability of our long-lived assets to determine whether an impairment loss should be recognized. The Company compared its forecasted undiscounted cash flows over the remaining useful life of the principal long-lived asset to the carrying value. We determined that the fair value of our long-lived asset group exceeds its carrying value at October 31, 2016 and, accordingly, did not recognize an impairment loss on the long-lived assets.

### ***Liquidity***

We continue to realize the savings related to the wind down of the TimeLine Labs operation and the restructuring of our In-Home business from Milpitas to Poland. Additionally, during the third quarter of fiscal 2017, we made substantial progress on a cost reduction program, which we expect to generate annualized savings of approximately \$15 million. We have executed annualized cost savings of approximately \$7.5 million to date. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash provided by future operating activities, augmented by the plans highlighted above are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

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### **3. Fair Value Measurements**

#### ***Definition and Hierarchy***

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

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

Level 1 Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.

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

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. The fair value of the contingent consideration obligations related to our business acquisitions are valued using Level 3 inputs.

#### ***Valuation Techniques***

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

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



**Table of Contents****Assets and Liabilities that are Measured at Fair Value on a Recurring Basis**

The following tables set forth our financial assets and liabilities that were accounted for at fair value on a recurring basis as of October 31, 2016 and January 31, 2016. There were no fair value measurements of our financial assets and liabilities using significant Level 3 inputs for the periods presented:

|  | <b>Fair Value at October 31, 2016 Using</b> |                         |                    |
|--|---|-------------------------|--------------------|
|  | <b>Quoted</b>                               |                         |                    |
|  | <b>Prices in</b>                            |                         |                    |
|  | <b>Active</b>                               |                         |                    |
|  | <b>Markets</b>                              |                         |                    |
|  | <b>for</b>                                  |                         |                    |
|  | <b>October 31,</b>                          | <b>Identical Assets</b> | <b>Significant</b> |
|  | <b>2016</b>                                 | <b>(Level 1)</b>        | <b>Other</b>       |
|  |   |                         | <b>Observable</b>  |
|  |   |                         | <b>Inputs</b>      |
|  |   |                         | <b>(Level 2)</b>   |
|  | <b>(Amounts in thousands)</b>               |                         |                    |
| <b>Financial assets:</b>                         |   |                         |                    |
| Money market accounts (a)                        | \$ 2,721                                    | \$ 2,721                | \$                 |
| <b>Available-for-sale marketable securities:</b> |   |                         |                    |
| Current marketable securities:                   |   |                         |                    |
| U.S. treasury notes and bonds - conventional     | 4,256                                       | 4,256                   |                    |
| Non-current marketable securities:               |   |                         |                    |
| U.S. treasury notes and bonds - conventional     | 2,004                                       | 2,004                   |                    |
| U.S. government agency issues                    | 4,010                                       |                         | 4,010              |
| <b>Total</b>                                     | <b>\$ 12,991</b>                            | <b>\$ 8,981</b>         | <b>\$ 4,010</b>    |

|  | <b>Fair Value at January 31, 2016 Using</b> |                         |                    |
|--|---|-------------------------|--------------------|
|  | <b>Quoted</b>                               |                         |                    |
|  | <b>Prices in</b>                            |                         |                    |
|  | <b>Active</b>                               |                         |                    |
|  | <b>Markets for</b>                          |                         |                    |
|  | <b>January 31,</b>                          |                         |                    |
|  | <b>2016</b>                                 | <b>Identical Assets</b> | <b>Significant</b> |
|  |   | <b>(Level 1)</b>        | <b>Other</b>       |
|  |   |                         | <b>Observable</b>  |
|  |   |                         | <b>Inputs</b>      |
|  |   |                         | <b>(Level 2)</b>   |
|  | <b>(Amounts in thousands)</b>               |                         |                    |
| <b>Financial assets:</b>                         |   |                         |                    |
| Money market accounts (a)                        | \$ 3,654                                    | \$ 3,654                | \$                 |
| <b>Available-for-sale marketable securities:</b> |   |                         |                    |
| Current marketable securities:                   |   |                         |                    |
| U.S. treasury notes and bonds - conventional     | 502   | 502                     |                    |
| U.S. government agency issues                    | 1,002                                       |                         | 1,002              |
| Non-current marketable securities:               |   |                         |                    |
| U.S. treasury notes and bonds - conventional     | 7,762                                       | 7,762                   |                    |
| U.S. government agency issues                    | 3,002                                       |                         | 3,002              |

|       |           |    |        |    |       |
|-------|-----------|----|--------|----|-------|
| Total | \$ 15,922 | \$ | 11,918 | \$ | 4,004 |
|-------|-----------|----|--------|----|-------|

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- (a) Money market funds and U.S. treasury bills are included in cash and cash equivalents on the accompanying consolidated balance sheets and are valued at quoted market prices for identical instruments in active markets.

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

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible property and equipment, goodwill, and other intangible assets, which are re-measured when the derived fair value is below carrying value on our consolidated balance sheets. For these assets and liabilities, we do not periodically adjust carrying value to fair value except in the event of impairment. When we determine that impairment has occurred, the carrying value of the asset is reduced to fair value and the difference is recorded to loss from impairment in our consolidated statements of operations and comprehensive loss. During the three and nine months ended October 31, 2016, we recorded a \$0.1 million loss on impairment of long-lived assets in our consolidated statements of operations and comprehensive loss. This impairment was taken on an asset group classified as an asset held for sale on our consolidated balance sheet as of October 31, 2016, (as disclosed in Note 5, *Consolidated Balance Sheet Detail* ). This impairment was determined based on Level 2 inputs, as the valuation methodologies used to determine impairment considered a purchase and sale agreement from a potential buyer of the asset group.

We also have direct investments in privately-held companies accounted for under the cost method of accounting, of which we do not have significant influence over their operating and financial activities. Management periodically assesses these investments for other-than-temporary impairment considering available information provided by the investees and any other readily available market data. If we determine that an other-than-temporary impairment has occurred, we write down the investment to its fair value. For the three and nine months ended October 31, 2016, we determined there were no other-than-temporary impairments on our cost method investments.

***Available-For-Sale Securities***

We determine the appropriate classification of debt investment securities at the time of purchase and reevaluate such designation as of each balance sheet date. Our investment portfolio consists of money market funds, U.S. treasury notes and bonds, and U.S. government agency notes and bonds as of October 31, 2016 and January 31, 2016. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. Our marketable securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses, net of tax, reported in stockholders' equity as a component of accumulated other comprehensive loss. The amortization of premiums and accretion of discounts to maturity are computed under the effective interest method and are included in other (expenses) income, net, in our consolidated statements of operations and comprehensive loss. Interest on securities is recorded as earned and is also included in other (expenses) income, net. Any realized gains or losses would be shown in the accompanying consolidated statements of operations and comprehensive loss in other (expenses) income, net. We provide fair value measurement disclosures of available-for-sale securities in accordance with one of three levels of fair value measurement mentioned above.

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The following is a summary of cash, cash equivalents and available-for-sale securities, including the cost basis, aggregate fair value and gross unrealized gains and losses, for short- and long-term marketable securities portfolio as of October 31, 2016 and January 31, 2016:

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|--|-------------------|------------------------------|-------------------------------|-------------------------|
| (Amounts in thousands)                                 |                   |                              |                               |                         |
| <b>October 31, 2016:</b>                               |                   |                              |                               |                         |
| Cash   | \$ 24,763         | \$                           | \$                            | \$ 24,763               |
| Cash equivalents                                       | 2,721             |                              |                               | 2,721                   |
| Cash and cash equivalents                              | 27,484            |                              |                               | 27,484                  |
| U.S. treasury notes and bonds - short-term             | 4,250             | 6                            |                               | 4,256                   |
| U.S. treasury notes and bonds - long-term              | 2,004             | 1                            | (1)                           | 2,004                   |
| U.S. government agency issues - long-term              | 3,987             | 23                           |                               | 4,010                   |
| Total cash, cash equivalents and marketable securities | \$ 37,725         | \$ 30                        | \$ (1)                        | \$ 37,754               |
| <b>January 31, 2016:</b>                               |                   |                              |                               |                         |
| Cash   | \$ 55,079         | \$                           | \$                            | \$ 55,079               |
| Cash equivalents                                       | 3,654             |                              |                               | 3,654                   |
| Cash and cash equivalents                              | 58,733            |                              |                               | 58,733                  |
| U.S. treasury notes and bonds - short-term             | 503               |                              | (1)                           | 502                     |
| U.S. treasury notes and bonds - long-term              | 7,756             | 6                            |                               | 7,762                   |
| U.S. government agency issues - short-term             | 1,001             | 1                            |                               | 1,002                   |
| U.S. government agency issues - long-term              | 2,977             | 25                           |                               | 3,002                   |
| Total cash, cash equivalents and marketable securities | \$ 70,970         | \$ 32                        | \$ (1)                        | \$ 71,001               |

The gross realized gains and losses on sale of available-for-sale securities as of October 31, 2016 and January 31, 2016 were immaterial. For purposes of determining gross realized gains and losses, the cost of securities is based on specific identification.

Contractual maturities of available-for-sale investments as of October 31, 2016 are as follows (amounts in thousands):

|                              |                                 |
|------------------------------|---------------------------------|
|                              | <b>Estimated<br/>Fair Value</b> |
| Maturity of one year or less | \$ 4,256                        |

|                                     |                  |
|-------------------------------------|------------------|
| Maturity between one and five years | 6,014            |
| <b>Total</b>                        | <b>\$ 10,270</b> |

### ***Cash, Cash Equivalents and Marketable Securities***

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

The fair value of cash, cash equivalents, restricted cash and marketable securities at October 31, 2016 and January 31, 2016 was \$37.9 million and \$71.1 million, respectively.

The Company believes that existing funds and cash provided by future operating activities are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

### ***Restricted Cash***

At times, we may be required to maintain cash held as collateral for performance obligations with our customers which we classify as restricted cash on our consolidated balance sheets. As of October 31, 2016 and January 31, 2016 we had \$0.1 million in restricted cash related to performance obligations.

**Table of Contents****4. Acquisitions and Loss on Impairment*****DCC Labs***

On May 5, 2016 we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.6 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all of the stock is initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement. The stock consideration was determined by dividing the total value of \$2.6 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing.

The acquisition of DCC Labs enables us to optimize the operations of our In Home business, which is our developer of deployed software solutions including the SeaChange Nucleus home video gateway. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe's Digital Video Broadcasting community and an HTML5 framework for building future-proof user interfaces for CPE devices.

We accounted for the acquisition of DCC Labs as a business combination, which requires us to record the assets acquired and liabilities assumed at fair value. The amount by which the purchase price exceeds the fair value of the net assets acquired is recorded as goodwill. We engaged an independent appraiser to assist management in assessing the fair values of the tangible and intangible assets acquired and liabilities assumed and the amount of goodwill to be recognized as of the acquisition date. Assets acquired as a result of the acquisition include receivables, prepaid expenses and property and equipment while liabilities assumed include accounts payable, other accrued expenses, deferred taxes and income taxes payable. The amounts recorded for these assets and liabilities are preliminary in nature and are subject to adjustment as additional information is obtained about the facts and circumstances that existed as of the acquisition date. Adjustments to these amounts are allowed under U.S. GAAP during the measurement period, which is up to one year from the acquisition date. The final determination of the fair values of the acquired assets and liabilities will be completed within the measurement period.

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

|   |                 |
|---|-----------------|
| <b>Estimated Fair value of consideration:</b>                           |                 |
| Cash, net of cash acquired  | \$ 5,243        |
| Stock consideration   | 2,640           |
| <b>Total purchase price</b>   | <b>\$ 7,883</b> |
| <b>Estimated Fair value of assets acquired and liabilities assumed:</b> |                 |
| Current assets  | 826             |
| Other long-term assets  | 116             |
| Finite-life intangible assets   | 3,100           |
| Goodwill  | 5,401           |
| Current liabilities   | (618)           |
| Other long-term liabilities   | (942)           |
| <b>Allocated purchase price</b>   | <b>\$ 7,883</b> |

*Acquired Goodwill*

The preliminary purchase price allocation is subject to our final determination of fair value. We recorded the \$5.4 million excess of the purchase price over the fair value of the identified tangible and intangible assets as goodwill, primarily due to expected synergies between the combined companies and expanded market opportunities. The goodwill is not deductible for tax purposes.

*Intangible Assets*

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

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

|                        | Useful life | Fair Value<br>(Amounts in thousands) |
|------------------------|-------------|--------------------------------------|
| Tradename              | 5 years     | \$ 200                               |
| Customer contracts     | 9 years     | 1,400                                |
| Non-compete agreements | 2 years     | 100                                  |
| Existing technology    | 7 years     | 1,400                                |
|                        |             | \$ 3,100                             |

*Measurement Period Adjustments*

During the quarter ended October 31, 2016, we identified measurement period adjustments that impacted the estimated fair value of the DCC Labs assets and liabilities assumed on May 5, 2016 as a result of new information obtained about the facts and circumstances that existed as of the acquisition date. The total measurement period adjustments recorded during the third quarter of fiscal 2017 resulted in a decrease in receivables of \$0.3 million and an increase in goodwill of \$0.3 million. There was no impact to the consolidated statements of operations and comprehensive loss for the three and nine months ended October 31, 2016. Further adjustments are expected through the end of the measurement period as third-party valuations are finalized.

*Impact to Fiscal 2017 Financial Results*

DCC Labs financial results have been included in our consolidated financial results only for the period from the May 5, 2016 acquisition date through October 31, 2016. As a result, our consolidated financial results for the nine months ended October 31, 2016 do not reflect a full nine months of DCC Labs results. From the May 5, 2016 acquisition date through October 31, 2016, DCC Labs generated revenue of \$0.7 million and an operating loss of \$2.0 million.

*Acquisition-related Costs*

In connection with the acquisition, we incurred approximately \$0.2 million in acquisition-related costs, including legal, accounting and other professional services for fiscal 2017. The acquisition costs were expensed as incurred and included in professional fees other, in our consolidated statements of operations and comprehensive loss for the period ended October 31, 2016.

*TLL, LLC*

On February 2, 2015, pursuant to an Agreement and Plan of Merger (the Merger Agreement), dated as of December 22, 2014, we acquired 100% of the member interests in TLL, LLC (Timeline Labs), a privately-owned California-based software-as-a-service (SaaS) company.

We accounted for the acquisition of Timeline Labs as a business combination and the financial results of Timeline Labs have been included in our consolidated financial statements as of the date of acquisition. Under the acquisition method of accounting, the purchase price was allocated to the acquired net tangible and intangible assets based upon their fair values as of February 2, 2015.





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

|   |                  |
|---|------------------|
| <b>Fair value of consideration:</b>                           |                  |
| Cash, net of cash acquired                                    | \$ 14,186        |
| Closing stock consideration                                   | 3,019            |
| Deferred stock consideration                                  | 4,959            |
| Contingent consideration                                      | 475              |
| <b>Total purchase price</b>                                   | <b>\$ 22,639</b> |
| <b>Fair value of assets acquired and liabilities assumed:</b> |                  |
| Current assets  | 95               |
| Other long-term assets  | 108              |
| Finite-life intangible assets                                 | 6,720            |
| Goodwill  | 15,787           |
| Current liabilities   | (71)             |
| <b>Allocated purchase price</b>                               | <b>\$ 22,639</b> |

*Fair Value of Consideration Transferred*

Upon completion of the acquisition, the Company made cash consideration payments to the former members of Timeline Labs in the amount of \$14.2 million ( Closing Cash Consideration ). The Closing Cash Consideration included \$1.4 million deposited in escrow to secure certain indemnification obligations of the former members of Timeline Labs under the Merger Agreement. Also upon completion of the acquisition, the Company issued 344,055 shares of common stock to the former members of Timeline Labs and deposited 173,265 shares of common stock into escrow.

On August 3, 2015, we issued 260,537 shares of our common stock with a value of \$1.8 million to the former members of Timeline Labs, in satisfaction of the six-month deferred stock consideration obligation pursuant to the Merger Agreement. In satisfaction of the twelve-month deferred stock consideration obligation pursuant to the Merger Agreement, on February 2, 2016 we issued 542,274 shares of our common stock with a value of \$3.2 million and in May 2016, pursuant to an adjustment mechanism based on stock price provided for in the Merger Agreement with respect to deferred stock consideration issuances, we issued an additional 70,473 shares of our common stock with a value of \$0.2 million.

*Contingent Consideration*

The former interest holders of Timeline Labs were eligible to receive earn-out compensation, consisting of shares of our common stock, if defined performance criteria were achieved for fiscal 2016 and 2017. We recorded a liability of \$3.2 million in February 2015 in our consolidated balance sheets that represented the fair value of the estimated shares at full achievement of the defined performance criteria on the date of acquisition. As of January 31, 2016, the Company determined that the defined performance criteria would not be achieved and the liability was reduced to zero with a \$0.4 million reversal of liability credited to loss on impairment of TLL, LLC net assets in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016.

*Intangible Assets*

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

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

|                        | Useful life | Fair Value<br>(Amounts in thousands) |
|------------------------|-------------|--------------------------------------|
| Tradename              | 7 years     | \$ 620                               |
| Customer contracts     | 7 years     | 4,760                                |
| Non-compete agreements | 2 years     | 170                                  |
| Existing technology    | 5 years     | 1,170                                |
|                        |             | \$ 6,720                             |

*Acquired Goodwill*

We finalized the purchase price allocation in January 2016. We recorded the \$15.8 million excess of the purchase price over the fair value of the identified tangible and intangible assets as goodwill, primarily due to expected synergies between the combined companies and expanded market opportunities. The goodwill was deductible for tax purposes.

*Acquisition-related Costs*

In connection with the acquisition, we incurred approximately \$0.2 million in acquisition-related costs, including legal, accounting and other professional services for fiscal 2016. The acquisition costs were expensed as incurred and included in professional fees other, in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016.

*Loss on Impairment of Assets*

In January 2016, our Board of Directors authorized a restructuring plan to wind down the Timeline Labs operations, as previously reported in a Current Report on Form 8-K filed with the SEC on February 17, 2016. Based on the decision to enter into the restructuring plan and the plan's impact on the projected future cash flows of the Timeline Labs operations, we determined that the carrying amount of all long-term assets that resulted from the February 2015 acquisition had exceeded their fair value as of January 31, 2016. As a result, these long-term assets were deemed fully impaired and we recorded the \$21.9 million net book value of these long-term assets as a component of loss on impairment of TLL, LLC net assets in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016. Additionally, we reduced the contingent consideration liability associated with the Timeline Labs acquisition to zero, as we determined that the defined performance criteria would not be achieved, and credited the reversal of the liability of \$0.4 million to loss on impairment of TLL, LLC net assets in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016.

In addition, we incurred \$0.6 million in severance and other restructuring charges during fiscal 2017 related to cost-saving actions taken with respect to the Timeline Labs business.

**5. Consolidated Balance Sheet Detail**

***Inventories, net***

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

|                               | <b>As of</b>                  |                    |
|-------------------------------|-------------------------------|--------------------|
|                               | <b>October 31,</b>            | <b>January 31,</b> |
|                               | <b>2016</b>                   | <b>2016</b>        |
|                               | <b>(Amounts in thousands)</b> |                    |
| Components and assemblies     | \$ 473                        | \$ 1,223           |
| Finished products             | 525                           | 459                |
| <b>Total inventories, net</b> | <b>\$ 998</b>                 | <b>\$ 1,682</b>    |

**Table of Contents*****Asset Held for Sale***

In fiscal 2012 as a result of the restructuring of our video on-demand server product lines and divestiture of a portion of our broadcast servers and storage business, we determined we would no longer utilize our facility in Greenville, New Hampshire as an active operation. As a result, we placed the asset group on the market for sale. We classified the asset group as held for sale beginning in fiscal 2012 because at the time, the potential sale of this asset group met all the criteria for an asset held for sale. The asset group continued to be classified as held for sale until fiscal 2014 when management concluded that the sale of the asset group would take longer than they first expected due to the location of the property and the overall market conditions. We felt that the asset group no longer met the criteria for held for sale accounting because the sale of the building was not imminent. Accordingly, in the third quarter of fiscal 2014 we reclassified \$0.5 million, which represented the fair value of the asset group at the date of the subsequent decision not to sell, as held and used and began depreciating it over its remaining life.

During the third quarter of fiscal 2017, we began actively marketing the asset group for sale and identified a potential buyer. Accordingly, we determined that the sale of the asset group is probable by the end of the fourth quarter of fiscal 2017. We determined that the asset group meets all the criteria of held for sale accounting and have classified the asset group as held for sale on our consolidated balance sheets beginning in the third quarter of fiscal 2017. We originally placed the asset group on the market in August 2016 for \$0.3 million, which was the net book value of the asset group at that time. To be more competitive in the real estate market in which the property is located, we reduced the selling price in September 2016 to \$0.2 million. As a result, we recorded a loss on impairment of long-lived assets of \$0.1 million in our consolidated statements of operations and comprehensive loss during the three and nine months ended October 31, 2016.

***Property and equipment, net***

Property and equipment, net consists of the following:

|  | Estimated<br>Useful<br>Life (Years) | As of<br>October 31,<br>2016 | January 31,<br>2016 |
|--|-------------------------------------|------------------------------|---------------------|
| (Amounts in thousands)                                   |                                     |                              |                     |
| Land   |                                     | \$ 2,780                     | \$ 2,880            |
| Buildings  | 20                                  | 11,654                       | 11,908              |
| Office furniture and equipment                           | 5                                   | 1,111                        | 1,099               |
| Computer equipment, software and demonstration equipment | 3                                   | 18,472                       | 18,639              |
| Service and spare components                             | 5                                   | 1,158                        | 1,158               |
| Leasehold improvements                                   | 1-7                                 | 1,091                        | 1,087               |
|  |                                     | 36,266                       | 36,771              |
| Less - Accumulated depreciation and amortization         |                                     | (24,177)                     | (22,642)            |
| <b>Total property and equipment, net</b>                 |                                     | <b>\$ 12,089</b>             | <b>\$ 14,129</b>    |



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Depreciation and amortization expense on property and equipment, net was \$0.7 million and \$2.3 million for the three and nine months ended October 31, 2016, respectively, and \$0.9 million and \$2.6 million for the three and nine months ended October 31, 2015, respectively.

**Other accrued expenses**

Other accrued expenses consist of the following:

|                                      | As of<br>October 31,<br>2016 | January 31,<br>2016 |
|--------------------------------------|------------------------------|---------------------|
|                                      | (Amounts in thousands)       |                     |
| Accrued compensation and commissions | \$ 1,473                     | \$ 1,676            |
| Accrued bonuses                      | 2,062                        | 2,902               |
| Accrued severance                    | 420                          | 47                  |
| Accrued restructuring                | 1,186                        |                     |
| Employee benefits                    | 759                          | 1,484               |
| Accrued provision for contract loss  | 3,358                        | 6,497               |
| Accrued other                        | 3,665                        | 4,808               |
| Total other accrued expenses         | \$ 12,923                    | \$ 17,414           |

**6. Goodwill and Intangible Assets****Goodwill**

Goodwill represents the difference between the purchase price and the estimated fair value of identifiable assets acquired and liabilities assumed. We are required to perform impairment tests related to our goodwill annually, which we perform during the third quarter of each fiscal year, or when we identify certain triggering events or circumstances that would more likely than not reduce the estimated fair value of the goodwill of the Company below its carrying amount. Changes in the carrying amount of goodwill for the nine months ended October 31, 2016 were as follows (amounts in thousands):

|                                   |           |
|-----------------------------------|-----------|
| Balance as of February 1, 2016    |           |
| Goodwill                          | \$ 55,962 |
| Accumulated impairment losses     | (15,787)  |
|                                   | 40,175    |
| Acquisition of DCC Labs           | 5,401     |
| Cumulative translation adjustment | 113       |
| Balance as of October 31, 2016    |           |
| Goodwill                          | 61,476    |



|                               |           |
|-------------------------------|-----------|
| Accumulated impairment losses | (15,787)  |
|                               | \$ 45,689 |

Preliminary goodwill is reported at \$5.4 million as of October 31, 2016, related to the acquisition of DCC Labs based on the preliminary allocation of the estimated purchase price. We will continue to evaluate certain assets, liabilities and tax estimates that are subject to change within the measurement period (up to one year from the acquisition date).

In the second quarter of fiscal 2017, triggering events prompted us to perform step one of the goodwill impairment test. The triggering events included; a sustained decrease in our stock price during the period, the withdrawal of the permanent reinvestment assertion on earnings generated by our Irish operations (see Note 12, *Income Taxes* to our consolidated financial statements for more information) and a decline in actual revenue for the quarter compared to projected amounts, which was previously reported in a Current Report on Form 8-K furnished to the SEC on August 23, 2016. The outcome of that preliminary step one analysis revealed that as of July 31, 2016, the fair value of the net assets exceeded its carrying value by a range of \$15.4 million to \$25.0 million, or 15.0% to 24.4% of the carrying value of our net assets.

In the third quarter of fiscal 2017, we finalized our step one analysis of the goodwill impairment test. Our forecast indicated that the estimated fair value of net assets may be less than the carrying value which is a potential indicator of impairment. As such, we are required to perform step two of the impairment test during which we compare the implied fair value of our goodwill to its carrying value. We currently continue to work through various restructuring actions and execute on other strategic plans which has not enabled us to complete the step two testing at this time. We expect to complete the goodwill impairment testing of our reporting unit during the fourth quarter of fiscal 2017. To the extent that the finalization of this assessment of goodwill requires recognition of an impairment loss, such adjustment would be recorded in the fourth quarter of fiscal 2017. We have estimated the range of impairment loss to be between \$0 and \$45.7 million and have not recognized an impairment loss in the third quarter of fiscal 2017. See *Critical Accounting Policies and Significant Judgment and Estimates – Goodwill*, in Part I, Item 2 of this Form 10Q for more information on the impairment testing.

**Table of Contents****Intangible Assets**

Intangible assets, net, consisted of the following at October 31, 2016 and January 31, 2016:

|                                       | Weighted average<br>remaining life<br>(Years) | As of October 31, 2016 |                             |          | As of January 31, 2016 |                             |          |
|---------------------------------------|---|------------------------|-----------------------------|----------|------------------------|-----------------------------|----------|
|                                       |   | Gross                  | Accumulated<br>Amortization | Net      | Gross                  | Accumulated<br>Amortization | Net      |
| <b>Finite-life intangible assets:</b> |   |                        |                             |          |                        |                             |          |
| Customer contracts                    | 4.3   | \$ 31,454              | \$ (27,797)                 | \$ 3,657 | \$ 29,956              | \$ (26,284)                 | \$ 3,672 |
| Non-compete agreements                | 1.8   | 2,483                  | (2,410)                     | 73       | 2,365                  | (2,365)                     |          |
| Completed technology                  | 6.0   | 11,509                 | (10,029)                    | 1,480    | 10,075                 | (9,621)                     | 454      |
| Trademarks, patents and other         | 4.8   | 7,267                  | (7,092)                     | 175      | 7,068                  | (7,068)                     |          |
| Total finite-life intangible assets   | 4.7   | \$ 52,713              | \$ (47,328)                 | \$ 5,385 | \$ 49,464              | \$ (45,338)                 | \$ 4,126 |

As of October 31, 2016, the estimated future amortization expense for our finite-life intangible assets is as follows (amounts in thousands):

| Fiscal Year Ended January 31,         | Estimated<br>Amortization<br>Expense |
|---------------------------------------|--------------------------------------|
| 2017 (for the remaining three months) | \$ 635                               |
| 2018                                  | 1,721                                |
| 2019                                  | 1,038                                |
| 2020                                  | 524                                  |
| 2021                                  | 389                                  |
| 2022 and thereafter                   | 1,078                                |
| Total                                 | \$ 5,385                             |

## 7. Commitments and Contingencies

### Indemnification and Warranties

We provide indemnification, to the extent permitted by law, to our officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee or agent is, or was, serving at our request in such capacity. With respect to acquisitions, we provide indemnification to, or assume indemnification

obligations for, the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' governing documents. As a matter of practice, we have maintained directors' and officers' liability insurance including coverage for directors and officers of acquired companies.

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

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

**Table of Contents*****Revolving Line of Credit/Demand Note Payable***

We had a letter agreement with JP Morgan Chase Bank, N.A. ( JP Morgan ) for a demand discretionary line of credit and a Demand Promissory Note in the aggregate amount of \$20.0 million, which expired on August 31, 2016 with no outstanding balance. This line of credit and Demand Promissory Note was not renewed.

**8. Severance and Other Restructuring Costs*****Restructuring Costs***

During the nine months ended October 31, 2016, we incurred restructuring charges of \$4.6 million primarily from employee-related benefits for terminated employees and costs to close facilities.

The following table shows the activity in accrued restructuring reported as a component of other accrued expenses on the consolidated balance sheet as of October 31, 2016 (amounts in thousands):

|  | <b>Employee-<br/>Related<br/>Benefits</b> | <b>Closure of<br/>Leased<br/>Facilities</b> | <b>Other<br/>Restructuring</b> | <b>Total</b> |
|--|---|---|--------------------------------|--------------|
| Accrual balance as of January 31, 2016 | \$  | \$  | \$                             | \$           |
| Restructuring charges incurred         | 3,868                                     | 470   | 250                            | 4,588        |
| Cash payments                          | (2,946)                                   | (274)                                       | (182)                          | (3,402)      |
| Other charges                          |   |   |                                |              |
| Accrual balance as of October 31, 2016 | \$ 922                                    | \$ 196                                      | \$ 68                          | \$ 1,186     |

During the third quarter of fiscal 2017, we implemented a restructuring program ( Fiscal 2017 Restructuring Plan ) with the purpose of reducing costs and assisting in restoring SeaChange to profitability and positive cash flow. The total estimated restructuring costs associated with the Fiscal 2017 Restructuring Plan are anticipated to be approximately \$3 million and will be recorded in severance and other restructuring costs in our consolidated statements of operations and comprehensive loss as they are incurred. We recorded \$2.1 million of restructuring expense in connection with this plan during the three and nine months ended October 31, 2016, which was primarily made up of employee related costs, and we expect to incur a majority of the estimated remaining amount through the first quarter of fiscal 2018. Any changes to the estimate of executing the Fiscal 2017 Restructuring Plan will be reflected in our future results of operations.

During the second quarter of fiscal 2017, we restructured our operations in connection with the acquisition of DCC Labs. This restructuring resulted in a workforce reduction within our In Home engineering and services organization and in the closing of our facility in Portland, Oregon. We incurred charges totaling \$1.9 million in severance and other restructuring costs during fiscal 2017 related to the acquisition of DCC Labs. Once we complete our integration plan, any further reduction in workforce may result in additional restructuring charges.

As a result of restructuring activities relating to our Timeline Labs operations in fiscal 2017, we incurred \$0.6 million of charges, which include \$0.5 million in severance to former Timeline Labs employees and \$0.1 million in other restructuring charges relating to our remaining lease obligation of our Timeline Labs facilities in San Francisco and

Santa Monica, California.

***Severance Costs***

During the nine months ended October 31, 2016, we incurred severance charges of \$1.4 million primarily from the departure of our former Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ) during the first half of fiscal 2017 as well as the termination of 12 other former employees.

Effective April 6, 2016, we terminated the employment of Jay Samit, our former CEO. In connection with his termination, Mr. Samit and SeaChange entered into a Separation Agreement and Release of Claims (the CEO Separation Agreement ). Under the terms of the CEO Separation Agreement and consistent with our pre-existing obligations to Mr. Samit in connection with a termination without cause, we incurred a charge of \$1.0 million in the first quarter of fiscal 2017, which included \$0.2 million for satisfaction of his remaining fiscal 2016 and 2017 annual bonuses and \$0.8 million in severance payable in twelve equal monthly installments which will be completed in the first quarter of fiscal 2018. In addition, on July 6, 2016, Anthony Dias resigned as CFO of SeaChange, though he continued as an

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employee until July 31, 2016. In connection with his resignation, Mr. Dias and SeaChange entered into an Employment Separation Agreement and Voluntary Release, dated July 6, 2016 (the CFO Separation Agreement ). Under the terms of the CFO Separation Agreement, we incurred a charge of \$0.2 million, which included his fiscal 2017 pro-rated bonus (paid in fiscal 2018) and six months base salary as severance payable in twelve equal semi-monthly installments, which will be completed by the end of fiscal 2017.

**9. Stockholders Equity*****2011 Compensation and Incentive Plan***

In July 2011, our stockholders approved the adoption of our 2011 Compensation and Incentive Plan (the 2011 Plan ). Under the 2011 Plan, as amended in July 2013, the number of shares of common stock authorized for grant is equal to 5,300,000 shares plus the number of shares that expired, terminated, surrendered or forfeited awards subsequent to July 20, 2011 under the Amended and Restated 2005 Equity Compensation and Incentive Plan (the 2005 Plan ). Following approval of the 2011 Plan, we terminated the 2005 Plan. The 2011 Plan provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units ( RSUs ), deferred stock units ( DSUs ) and other equity based non-stock option awards as determined by the plan administrator to officers, employees, consultants, and directors of the Company. On July 13, 2016, our stockholders approved an amendment to the 2011 Plan which:

Approved the removal of minimum vesting periods for stock option, RSU and other stock-based awards, but excluding restricted stock, under the 2011 Plan; and

Approved the material terms of the performance goals of the 2011 Plan under which tax-deductible compensation may be paid for purposes of rules under the Internal Revenue Code of 1986, as amended, including the business criteria on which performance goals may be based.

Effective February 1, 2014, SeaChange gave its non-employee members of the Board of Directors the option to receive DSUs in lieu of RSUs, beginning with the annual grant for fiscal 2015. The number of units subject to the DSUs is determined as of the grant date and shall fully vest one year from the grant date. The shares underlying the DSUs are not vested and issued until the earlier of the director ceasing to be a member of the Board of Directors (provided such time is subsequent to the first day of the succeeding fiscal year) or immediately prior to a change in control. Commencing with fiscal 2016, we changed the policy regarding the timing of the equity grant from the first day of the applicable fiscal year to the date of our annual meeting of stockholders. To facilitate the transition, a partial year grant was made to our non-employee directors, effective February 1, 2015, and a full year grant was made to our non-employee directors, effective July 15, 2015.

We may satisfy awards upon the exercise of stock options or the vesting of stock units with newly issued shares or treasury shares. The Board of Directors is responsible for the administration of the 2011 Plan and determining the terms of each award, award exercise price, the number of shares for which each award is granted and the rate at which each award vests. In certain instances, the Board of Directors may elect to modify the terms of an award. As of October 31, 2016, there were 1,080,312 shares available for future grant under the 2011 Plan.

Option awards may be granted to employees at an exercise price per share of not less than 100% of the fair market value per common share on the date of the grant. Stock units may be granted to any officer, employee, director, or

consultant at a purchase price per share as determined by the Board of Directors. Option awards granted under the 2011 Plan generally vest over a period of one to four years and expire ten years from the date of the grant.

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

We have granted market-based options to certain newly appointed officers. These stock options have an exercise price equal to our closing stock price on the date of grant and will vest in approximately equal increments based upon the closing price of SeaChange's common stock. We record the fair value of these stock options using the Monte Carlo simulation model, since the stock option vesting is variable depending on the closing price of our traded common stock. The model simulated the daily trading price of the market-based stock options' expected terms to determine if the vesting conditions would be triggered during the term. Effective April 6, 2016, Ed Terino, who previously served as our Chief Operating Officer ( COO ), was appointed Chief Executive Officer ( CEO ) of SeaChange and was granted 600,000 market-based options, bringing the total of his market-based options, when added to the 200,000 market-based options

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he received upon hire as COO in June 2015, to 800,000 market-based options. The fair value of these stock options was estimated to be \$2.1 million. As of October 31, 2016, \$1.1 million remained unamortized on these market-based stock options, which will be expensed over the next 2.5 years, the remaining weighted average amortization period.

***2015 Employee Stock Purchase Plan***

In July 2015 we adopted the 2015 Employee Stock Purchase Plan (the "ESPP"). The purpose of the ESPP is to provide eligible employees, including executive officers of SeaChange, with the opportunity to purchase shares of our common stock at a discount through accumulated payroll deductions of up to 15%, but not less than one percent of their eligible compensation, subject to any plan limitations. Offering periods typically commence on October 1<sup>st</sup> and April 1<sup>st</sup> and end on March 31<sup>st</sup> and September 30<sup>th</sup> with the last trading day being the exercise date for the offering period. On each purchase date, eligible employees will purchase our stock at a price per share equal to 85% of the closing price of our common stock on the exercise date, but no less than par value. The maximum number of shares of our common stock which will be authorized for sale under the ESPP is 1,150,000 shares. Stock-based compensation expense related to the ESPP was not significant for the three and nine months ended October 31, 2016.

**10. Accumulated Other Comprehensive Loss**

The following shows the changes in the components of accumulated other comprehensive loss for the nine months ended October 31, 2016:

|                             | <b>Foreign<br/>Currency<br/>Translation<br/>Adjustment</b> | <b>Changes<br/>in<br/>Fair Value of<br/>Available-<br/>for-Sale<br/>Investments</b> | <b>Total</b> |
|-----------------------------|--|---|--------------|
|                             | <b>(Amounts in thousands)</b>                              |   |              |
| Balance at January 31, 2016 | \$ (6,644)   | \$ 31   | \$ (6,613)   |
| Other comprehensive loss    | (316)  | (2)   | (318)        |
| Balance at October 31, 2016 | \$ (6,960)   | \$ 29   | \$ (6,931)   |

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

Comprehensive loss consists of our net loss and other comprehensive loss, which includes foreign currency translation adjustments and changes in unrealized gains and losses on marketable securities available-for-sale. For purposes of comprehensive loss disclosures, we do not record tax expense or benefits for the net changes in the foreign currency translation adjustments.

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



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

### *Significant Customers*

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

|            | <b>Three Months Ended</b> |                    | <b>Nine Months Ended</b> |                    |
|------------|---------------------------|--------------------|--------------------------|--------------------|
|            | <b>October 31,</b>        | <b>October 31,</b> | <b>October 31,</b>       | <b>October 31,</b> |
|            | <b>2016</b>               | <b>2015</b>        | <b>2016</b>              | <b>2015</b>        |
| Customer A | 33%                       | 30%                | 31%                      | 25%                |
| Customer B | N/A                       | N/A                | N/A                      | 12%                |

**Table of Contents****Geographic Information**

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

|   | Three Months Ended<br>October 31, |     |           |     | Nine Months Ended<br>October 31, |     |           |     |
|---|-----------------------------------|-----|-----------|-----|----------------------------------|-----|-----------|-----|
|   | 2016                              |     | 2015      |     | 2016                             |     | 2015      |     |
|   | Amount                            | %   | Amount    | %   | Amount                           | %   | Amount    | %   |
| (Amounts in thousands, except percentages)  |                                   |     |           |     |                                  |     |           |     |
| Revenues by customers geographic locations: |                                   |     |           |     |                                  |     |           |     |
| North America(1)                            | \$ 9,116                          | 45% | \$ 14,659 | 51% | \$ 28,306                        | 47% | \$ 44,447 | 56% |
| Europe and Middle East                      | 8,518                             | 43% | 12,322    | 43% | 26,098                           | 44% | 29,979    | 37% |
| Latin America                               | 1,334                             | 7%  | 1,433     | 5%  | 3,785                            | 6%  | 3,884     | 5%  |
| Asia Pacific                                | 993                               | 5%  | 333       | 1%  | 1,794                            | 3%  | 1,485     | 2%  |
| Total                                       | \$ 19,961                         |     | \$ 28,747 |     | \$ 59,983                        |     | \$ 79,795 |     |

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

|                     | Three Months<br>Ended<br>October 31, |           | Nine Months Ended<br>October 31, |           |
|---------------------|--------------------------------------|-----------|----------------------------------|-----------|
|                     | 2016                                 | 2015      | 2016                             | 2015      |
| U.S. Revenue        | \$ 6,905                             | \$ 11,880 | \$ 22,040                        | \$ 35,609 |
| % of total revenues | 34.6%                                | 41.3%     | 36.7%                            | 44.6%     |

**12. Income Taxes**

We recorded an income tax benefit of \$0.4 million for the three months ended October 31, 2016 and a tax provision of \$14.4 million for the nine months ended October 31, 2016. The tax benefit for the three-month period includes the reversal of tax reserves for uncertain tax positions due to the expiration of the Irish statute of limitations of \$0.4 million. The tax provision for the nine-month period is primarily due to deferred income tax expense of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2017 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

Our foreign subsidiaries generate earnings that are not subject to U.S. income taxes so long as they are permanently reinvested in our operations outside of the U.S. Pursuant to Accounting Standard Codification Topic No. 740-30, *Income Taxes - Other Considerations or Special Areas*, undistributed earnings of foreign subsidiaries that are not

longer permanently reinvested would become subject to deferred income taxes under U.S. tax law. Prior to the second quarter of fiscal 2017, we asserted that the undistributed earnings of all our foreign subsidiaries were permanently reinvested.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings.

There is no certainty as to the timing of when such foreign earnings will be distributed to the United States in whole or in part. Further, when the foreign earnings are distributed to the United States, we anticipate that a substantial portion of the resulting U.S. income taxes would be reduced by existing tax attributes.

We have not provided for U.S. federal or foreign income taxes on \$4.8 million of our non-U.S. subsidiaries undistributed earnings as of October 31, 2016. The \$4.8 million of undistributed foreign earnings have been reinvested in our foreign operations, as we have determined that these earnings are necessary to support our planned ongoing investments in our foreign operations, and as a result, these earnings remain indefinitely reinvested in those operations.

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In making this decision, we considered cash needs for: investing in our existing businesses, potential acquisitions and capital transactions.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of October 31, 2016, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

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

**13. Net Loss Per Share**

Net loss per share is presented in accordance with authoritative guidance which requires the presentation of basic and diluted earnings per share. Basic earnings (loss) per share is computed by dividing earnings (loss) available to common shareholders by the weighted-average shares of common stock outstanding during the period. For the purposes of calculating diluted earnings per share, the denominator includes both the weighted average number of shares of common stock outstanding during the period and the weighted average number of shares of potential dilutive shares of common stock, such as stock awards, calculated using the treasury stock method. Basic and diluted net loss per share was the same for all the periods presented as the impact of potential dilutive shares outstanding was anti-dilutive.

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

|  | <b>Three Months<br/>Ended<br/>October 31,</b> |             | <b>Nine Months Ended<br/>October 31,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2016</b>                                   | <b>2015</b> | <b>2016</b>                              | <b>2015</b> |
| Net loss   | \$ (8,082)                                    | \$ (10,565) | \$ (43,873)                              | \$ (25,417) |
| Weighted average shares used in computing net loss per share - basic and diluted | 35,186  | 33,636      | 34,889                                   | 33,440      |
| Net loss per share:  |   |             |  |             |
| Basic  | \$ (0.23)                                     | \$ (0.31)   | \$ (1.26)                                | \$ (0.76)   |
| Diluted  | \$ (0.23)                                     | \$ (0.31)   | \$ (1.26)                                | \$ (0.76)   |

The number of common shares used in the computation of diluted net loss per share for the three and nine months ended October 31, 2016 and 2015 does not include the effect of the following potentially outstanding common shares because the effect would have been anti-dilutive (amounts in thousands):

|                        | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|------------------------|---------------------------|-------------|--------------------------|-------------|
|                        | <b>October 31,</b>        |             | <b>October 31,</b>       |             |
|                        | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Stock options          | 1,756                     | 1,791       | 1,443                    | 1,503       |
| Restricted stock units | 845                       | 169         | 787                      | 176         |
| Deferred stock units   | 28                        | 30          | 55                       | 20          |
| Total                  | 2,629                     | 1,990       | 2,285                    | 1,699       |

#### **14. Recent Accounting Standard Updates**

We consider the applicability and impact of all ASUs. Updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations.

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**Table of Contents*****Recently Issued Accounting Standard Updates Not Yet Adopted******Revenue from Contracts with Customers (Topic 606)***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and the International Financial Reporting Standards. This guidance supersedes previously issued guidance on revenue recognition and gives a five step process an entity should follow so that the entity recognizes revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB deferred the effective date of this guidance to annual reporting periods beginning after December 15, 2017, which would be our fiscal 2019 reporting period. It must be applied either retrospectively during each prior reporting period presented or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of the initial application. Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. ASU 2016-08 is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The effective date for ASU 2016-08 is the same as the effective date for ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. ASU 2016-10 provides clarification on two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance. Specifically, the amendments reduce the cost and complexity of identifying promised goods or services and improve the guidance for determining whether promises are separately identifiable. The effective date of ASU 2016-10 is the same as the effective date for ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. ASU 2016 clarifies aspects of ASU 2014-09, including clarifying noncash consideration, and provides a practical expedient for reflecting contract modifications at transition. The effective date of ASU 2016-12 is the same as the effective date of ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

***Leases***

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

*Stock Compensation*

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 intended to simplify several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statements of cash flows. ASU 2016-09 is effective for us in the first quarter of fiscal 2018. Early adoption is permitted. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

*Cash Flow Statement*

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and

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annual periods beginning in our first quarter of fiscal 2018, and early adoption is permitted. ASU 2016-15 must be applied retrospectively to all periods presented but may be applied prospectively if retrospective application would be impracticable. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

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

The Company believes that no other new accounting guidance that was issued during fiscal 2016 will be relevant to the readers of its financial statements.

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

### ***Forward-Looking Statements***

This Form 10-Q contains or incorporates forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which involve risks and uncertainties. The following information should be read in conjunction with the unaudited consolidated financial information and the notes thereto included in this Form 10-Q. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially due to competitive factors and other factors referred to in Part I, Item 1A. **Risk Factors** in our Form 10-K for our fiscal year ended January 31, 2016 and elsewhere in this Form 10-Q. These factors may cause our actual results to differ materially from any forward-looking statement. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate, and management's beliefs and assumptions. We undertake no obligation to publicly update or revise the statements in light of future developments. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as *expect, anticipate, intend, plan, believe, could, estimate, project, or variations of such words and similar expressions* are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict.

### ***Business Overview***

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

We continue to address what we see as the continuing rise of OTT services by such companies as Netflix, Hulu and Amazon and by media companies such as HBO, CBS and BBC. This rise of OTT video services in the United States has increased the demand for multiscreen capabilities on a range of consumer devices operating on cloud-based platforms. We have been increasing our strategic investments in research and development related to our cloud-based offerings, as well as in sales and marketing as we work to increase our go-to-market efforts in this area.



We continue to invest in our Rave premium OTT platform ( Rave ), which is our cloud-based software-as-a-service ( SaaS ) offering that permits service providers and media companies to offer features and functions through a service hosted and managed by SeaChange, reducing cost and increasing speed and ease of use for end-users. We believe that by delivering innovative solutions to both our existing customer base and to content owners that are looking to provide OTT services, we can meet their growing needs and help them get to market faster, which will help them drive new revenue growth. Recognizing the importance of OTT, we have architected our cloud solutions and products to make integrating with existing networks simple and a core competency of our platform. We have optimized our software solutions to serve a wide range of consumer devices.

We expect to increase software sales in North America and EMEA through an increase in sales efforts in those regions. In addition, we believe that we have the opportunity for continued revenue growth by expanding our sales efforts in other geographic areas such as Asia Pacific and Latin America. We also believe that our existing service operator customers will continue upgrading to new features that enable the capacity to increase average revenue per subscriber, reduced operating and capital expenses, and lower customer churn.

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

Changes in estimated times to complete long-term projects;

The time required to deliver and install the product and for the customer to accept the product and services;

Timing of our customers in selecting programs to launch our services to their end users;

The ability of our customers to process the purchase order within their organization in a timely manner;

Budgetary approvals by our customers for capital purchases;

Uncertainty caused by potential consolidation in the industry; and

Changes in foreign exchange rates.

These, together with other factors, could result in the reduction in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, a longer period of time before we may recognize revenue attributable to a sale, changes in cost estimates in long-term contracts which could result in a loss provision, gross margin deterioration, slower adoption of new technologies, the transition to SaaS, and an increase in price competition.

On February 2, 2015, we acquired TLL, LLC ( Timeline Labs ), a California-based SaaS company. In January 2016, our Board of Directors authorized a restructuring plan (including a possible winding down of the Timeline Labs operations), as previously reported in a Form 8-K filed with the SEC on February 17, 2016. Based on the decision to enter into the restructuring plan and the plan's impact on the projected future cash flows of the Timeline Labs operations, we determined that the carrying amount of all long-term assets that resulted from the February 2015 acquisition had exceeded their fair value as of January 31, 2016. As a result, these long-term assets were deemed fully impaired and we recorded the \$21.9 million net book value of these long-term assets as a component of loss on impairment of TLL, LLC net assets in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016. Additionally, we reduced the contingent consideration liability associated with the Timeline Labs acquisition to zero, as we determined that the defined performance criteria would not be achieved, and credited the reversal of the liability of \$0.4 million to loss on impairment of TLL, LLC net assets in our consolidated statements of operations and comprehensive loss for the fiscal year ended January 31, 2016. In February 2016, we implemented cost-saving actions related to the restructuring plan resulting in charges of \$0.6 million related to severance paid to former TLL, LLC employees and facility closings. See Note 4, *Acquisitions and Loss on Impairment*, to our consolidated financial statements for more information.

Effective April 6, 2016, Edward Terino, who previously served as our Chief Operating Officer, was appointed Chief Executive Officer ( CEO ) of SeaChange, following the termination of the employment of Jay Samit as CEO, as

previously reported in a Current Report on Form 8-K filed with the SEC on April 7, 2016.

On May 5, 2016 we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.6 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all of the stock is initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement. The stock consideration is determined by dividing the total value of \$2.6 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing.

The acquisition of DCC Labs enables us to optimize the operations of our In Home business, which is our developer of deployed software solutions including the SeaChange Nucleus home video gateway. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe's Digital Video Broadcasting community, and an HTML5 framework for building future-proof user interfaces for CPE devices.

In conjunction with the DCC Labs acquisition, SeaChange commenced a workforce reduction within its In Home engineering and services organization, which we anticipate will achieve approximately \$8 million in annualized cost savings. This initial reduction in workforce resulted in aggregate charges of \$1.9 million in severance and other restructuring costs during the nine months ended October 31, 2016. Once we complete our integration plan, any further reduction in workforce may result in additional restructuring charges.

In addition to the reduction in workforce due to the acquisition of DCC Labs, we implemented additional company-wide cost savings during our third quarter, which includes a worldwide reduction in workforce, to help improve operations and optimize our cost structure with the goal of assisting in restoring SeaChange to profitability and positive cash flow.

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During the first nine months of fiscal 2017, we recognized \$2.1 million of restructuring costs related to these cost saving initiatives.

Effective July 6, 2016, Peter Faubert was appointed Chief Financial Officer ( CFO ) of SeaChange, following the resignation of Anthony Dias as CFO, as previously reported in a Current Report on Form 8-K filed with the SEC on July 7, 2016.

We recorded an income tax provision of \$14.4 million for the nine months ended October 31, 2016, primarily relating to deferred income tax expense of \$14.7 million related to the undistributed foreign earnings of certain of our foreign subsidiaries. Prior to the end of the second quarter of fiscal 2017, we asserted that the undistributed earnings of all our foreign subsidiaries were permanently reinvested and, accordingly were not subject to U.S. income taxes. In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016, and recorded a deferred tax liability of \$14.7 million related to the foreign income on the \$58.6 million of undistributed earnings. There is no certainty as to the timing of when such foreign earnings will be distributed to the United States in whole or in part. In addition, when the foreign earnings are distributed to the United States, we anticipate that a substantial portion of the resulting U.S. income taxes would be reduced by existing tax attributes.

**Results of Operations**

The following discussion summarizes the key factors our management believes are necessary for an understanding of our consolidated financial statements.

**Revenues**

The following table summarizes information about our revenues for the three and nine months ended October 31, 2016 and 2015:

|  | Three Months Ended October 31, |          | Increase/ (Decrease) |          | Nine Months Ended October 31, |           | Increase/ (Decrease) |          |
|--|--------------------------------|----------|----------------------|----------|-------------------------------|-----------|----------------------|----------|
|  | 2016                           | 2015     | \$ Amount            | % Change | 2016                          | 2015      | \$ Amount            | % Change |
| (Amounts in thousands, except for percentage data) |                                |          |                      |          |                               |           |                      |          |
| <b>Revenues:</b>                                   |                                |          |                      |          |                               |           |                      |          |
| Product  | \$ 3,746                       | \$ 6,195 | \$ (2,449)           | (39.5%)  | \$ 10,481                     | \$ 16,314 | \$ (5,833)           | (35.8%)  |
| Service  | 16,215                         | 22,552   | (6,337)              | (28.1%)  | 49,502                        | 63,481    | (13,979)             | (22.0%)  |
| Total revenues                                     | 19,961                         | 28,747   | (8,786)              | (30.6%)  | 59,983                        | 79,795    | (19,812)             | (24.8%)  |
| <b>Cost of product revenues</b>                    |                                |          |                      |          |                               |           |                      |          |
| Cost of product revenues                           | 1,906                          | 1,712    | 194                  | 11.3%    | 4,752                         | 5,323     | (571)                | (10.7%)  |
| <b>Cost of service revenues</b>                    |                                |          |                      |          |                               |           |                      |          |
| Cost of service revenues                           | 8,243                          | 10,996   | (2,753)              | (25.0%)  | 28,814                        | 33,890    | (5,076)              | (15.0%)  |

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|                             |          |          |          |          |           |           |            |          |
|-----------------------------|----------|----------|----------|----------|-----------|-----------|------------|----------|
| Provision for loss contract |          | 9,162    | (9,162)  | (100.0%) |           | 9,162     | (9,162)    | (100.0%) |
| Total cost of revenues      | 10,149   | 21,870   | (11,721) | (53.6%)  | 33,566    | 48,375    | (14,809)   | (30.6%)  |
| Gross profit                | \$ 9,812 | \$ 6,877 | \$ 2,935 | 42.7%    | \$ 26,417 | \$ 31,420 | \$ (5,003) | (15.9%)  |
| Gross product profit margin | 49.1%    | 72.4%    |          | (23.3%)  | 54.7%     | 67.4%     |            | (12.7%)  |
| Gross service profit margin | 49.2%    | 10.6%    |          | 38.6%    | 41.8%     | 32.2%     |            | 9.6%     |
| Gross profit margin         | 49.2%    | 23.9%    |          | 25.3%    | 44.0%     | 39.4%     |            | 4.6%     |

*Product Revenue.* The decrease in product revenue for the three and nine months ended October 31, 2016 of \$2.4 million and \$5.8 million, respectively, was primarily due to a \$1.3 million decrease and \$2.1 million decrease in our video platform revenue for the three and nine months ended October 31, 2016, as compared to the same periods of fiscal 2016. Also, there was a \$0.9 million decrease and a \$3.6 million decrease in hardware revenue during the same periods.

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*Service Revenue.* Service revenue decreased \$6.3 million for the three months ended October 31, 2016, and decreased \$14.0 million for the nine months ended October 31, 2016, as compared to the same periods of fiscal 2016. The decline was primarily due to less revenue recognized for professional services provided on our video platform during these periods. Additionally, there was a decrease in maintenance and support revenue provided on post-warranty contracts.

During the three and nine months ended October 31, 2016, one customer accounted for more than 10% of our total revenue. One and two customers accounted for more than 10% of our total revenue during the three and nine months ended October 31, 2015, respectively. See Note 11, *Segment Information, Significant Customers and Geographic Information*, to our consolidated financial statements for more information.

International sales accounted for 65% and 59% of total revenues in the three months ended October 31, 2016 and 2015, respectively. For the nine months ended October 31, 2016 and 2015, international sales accounted for 63% and 55% of total revenues. The increase in the international sales as a percentage of total revenue for the three and nine months ended October 31, 2016, as compared to the same prior periods is primarily due to a 42% and 38% decrease in domestic revenue, respectively.

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

Our gross profit margin increased 25 percentage points and five percentage points for the three and nine months ended October 31, 2016, as compared to the same periods of the prior fiscal year. However, excluding the provision for loss contract recorded in the third quarter of fiscal 2016, our gross profit margin decreased seven percentage points for the three and nine months ended October 31, 2016, as compared to the same periods of the prior fiscal year. Product gross margin decreased 23 percentage points for the three months and 13 percentage points for the nine months ended October 31, 2016, as compared to the same period in the prior fiscal year due to lower software and license revenue. Service profit margins increased 39 percentage points and 10 percentage points for the three and nine months ended October 31, 2016, as compared to the same periods of the prior fiscal year. However, excluding the provision for loss contract, service profit margin decreased two percentage points for the three months ended and five percentage points for the nine months ended October 31, 2016, as compared to the same periods of 2015. This is due to the lower service revenue to absorb our fixed costs of the professional services organization.

**Operating Expenses***Research and Development*

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

| Three Months Ended                                 |          | Increase/ Increase/  |          | Nine Months |           | Increase/ Increase/  |          |
|--|----------|----------------------|----------|-------------|-----------|----------------------|----------|
| October 31,  |          | (Decrease)(Decrease) |          | Ended       |           | (Decrease)(Decrease) |          |
| 2016   | 2015     | \$ Amount            | % Change | 2016        | 2015      | \$ Amount            | % Change |
| (Amounts in thousands, except for percentage data) |          |                      |          |             |           |                      |          |
| \$ 7,325   | \$ 8,273 | \$ (948)             | (11.5%)  | \$ 23,751   | \$ 26,176 | \$ (2,425)           | (9.3%)   |

## Research and

## development expenses

|                     |       |       |       |       |
|---------------------|-------|-------|-------|-------|
| % of total revenues | 36.7% | 28.8% | 39.6% | 32.8% |
|---------------------|-------|-------|-------|-------|

Research and development expenses consist primarily of employee costs, which include salaries, benefits and related payroll taxes, depreciation of development and test equipment and an allocation of related facility expenses. During the three and nine months ended October 31, 2016, research and development costs decreased \$0.9 million and \$2.4 million, respectively, as compared to the same periods of fiscal 2016. The reasons for the decrease are primarily due to lower labor costs associated with decreased headcount from the Timeline Labs restructuring in February 2016, to the restructuring of the research and development group after our acquisition of DCC Labs in May 2016 and to cost-savings efforts implemented in the third quarter of fiscal 2017. These restructuring efforts would have resulted in a larger decrease in our research and development costs period over period than would have been achieved if we did not capitalize \$0.7 million and \$2.1 million of costs related to the development of our internal-use software in the three and nine months ended October 31, 2015, respectively. This software was placed in service at the beginning of fiscal 2017 and no further costs were capitalized.

**Table of Contents***Selling and Marketing*

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

|                                | <b>Three Months Ended</b>                                 |             | <b>Increase/ Increase/</b>  |                 | <b>Nine Months Ended</b> |             | <b>Increase/ Increase/</b>  |                 |
|--------------------------------|---|-------------|-----------------------------|-----------------|--------------------------|-------------|-----------------------------|-----------------|
|                                | <b>October 31,</b>  |             | <b>(Decrease)(Decrease)</b> |                 | <b>October 31,</b>       |             | <b>(Decrease)(Decrease)</b> |                 |
|                                | <b>2016</b>   | <b>2015</b> | <b>\$ Amount</b>            | <b>% Change</b> | <b>2016</b>              | <b>2015</b> | <b>\$ Amount</b>            | <b>% Change</b> |
|                                | <b>(Amounts in thousands, except for percentage data)</b> |             |                             |                 |                          |             |                             |                 |
| Selling and marketing expenses | \$ 3,422  | \$ 3,965    | \$ (543)                    | (13.7%)         | \$ 10,841                | \$ 11,263   | \$ (422)                    | (3.7%)          |
| % of total revenues            | 17.1%   | 13.8%       |                             |                 | 18.1%                    | 14.1%       |                             |                 |

Selling and marketing expenses consist primarily of payroll costs, which include salaries and related payroll taxes, benefits and commissions, travel expenses and certain promotional expenses. Selling and marketing expenses decreased \$0.5 million and \$0.4 million for the three and nine months ended October 31, 2016, respectively, primarily due to lower employee-related costs. These lower costs were a result of the cost-savings initiative implemented in the third quarter of fiscal 2017. This restructuring resulted in terminations of eight sales and marketing employees, including two senior vice presidents. In addition, commission expense was lower for the three and nine months ended October 31, 2016 due to lower revenues. Partially offsetting the decrease for each period is an increase in marketing payroll costs resulting from the addition of DCC Labs in May 2016 and to the hiring of a new senior vice president of marketing in February 2016.

*General and Administrative*

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

|                                     | <b>Three Months Ended</b>                                 |             | <b>Increase/ Increase/</b>  |                 | <b>Nine Months Ended</b> |             | <b>Increase/ Increase/</b>  |                 |
|-------------------------------------|---|-------------|-----------------------------|-----------------|--------------------------|-------------|-----------------------------|-----------------|
|                                     | <b>October 31,</b>  |             | <b>(Decrease)(Decrease)</b> |                 | <b>October 31,</b>       |             | <b>(Decrease)(Decrease)</b> |                 |
|                                     | <b>2016</b>   | <b>2015</b> | <b>\$ Amount</b>            | <b>% Change</b> | <b>2016</b>              | <b>2015</b> | <b>\$ Amount</b>            | <b>% Change</b> |
|                                     | <b>(Amounts in thousands, except for percentage data)</b> |             |                             |                 |                          |             |                             |                 |
| General and administrative expenses | \$ 3,673  | \$ 3,648    | \$ 25                       | 0.7%            | \$ 11,579                | \$ 11,446   | \$ 133                      | 1.2%            |
| % of total revenues                 | 18.4%   | 12.7%       |                             |                 | 19.3%                    | 14.3%       |                             |                 |

General and administrative expenses consist primarily of employee costs, which include salaries and related payroll taxes and benefit-related costs, legal and accounting services and an allocation of related facilities expenses. General and administrative expenses remained relatively stable for the three and nine months ended October 31, 2016, respectively, as compared to the same periods of fiscal 2016, but do not reflect the full benefit that we anticipate to realize from our restructuring efforts.

*Amortization of Intangible Assets*

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



|                                   | Three Months Ended                                 |             | Increase/ Increase/  |                      | Nine Months Ended |             | Increase/ Increase/  |                      |
|-----------------------------------|--|-------------|----------------------|----------------------|-------------------|-------------|----------------------|----------------------|
|                                   | October 31,  | October 31, | (Decrease)(Decrease) | (Decrease)(Decrease) | October 31,       | October 31, | (Decrease)(Decrease) | (Decrease)(Decrease) |
|                                   | 2016   | 2015        | \$ Amount            | % Change             | 2016              | 2015        | \$ Amount            | % Change             |
|                                   | (Amounts in thousands, except for percentage data) |             |                      |                      |                   |             |                      |                      |
| Amortization of intangible assets | \$ 855   | \$ 1,222    | \$ (367)             | (30.0%)              | \$ 2,519          | \$ 3,560    | \$ (1,041)           | (29.2%)              |
| % of total revenues               | 4.3%   | 4.3%        |                      |                      | 4.2%              | 4.5%        |                      |                      |



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|                     |       |      |       |      |
|---------------------|-------|------|-------|------|
| % of total revenues | 11.9% | 0.7% | 10.0% | 1.3% |
|---------------------|-------|------|-------|------|

Severance and other restructuring costs increased \$2.2 million for the three months ended October 31, 2016, as compared to the same period of fiscal 2016, primarily due to cost savings initiatives implemented during the third quarter of fiscal 2017, including a companywide reduction in workforce, which we expect to complete by the first quarter of fiscal 2018. Severance and other restructuring costs for the three months ended October 31, 2015 of \$0.2 million included severance for seven former employees and costs related to the downsizing of our Portland, Oregon facility as a result of the restructuring program.

Severance and other restructuring costs increased \$5.0 million for the nine months ended October 31, 2016, as compared to the same period of fiscal 2016, primarily due to cost savings initiatives implemented during the third quarter of fiscal 2017 which resulted in charges of \$2.1 million and restructuring activities relating to our Timeline Labs operation and

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DCC Labs acquisition, which resulted in charges totaling \$2.5 million recorded during fiscal 2017. In addition, severance charges of \$1.4 million not related to a restructuring plan included \$1.0 million of severance to our former CEO and \$0.2 million of severance to our former CFO. Severance and other restructuring costs for the nine months ended October 31, 2015 of \$1.0 million included severance for a former General Manager of our EMEA operations and 16 other former employees.

*Earn-outs and Change in Fair Value of Earn-outs*

The following table provides information regarding the change in earn-outs and change in fair value of earn-outs during the periods presented:

|  | Three Months Ended |                  | Increase/            |                     | Nine Months Ended |                  | Increase/            |                     |
|--|--------------------|------------------|----------------------|---------------------|-------------------|------------------|----------------------|---------------------|
|  | October 31, 2016   | October 31, 2015 | (Decrease) \$ Amount | (Decrease) % Change | October 31, 2016  | October 31, 2015 | (Decrease) \$ Amount | (Decrease) % Change |
| (Amounts in thousands, except for percentage data) |                    |                  |                      |                     |                   |                  |                      |                     |
| Earn-outs and change in fair value of earn-outs    | \$                 | \$ 492           | \$ (492)             | (100.0%)            | \$ 249            | \$ 1,475         | \$ (1,226)           | (83.1%)             |
| % of total revenues                                | 0.0%               | 1.7%             |                      |                     | 0.4%              | 1.8%             |                      |                     |

The \$0.5 million and \$1.2 million decreases in earn-outs costs for the three and nine months ended October 31, 2016, compared to the same periods of last fiscal year are primarily due to the determination made in January 2016 that the performance criteria defined in accordance with the Timeline Labs acquisition, would not be achieved. Therefore, no further adjustment to the fair value was necessary in fiscal 2017. However, in the second quarter of fiscal 2017, a charge was recorded that represents the fair value (at the issuance date) of additional shares issued to the former holders of Timeline Labs pursuant to the terms of the Timeline Labs purchase agreement based on our stock price at the time of deferred stock consideration issuances.

*Other (Expenses) Income, Net*

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

|  | Three Months Ended |                  | Increase/            |                     | Nine Months Ended |                  | Increase/            |                     |
|--|--------------------|------------------|----------------------|---------------------|-------------------|------------------|----------------------|---------------------|
|  | October 31, 2016   | October 31, 2015 | (Decrease) \$ Amount | (Decrease) % Change | October 31, 2016  | October 31, 2015 | (Decrease) \$ Amount | (Decrease) % Change |
| (Amounts in thousands, except for percentage data) |                    |                  |                      |                     |                   |                  |                      |                     |
| Gain (loss) on sale of equity investment           | \$ 7               | \$ (12)          | \$ 19                | >(100%)             | \$ 10             | \$ (12)          | \$ 22                | >(100%)             |
| Interest income, net                               | 11                 | 23               | (12)                 | (52.2%)             | 88                | 101              | (13)                 | (12.9%)             |
| Foreign exchange (loss) gain                       | (74)               | 23               | (97)                 | >(100%)             | 124               | (519)            | 643                  | >100%               |
| Miscellaneous (expenses) income                    | (11)               | 4                | (15)                 | >(100%)             | (2)               | 40               | (42)                 | >(100%)             |
|  | \$ (67)            | \$ 38            | \$ (105)             |                     | \$ 220            | \$ (390)         | \$ 610               |                     |

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For the three months ended October 31, 2016, foreign exchange losses increased by \$0.1 million, as compared to the same period of fiscal 2016 due to the strengthening of the U.S. dollar compared to other foreign currencies, primarily the British Pound and Euro. Foreign exchange losses decreased \$0.6 million for the nine months ended October 31, 2016, primarily due to the weakening of the U.S. dollar compared to other foreign currencies, primarily the British Pound and Euro.

**Table of Contents***Income Tax (Benefit) Provision*

|                     | <b>Three Months Ended</b>                                 |             | <b>Increase/ Increase/</b>  |                 | <b>Nine Months Ended</b> |             | <b>Increase/ Increase/</b>   |                 |
|---------------------|---|-------------|-----------------------------|-----------------|--------------------------|-------------|------------------------------|-----------------|
|                     | <b>October 31,</b>  |             | <b>(Decrease)(Decrease)</b> |                 | <b>October 31,</b>       |             | <b>(Decrease) (Decrease)</b> |                 |
|                     | <b>2016</b>   | <b>2015</b> | <b>\$ Amount</b>            | <b>% Change</b> | <b>2016</b>              | <b>2015</b> | <b>\$ Amount</b>             | <b>% Change</b> |
|                     | <b>(Amounts in thousands, except for percentage data)</b> |             |                             |                 |                          |             |                              |                 |
| Income tax          |   |             |                             |                 |                          |             |                              |                 |
| (benefit) provision | \$ (420)  | \$ (1,228)  | \$ 808                      | (65.8%)         | \$ 14,415                | \$ (1,003)  | \$ 15,418                    | >100%           |
| % of total revenues | (2.1%)  | (4.3%)      |                             |                 | 24.0%                    | (1.3%)      |                              |                 |

We recorded an income tax benefit of \$0.4 million for the three months ended October 31, 2016 and a tax provision of \$14.4 million for the nine months ended October 31, 2016. The tax benefit for the three-month period includes the reversal of tax reserves for uncertain tax positions due to the expiration of the Irish statute of limitations of \$0.4 million. The tax provision for the nine-month period is primarily due to deferred income tax expense of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2017 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

Our foreign subsidiaries generate earnings that are not subject to U.S. income taxes so long as they are permanently reinvested in our operations outside of the U.S. Pursuant to Accounting Standard Codification Topic No. 740-30, *Income Taxes - Other Considerations or Special Areas*, undistributed earnings of foreign subsidiaries that are no longer permanently reinvested would become subject to deferred income taxes under U.S. tax law. Prior to the second quarter of fiscal 2017, we asserted that the undistributed earnings of all our foreign subsidiaries were permanently reinvested.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we withdrew the permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings.

There is no certainty as to the timing of when such foreign earnings will be distributed to the United States in whole or in part. Further, when the foreign earnings are distributed to the United States, we anticipate that a substantial portion of the resulting U.S. income taxes would be reduced by existing tax attributes.

We have not provided for U.S. federal or foreign income taxes on \$4.8 million of our non-U.S. subsidiaries undistributed earnings as of October 31, 2016. The \$4.8 million of undistributed foreign earnings have been reinvested in our foreign operations, as we have determined that these earnings are necessary to support our planned ongoing investments in our foreign operations, and as a result, these earnings remain indefinitely reinvested in those operations. In making this decision, we considered cash needs for: investing in our existing businesses, potential acquisitions and capital transactions.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of October 31,

2016, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

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

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**Non-GAAP Measures.**

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

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



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The following table includes the reconciliations of our U.S. GAAP loss from operations, the most directly comparable U.S. GAAP financial measure, to our non-GAAP (loss) income from operations for the three and nine months ended October 31, 2016 and 2015 (amounts in thousands, except per share and percentage data):

|   | Three Months Ended<br>October 31, 2016 |             |            | Three Months Ended<br>October 31, 2015 |             |          |
|---|--|-------------|------------|--|-------------|----------|
|   | GAAP<br>As Reported                    | Adjustments | Non-GAAP   | GAAP<br>As Reported                    | Adjustments | Non-GAAP |
| <b>Revenues:</b>                                |  |             |            |  |             |          |
| Products  | \$ 3,746                               | \$          | \$ 3,746   | \$ 6,195                               | \$          | \$ 6,195 |
| Services  | 16,215                                 |             | 16,215     | 22,552                                 |             | 22,552   |
| <b>Total revenues</b>                           | 19,961                                 |             | 19,961     | 28,747                                 |             | 28,747   |
| <b>Cost of revenues:</b>                        |  |             |            |  |             |          |
| Products  | 1,824                                  |             | 1,824      | 1,528                                  |             | 1,528    |
| Services  | 8,036                                  |             | 8,036      | 10,963                                 |             | 10,963   |
| Provision for loss contract                     |  |             |            | 9,162                                  | (9,162)     |          |
| Amortization of intangible assets               | 315                                    | (315)       |            | 184                                    | (184)       |          |
| Stock-based compensation                        | (26)                                   | 26          |            | 33                                     | (33)        |          |
| <b>Total cost of revenues</b>                   | 10,149                                 | (289)       | 9,860      | 21,870                                 | (9,379)     | 12,491   |
| <b>Gross profit</b>                             | 9,812                                  | 289         | 10,101     | 6,877                                  | 9,379       | 16,256   |
| <b>Gross profit percentage</b>                  | 49.2%                                  | 1.4%        | 50.6%      | 23.9%                                  | 32.6%       | 56.5%    |
| <b>Operating expenses:</b>                      |  |             |            |  |             |          |
| Research and development                        | 7,325                                  |             | 7,325      | 8,273                                  |             | 8,273    |
| Selling and marketing                           | 3,422                                  |             | 3,422      | 3,965                                  |             | 3,965    |
| General and administrative                      | 3,673                                  |             | 3,673      | 3,648                                  |             | 3,648    |
| Amortization of intangible assets               | 540                                    | (540)       |            | 1,038                                  | (1,038)     |          |
| Stock-based compensation expense                | 791                                    | (791)       |            | 1,104                                  | (1,104)     |          |
| Earn-outs and change in fair value of earn-outs |  |             |            | 492                                    | (492)       |          |
| Professional fees: other                        | 24                                     | (24)        |            | 1                                      | (1)         |          |
| Severance and other restructuring costs         | 2,373                                  | (2,373)     |            | 197                                    | (197)       |          |
| Loss on impairment of long-lived asset          | 99                                     | (99)        |            |  |             |          |
| <b>Total operating expenses</b>                 | 18,247                                 | (3,827)     | 14,420     | 18,718                                 | (2,832)     | 15,886   |
|   | \$ (8,435)                             | \$ 4,116    | \$ (4,319) | \$ (11,841)                            | \$ 12,211   | \$ 370   |

**(Loss) income from operations**

|   |         |       |         |         |       |      |
|---|---------|-------|---------|---------|-------|------|
| <b>(Loss) income from operations percentage</b> | (42.3%) | 20.7% | (21.6%) | (41.2%) | 42.5% | 1.3% |
|---|---------|-------|---------|---------|-------|------|

**Weighted average common shares outstanding:**

|              |        |        |        |        |        |        |
|--------------|--------|--------|--------|--------|--------|--------|
| <b>Basic</b> | 35,186 | 35,186 | 35,186 | 33,636 | 33,636 | 33,636 |
|--------------|--------|--------|--------|--------|--------|--------|

|                |        |        |        |        |        |        |
|----------------|--------|--------|--------|--------|--------|--------|
| <b>Diluted</b> | 35,186 | 35,209 | 35,186 | 33,636 | 33,835 | 33,835 |
|----------------|--------|--------|--------|--------|--------|--------|

**Non-GAAP operating (loss) income per share:**

|              |           |         |           |           |         |         |
|--------------|-----------|---------|-----------|-----------|---------|---------|
| <b>Basic</b> | \$ (0.24) | \$ 0.11 | \$ (0.13) | \$ (0.35) | \$ 0.36 | \$ 0.01 |
|--------------|-----------|---------|-----------|-----------|---------|---------|

|                |           |         |           |           |         |         |
|----------------|-----------|---------|-----------|-----------|---------|---------|
| <b>Diluted</b> | \$ (0.24) | \$ 0.11 | \$ (0.13) | \$ (0.35) | \$ 0.36 | \$ 0.01 |
|----------------|-----------|---------|-----------|-----------|---------|---------|

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|  | Nine Months Ended<br>October 31, 2016 |             |             | Nine Months Ended<br>October 31, 2015 |             |            |
|--|---------------------------------------|-------------|-------------|---------------------------------------|-------------|------------|
|  | GAAP                                  |             | Non-GAAP    | GAAP                                  |             | Non-GAAP   |
|  | As Reported                           | Adjustments |             | As Reported                           | Adjustments |            |
| <b>Revenues:</b>                                   |                                       |             |             |                                       |             |            |
| Products   | \$ 10,481                             | \$          | \$ 10,481   | \$ 16,314                             | \$          | \$ 16,314  |
| Services   | 49,502                                |             | 49,502      | 63,481                                |             | 63,481     |
| <b>Total revenues</b>                              | 59,983                                |             | 59,983      | 79,795                                |             | 79,795     |
| <b>Cost of revenues:</b>                           |                                       |             |             |                                       |             |            |
| Products   | 4,506                                 |             | 4,506       | 4,766                                 |             | 4,766      |
| Services   | 27,982                                |             | 27,982      | 33,829                                |             | 33,829     |
| Provision for loss contract                        |                                       |             |             | 9,162                                 | (9,162)     |            |
| Amortization of intangible assets                  | 947                                   | (947)       |             | 557                                   | (557)       |            |
| Stock-based compensation                           | 131                                   | (131)       |             | 61                                    | (61)        |            |
| <b>Total cost of revenues</b>                      | 33,566                                | (1,078)     | 32,488      | 48,375                                | (9,780)     | 38,595     |
| <b>Gross profit</b>                                | 26,417                                | 1,078       | 27,495      | 31,420                                | 9,780       | 41,200     |
| <b>Gross profit percentage</b>                     | 44.0%                                 | 1.8%        | 45.8%       | 39.4%                                 | 12.2%       | 51.6%      |
| <b>Operating expenses:</b>                         |                                       |             |             |                                       |             |            |
| Research and development                           | 23,751                                |             | 23,751      | 26,176                                |             | 26,176     |
| Selling and marketing                              | 10,841                                |             | 10,841      | 11,263                                |             | 11,263     |
| General and administrative                         | 11,579                                |             | 11,579      | 11,446                                |             | 11,446     |
| Amortization of intangible assets                  | 1,572                                 | (1,572)     |             | 3,003                                 | (3,003)     |            |
| Stock-based compensation expense                   | 1,685                                 | (1,685)     |             | 2,943                                 | (2,943)     |            |
| Earn-outs and change in fair value of earn-outs    | 249                                   | (249)       |             | 1,475                                 | (1,475)     |            |
| Professional fees: other                           | 328                                   | (328)       |             | 145                                   | (145)       |            |
| Severance and other restructuring costs            | 5,991                                 | (5,991)     |             | 1,026                                 | (1,026)     |            |
| Loss on impairment of long-lived asset             | 99                                    | (99)        |             |                                       |             |            |
| <b>Total operating expenses</b>                    | 56,095                                | (9,924)     | 46,171      | 57,477                                | (8,592)     | 48,885     |
| <b>(Loss) income from operations</b>               | \$ (29,678)                           | \$ 11,002   | \$ (18,676) | \$ (26,057)                           | \$ 18,372   | \$ (7,685) |
| <b>(Loss) income from operations percentage</b>    | (49.5%)                               | 18.4%       | (31.1%)     | (32.7%)                               | 23.1%       | (9.6%)     |
| <b>Weighted average common shares outstanding:</b> |                                       |             |             |                                       |             |            |

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|                                  |           |         |           |           |         |           |
|----------------------------------|-----------|---------|-----------|-----------|---------|-----------|
| <b>Basic</b>                     | 34,889    | 34,889  | 34,889    | 33,440    | 33,440  | 33,440    |
| <b>Diluted</b>                   | 34,889    | 34,955  | 34,889    | 33,440    | 33,615  | 33,440    |
| <b>Non-GAAP operating (loss)</b> |           |         |           |           |         |           |
| <b>income per share:</b>         |           |         |           |           |         |           |
| <b>Basic</b>                     | \$ (0.85) | \$ 0.31 | \$ (0.54) | \$ (0.78) | \$ 0.55 | \$ (0.23) |
| <b>Diluted</b>                   | \$ (0.85) | \$ 0.31 | \$ (0.54) | \$ (0.78) | \$ 0.55 | \$ (0.23) |

The changes in the tables above during the three and nine months ended October 31, 2016, compared to the same periods of 2015, were a result of the factors described in connection with revenues and operating expenses under Item 2. *Management's Discussion and Analysis of Financial Conditions and Results of Operations - Results of Operations*, of this Form 10-Q.

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

***Provision for Loss Contract.*** We entered into a fixed-price customer contract on a multi-year arrangement, which included multiple vendors. As the system integrator on the project, we are subject to any costs overruns or increases with these vendors resulting in delays or acceptance by our customer. Delays of customer acceptance on this project required

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us to recognize a loss on this project in the period the determination is made. As a result, we recorded an estimated charge of \$9.2 million in the third quarter of fiscal 2016. We believe that the exclusion of this expense allows a comparison of operating results that would otherwise impair comparability between periods.

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

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

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

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

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

**Off-Balance Sheet Arrangements**

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

**Liquidity and Capital Resources**

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

| <b>Nine Months Ended</b>      |             | <b>Increase/<br/>(Decrease)</b> |
|-------------------------------|-------------|---------------------------------|
| <b>October 31,</b>            |             | <b>\$</b>                       |
| <b>2016</b>                   | <b>2015</b> | <b>Amount</b>                   |
| <b>(Amounts in thousands)</b> |             |                                 |

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|   |             |             |            |
|---|-------------|-------------|------------|
| Total cash used in operating activities     | \$ (26,989) | \$ (19,442) | \$ (7,547) |
| Total cash used in investing activities     | (3,765)     | (12,905)    | 9,140      |
| Total cash provided by financing activities | 60          | 88          | (28)       |
| Effect of exchange rate changes on cash     | (555)       | 270         | (825)      |
| Net decrease in cash and cash equivalents   | \$ (31,249) | \$ (31,989) | \$ 740     |

Historically, we have financed our operations and capital expenditures primarily with cash on-hand. Cash, cash equivalents, restricted cash, and marketable securities decreased from \$71.1 million at January 31, 2016 to \$37.8 million at October 31, 2016.

We had a letter agreement with JP Morgan Chase Bank, N.A. ( JP Morgan ) for a demand discretionary line of credit and a Demand Promissory Note in the aggregate amount of \$20.0 million, which expired on August 31, 2016 with no outstanding balance. This line of credit and Demand Promissory Note was not renewed.

We continue to realize the savings related to the wind down of the TimeLine Labs operation and the restructuring of our In-Home business from Milpitas to Poland. Additionally, during the third quarter of fiscal 2017, we made substantial progress on a cost reduction program, which we expect to generate annualized savings of approximately \$15 million. We have executed annualized cost savings of approximately \$7.5 million to date. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash provided by future operating activities, augmented by the plans highlighted above are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

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

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

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

**Operating Activities**

Below are key line items affecting cash from operating activities:

|  | <b>Nine Months Ended</b>      |             | <b>Increase/<br/>(Decrease)</b> |
|--|-------------------------------|-------------|---------------------------------|
|  | <b>October 31,</b>            |             | <b>\$ Amount</b>                |
|  | <b>2016</b>                   | <b>2015</b> |                                 |
|  | <b>(Amounts in thousands)</b> |             |                                 |
| Net loss   | \$ (43,873)                   | \$ (25,417) | \$ (18,456)                     |
| Adjustments to reconcile net loss to cash used in operating activities | 21,953                        | 18,921      | 3,032                           |
| Net loss including adjustments   | (21,920)                      | (6,496)     | (15,424)                        |
| Decrease (increase) in receivables                                     | 4,900                         | (4,848)     | 9,748                           |
| Decrease (increase) in inventory                                       | 338                           | (1,207)     | 1,545                           |
| Decrease (increase) in prepaid expenses and other current assets       | 428                           | (158)       | 586                             |
| (Decrease) increase in accounts payable                                | (2,102)                       | 718         | (2,820)                         |
| Decrease in accrued expenses   | (4,942)                       | (4,056)     | (886)                           |
| Decrease in deferred revenues  | (3,864)                       | (2,770)     | (1,094)                         |
| All other - net  | 173                           | (625)       | 798                             |
| Net cash used in operating activities                                  | \$ (26,989)                   | \$ (19,442) | \$ (7,547)                      |

We used net cash in operating activities of \$27.0 million for the nine months ended October 31, 2016. This cash used in operating activities was primarily the result of our net loss including adjustments of \$21.9 million offset by changes in working capital, which include a decrease in receivables of \$4.9 million due to the timing of customer payments, offset by a decrease in accrued expenses of \$4.9 million related to the payment of severance and bonuses, a \$3.9

million decrease in deferred revenue and a \$2.1 million decrease in accounts payable due to the timing of payments to vendors.



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Cash flows from investing activities are as follows:

|   | <b>Nine Months Ended<br/>October 31,</b> |                    | <b>Increase/<br/>(Decrease)</b> |
|---|--|--------------------|---------------------------------|
|   | <b>2016</b>                              | <b>2015</b>        | <b>\$<br/>Amount</b>            |
| <b>(Amounts in thousands)</b>                               |  |                    |                                 |
| Purchases of property and equipment                         | \$ (521)                                 | \$ (1,140)         | \$ 619                          |
| Investment in capitalized software                          |  | (2,030)            | 2,030                           |
| Purchases of marketable securities                          | (2,252)                                  | (3,005)            | 753                             |
| Proceeds from sale and maturity of marketable securities    | 4,249                                    | 4,503              | (254)                           |
| Cash paid for acquisition of business, net of cash Acquired | (5,243)                                  | (11,686)           | 6,443                           |
| Other investing activities                                  | 2  | 453                | (451)                           |
| <b>Net cash used in investing activities</b>                | <b>\$ (3,765)</b>                        | <b>\$ (12,905)</b> | <b>\$ 9,140</b>                 |

We used \$3.8 million in cash related to investing activities during the nine months ended October 31, 2016. Specifically, we used cash of \$5.2 million for the acquisition of DCC Labs and \$0.5 million for the purchase of capital assets offset by \$2.0 million of proceeds from the net sale of marketable securities.

**Financing Activities**

Cash flows from financing activities are as follows:

|  | <b>Nine Months Ended<br/>October 31,</b> |              | <b>Increase/<br/>(Decrease)</b> |
|--|--|--------------|---------------------------------|
|  | <b>2016</b>                              | <b>2015</b>  | <b>\$<br/>Amount</b>            |
| <b>(Amounts in thousands)</b>                    |  |              |                                 |
| Proceeds from issuance of common stock           | \$ 64                                    | \$ 88        | \$ (24)                         |
| Other financing activities                       | (4)                                      |              | (4)                             |
| <b>Net cash provided by financing activities</b> | <b>\$ 60</b>                             | <b>\$ 88</b> | <b>\$ (28)</b>                  |

In the nine months ended October 31, 2016, cash provided by financing activities is from proceeds received from the issuance of common stock for the exercise of employee stock options.

The effect of exchange rate changes decreased cash and cash equivalents by \$0.6 million for the nine months ended October 31, 2016, primarily due to the translation of European subsidiaries cash balances, which use the Euro as their functional currency, to U.S. dollars.

**Effects of Inflation**

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

***Contractual Obligations***

There have been no significant changes outside the ordinary course of our business in our contractual obligations disclosed in our Form 10-K for the fiscal year ended January 31, 2016.

**Critical Accounting Policies and Significant Judgment and Estimates**

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

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***Revenue Recognition***

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

persuasive evidence of an arrangement exists;

delivery has occurred, and title and risk of loss have passed to the customer;

fees are fixed or determinable; and

collection of the related receivable is considered probable.

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

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

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

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

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

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

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

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

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

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

***Goodwill***

In connection with acquisitions of businesses, we recognize the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired as goodwill. Goodwill is not amortized, but is required to be evaluated for impairment annually, which we conduct in our third quarter beginning August 1<sup>st</sup>, or more frequently if indicators are present or changes in circumstances suggest that an impairment may exist.

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The process of evaluating goodwill for impairment requires several judgments and assumptions to be made to determine the fair value, 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. We may employ the 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. The choice of which approach and methods to use in a particular situation depends on the facts and circumstances.

We chose to use the market approach and the income approach to determine the fair value. 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 cash flows. 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. 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 test, we took steps to ensure appropriate and reasonable cash flow projections and assumptions were used.

Our projections for the next five years included increased operating expenses in line with the expected revenue growth based on current market and economic conditions and our historical knowledge. 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 regarding anticipated customer contracts. The forecasts have incorporated any changes to the revenue and operating expenses through the third quarter of fiscal 2017. We estimated the operating expenses based on a rate consistent with the current experience and estimated revenue growth over the next five years. Future adverse changes in market conditions or poor operating results could result in losses, thereby possibly requiring an impairment charge in the future.

We determined based on Step 1 of our annual impairment test, that the fair value of our reporting unit was less than its carrying value, which was \$102.5 million at August 1, 2016. The comparison of estimated fair value to the carrying value of net assets ranged from a shortfall of approximately \$16.9 million to \$17.7 million. Since the estimated fair value of our reporting unit was less than its carrying value, we determined it is necessary to perform Step 2 of the impairment test. We expect to complete the interim goodwill impairment testing of our reporting unit during the fourth quarter of fiscal 2017.

In the second quarter of fiscal 2017, triggering events prompted us to perform step one of the goodwill impairment test. The triggering events included; a sustained decrease in our stock price during the period, the withdrawal of the permanent reinvestment assertion on earnings generated by our Irish operations (see Note 12, *Income Taxes* to our consolidated financial statements for more information) and a decline in actual revenue for the quarter compared to projected amounts, which was previously reported in a Current Report on Form 8-K furnished to the SEC on August 23, 2016. The outcome of that preliminary step one analysis revealed that as of July 31, 2016, the fair value of the net assets exceeded its carrying value by a range of \$15.4 million to \$25.0 million, or 15.0% to 24.4% of the carrying value of our net assets.

In the third quarter of fiscal 2017, we finalized our step one analysis of the goodwill impairment test. Our forecast indicated that the estimated fair value of net assets may be less than the carrying value which is a potential indicator of impairment. As such, we are required to perform step two of the impairment test during which we compare the implied fair value of our goodwill to its carrying value. We currently continue to work through various restructuring actions and execute on other strategic plans which has not enabled us to complete the step two testing at this time. We expect to complete the goodwill impairment testing of our reporting unit during the fourth quarter of fiscal 2017. To the extent that the finalization of this assessment of goodwill requires recognition of an impairment loss, such

adjustment would be recorded in the fourth quarter of fiscal 2017. We have estimated the range of impairment loss to be between \$0 and \$45.7 million and have not recognized an impairment loss in the third quarter of fiscal 2017. See *Critical Accounting Policies and Significant Judgment and Estimates - Goodwill*, in Part I, Item 2 of this Form 10Q for more information on the impairment testing.



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**Table of Contents****Recent Accounting Standard Updates**

We consider the applicability and impact of all ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations.

***Recently Issued Accounting Standard Updates Not Yet Adopted******Revenue from Contracts with Customers (Topic 606)***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and the International Financial Reporting Standards. This guidance supersedes previously issued guidance on revenue recognition and gives a five step process an entity should follow so that the entity recognizes revenue that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB deferred the effective date of this guidance to annual reporting periods beginning after December 15, 2017, which would be our fiscal 2019 reporting period. It must be applied either retrospectively during each prior reporting period presented or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of the initial application. Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. ASU 2016-08 is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The effective date for ASU 2016-08 is the same as the effective date for ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. ASU 2016-10 provides clarification on two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance. Specifically, the amendments reduce the cost and complexity of identifying promised goods or services and improve the guidance for determining whether promises are separately identifiable. The effective date of ASU 2016-10 is the same as the effective date for ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. ASU 2016 clarifies aspects of ASU 2014-09, including clarifying noncash consideration, and provides a practical expedient for reflecting contract modifications at transition. The effective date of ASU 2016-12 is the same as the effective date of ASU 2014-09. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

***Leases***

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires a lessee to recognize a right-of-use asset and a lease liability for operating leases with terms over twelve months, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease

cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. It also requires lessees to classify leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase of the leased asset by the lessee. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. ASU 2016-02 is effective for us in the first quarter of fiscal 2020. Early adoption is permitted. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

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**Table of Contents***Stock Compensation*

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. ASU 2016-09 intended to simplify several aspects of the accounting for share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statements of cash flows. ASU 2016-09 is effective for us in the first quarter of fiscal 2018. Early adoption is permitted. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

*Cash Flow Statement*

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and annual periods beginning in our first quarter of fiscal 2018, and early adoption is permitted. ASU 2016-15 must be applied retrospectively to all periods presented but may be applied prospectively if retrospective application would be impracticable. We are currently evaluating what impact the adoption of this update will have on our consolidated financial statements.

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

**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk***Foreign Currency Exchange Risk*

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

Our principal currency exposures relate primarily to the U.S. dollar, the Euro and the Philippine peso. All foreign currency gains and losses are included in other (expenses) income, net, in the accompanying consolidated statements of operations and comprehensive loss. For the nine months ended October 31, 2016, we recorded \$0.1 million in gains due to the international subsidiary translations and cash settlements of revenues and expenses.

A substantial portion of our earnings are generated by our foreign subsidiaries whose functional currency is other than the U.S. dollar. Therefore, our earnings could be materially impacted by movements in foreign currency exchange rates upon the translation of the subsidiary's earnings into the U.S. dollar. If the U.S. dollar had strengthened by 10% compared to the Euro, our total revenues would have decreased by \$0.7 million and \$2.1 million for the three and nine

months ended October 31, 2016 and would have decreased our operations by \$0.2 million and \$0.4 million, respectively.

In addition, the announcement of the referendum by British voters to exit the European Union (referred to as Brexit ) in June 2016 has resulted in significant decline of the British pound sterling against the U.S. dollar. In the short-term, volatility in the British pound sterling could continue as the United Kingdom negotiates its anticipated exit from the European Union. The announcement of Brexit may create further global economic uncertainty, which may cause our customers to closely monitor their costs and reduce their spending budget on our products and services. If the referendum is passed into law, there could be further uncertainty as the United Kingdom determines the future terms of its relationship with the European Union. The impact of Brexit to our results of operations for the period ended October 31, 2016 was not material. However, there can be no assurance that there will not be a material impact in the future.

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### ***Interest Rate Risk***

Exposure to market risk for changes in interest rates relates primarily to our investment portfolio of marketable debt securities of various issuers, types and maturities. We do not use derivative instruments in our investment portfolio, and our investment portfolio only includes highly liquid instruments. Our cash and marketable securities include cash equivalents, which we consider to be investments purchased with original maturities of 90 days or less. There is risk that losses could be incurred if we were to sell any of our securities prior to stated maturity. Given the short maturities and investment grade quality of the portfolio holdings at October 31, 2016, a hypothetical 10% adverse change in interest rates should not have a material adverse impact on the fair value of our investment portfolio.

### **ITEM 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures.* We evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this Form 10-Q. Edward Terino, our Chief Executive Officer, and Peter R. Faubert, our Chief Financial Officer, reviewed and participated in this evaluation. Based upon that evaluation, Messrs. Terino and Faubert concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report and as of the date of the evaluation.

*Changes in internal control over financial reporting.* As a result of the evaluation completed by us, and in which Messrs. Terino and Faubert participated, we have concluded that there were no changes during the fiscal quarter ended October 31, 2016 in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

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

### **ITEM 1A. Risk Factors**

In addition to other information set forth in this Form 10-Q, you should carefully consider the risk factors discussed in Part I, Item 1A. Risk Factors in our Form 10-K for the fiscal year ended January 31, 2016, which could materially affect our business, financial conditions, and results of operations. The risks described in our Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

### **ITEM 6. Exhibits**

(a) Exhibits

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

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**SIGNATURES**

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

Dated: December 8, 2016

**SEACHANGE INTERNATIONAL, INC.**

by: /s/ PETER R. FAUBERT  
Peter R. Faubert  
*Chief Financial Officer, Senior Vice  
President,*

*Finance and Administration and  
Treasurer*

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**Index to Exhibits**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 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 (filed herewith). |
| 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 (filed herewith). |
| 32.1       | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).         |
| 32.2       | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).         |
| 101.INS    | XBRL Instance Document   |
| 101.SCH    | XBRL Taxonomy Extension Schema   |
| 101.CAL    | XBRL Taxonomy Extension Calculation Linkbase   |
| 101.DEF    | XBRL Taxonomy Extension Definition Linkbase  |
| 101.LAB    | XBRL Taxonomy Extension Label Linkbase   |
| 101.PRE    | XBRL Taxonomy Extension Presentation Linkbase  |