

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, 2001

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-21393

SEACHANGE INTERNATIONAL, INC.  
(Exact name of registrant as specified in its charter)

Delaware 04-3197974  
(State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization)

124 Acton Street, Maynard, MA 01754  
(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

The number of shares outstanding of the registrant's Common Stock on December 10, 2001 was 23,052,890.

SEACHANGE INTERNATIONAL, INC.

Table of Contents

<TABLE>  
<CAPTION>

PART I. FINANCIAL INFORMATION

	Page
<S>	----
Item 1. Consolidated Financial Statements	<C>
Consolidated Balance Sheet at October 31, 2001 and January 31, 2001.....	3
Consolidated Statement of Operations Three and nine months ended October 31, 2001 and October 31, 2000...	4
Consolidated Statement of Cash Flows Nine months ended October 31, 2001 and October 31, 2000.....	5
Notes to Consolidated Financial Statements.....	6-11
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	12-19
Item 3. Quantitative and Qualitative Disclosures About Market Risk.....	19

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.....	19-20
Item 6. Exhibits and Reports on Form 8-K.....	20

SIGNATURES..... 21

EXHIBIT INDEX..... 22

</TABLE>

## ITEM I. Financial Statements

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

<TABLE>  
 <CAPTION>

	October 31, 2001 ----	January 31, 2001 ----
<S>	<C>	<C>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents.....	\$ 7,280	\$ 6,145
Accounts receivable, net of allowance for doubtful accounts of \$687 at October 31, 2001 and \$742 at January 31, 2001.....	24,316	27,112
Inventories.....	24,923	24,907
Prepaid expenses and other current assets.....	3,187	2,671
Deferred income taxes.....	7,001	7,001
	-----	-----
Total current assets.....	66,707	67,836
Property and equipment, net.....	17,526	15,886
Other assets.....	1,117	1,159
Deferred income taxes.....	1,481	674
Goodwill and intangibles, net.....	4,575	2,698
	-----	-----
	\$91,406	\$88,253
	=====	=====
 <b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities</b>		
Line of credit.....	\$ -	\$ 4,000
Current portion of line of credit and obligations under capital leases.....	316	2,532
Accounts payable.....	16,131	17,332
Accrued expenses.....	1,888	1,816
Customer deposits.....	946	3,946
Deferred revenue.....	9,362	8,435
Income taxes payable.....	471	956
	-----	-----
Total current liabilities.....	29,114	39,017
	-----	-----
Long-term line of credit and obligations under capital leases.....	6,442	3,934
	-----	-----
 Commitments and contingencies (Note 9)		
 <b>Stockholders' Equity</b>		
Common stock, \$.01 par value; 100,000,000 shares authorized; 22,962,415 and 22,037,811 shares issued at October 31, 2001 and January 31, 2001, respectively.....	230	221
Additional paid-in capital.....	63,630	50,157
Deferred equity discount (Note 10).....	(1,187)	-
Accumulated deficit.....	(6,619)	(4,905)
Accumulated other comprehensive loss.....	(204)	(171)
	-----	-----
Total stockholders' equity.....	55,850	45,302
	-----	-----
	\$ 91,406	\$ 88,253
	=====	=====

&lt;/TABLE&gt;

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

3

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

<TABLE>  
 <CAPTION>

months ended

Three months ended

Nine

October 31, 2000	October 31, 2001	October 31, 2000	October 31, 2001
<S>	<C>	<C>	<C>
<C>			
Revenues			
Systems.....	\$17,776	\$19,110	\$60,829
\$55,794			
Services.....	7,445	5,916	21,572
16,892			
-----			
72,686	25,221	25,026	82,401
Cost of revenues			
Systems.....	10,682	9,684	35,208
30,043			
Services.....	5,201	4,582	15,644
13,271			
-----			
43,314	15,883	14,266	50,852
-----			
Gross profit.....	9,338	10,760	31,549
29,372			
-----			
Operating expenses			
Research and development.....	5,883	5,101	17,560
14,456			
Selling and marketing.....	3,410	3,169	10,599
8,284			
General and administrative.....	1,748	1,675	5,579
4,977			
-----			
27,717	11,041	9,945	33,738
-----			
Income (loss) from operations.....	(1,703)	815	(2,189)
1,655			
Interest (expense), net.....	(80)	(54)	(332)
(30)			
-----			
Income (loss) before income taxes.....	(1,783)	761	(2,521)
1,625			
Provision (benefit) for income taxes.....	(571)	249	(807)
520			
-----			
Income (loss) before cumulative effect of change in accounting principle.....	(1,212)	512	(1,714)
1,105			
Cumulative effect of change in accounting principle, net of tax of \$732.....	-	-	-
(1,100)			
-----			
Net income (loss).....	\$ (1,212)	\$ 512	\$ (1,714)
\$ 5	=====	=====	=====
=====			
Basic earnings (loss) per share before cumulative effect of change in accounting principle.....	\$ (0.05)	\$ 0.02	\$ (0.08)
\$ 0.05			
Cumulative effect of change in accounting principle..	-	-	-
\$ (0.05)			
-----			
Basic earnings (loss) per share.....	\$ (0.05)	\$ 0.02	\$ (0.08)
\$ 0.00	=====	=====	=====
=====			
Diluted earnings (loss) per share.....	\$ (0.05)	\$ 0.02	\$ (0.08)

\$ 0.00			
Weighted average common shares outstanding:			
Basic.....	22,939	21,855	22,796
21,668			
Diluted.....	22,939	23,218	22,796
23,170			

</TABLE>

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

4

SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
INCREASE IN CASH AND CASH EQUIVALENTS  
(in thousands)

<TABLE>  
<CAPTION>

	Nine months ended	
	October 31, 2001	October 31, 2000
Cash flows from operating activities:		
Net income (loss).....	\$ (1,714)	\$
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization.....	5,268	
Inventory valuation allowance.....	-	
Amortization of deferred equity discount.....	1,142	
Deferred taxes.....	(807)	
Changes in operating assets and liabilities:		
Accounts receivable.....	2,796	
Inventories.....	(533)	
Prepaid expenses and other assets.....	(506)	
Accounts payable.....	(1,201)	
Accrued expenses.....	72	
Customer deposits.....	(3,000)	
Deferred revenue.....	927	
Income taxes payable.....	(485)	
Net cash provided by (used in) operating activities	1,959	
Cash flows from investing activities:		
Purchases of property and equipment.....	(5,559)	
Increase in intangible assets.....	(2,709)	
Net cash used in investing activities	(8,268)	

Cash flows from financing activities:		
1,044	Borrowings under construction loan.....	-
4,324	Borrowings under line of credit.....	5,409
-	Repayment of borrowings under revolving line of credit.....	(4,000)
(1,017)	Repayment of borrowings under construction loan and line of credit....	(4,967)
(181)	Repayment of obligations under capital lease.....	(150)
11,923	Net proceeds from issuance of common stock.....	11,152
----		-----
16,093	Net cash provided by financing activities	7,444
----		-----
4,523	Net increase in cash and cash equivalents.....	1,135
2,721	Cash and cash equivalents, beginning of period.....	6,145
----		-----
7,244	Cash and cash equivalents, end of period.....	\$ 7,280
=====		=====
		\$

Supplemental disclosure of noncash activities		
497	Transfer of items originally classified as fixed assets to inventories.....	\$ 530
	Transfer of items originally classified as inventories to fixed assets.....	\$ 1,047
-		\$

</TABLE>

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

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries. SeaChange believes that the unaudited consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments), necessary for a fair statement of SeaChange's financial position, results of operations and cash flows at the dates and for the periods indicated. The results of operations for the periods presented are not necessarily indicative of results expected for the full fiscal year or any other future periods. The unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended January 31, 2001, included in SeaChange's Annual Report on Form 10-K for such fiscal year.

2. Revenue Recognition

Revenues from sales of systems are recognized upon shipment provided title and risk of loss has passed to the customer, there is evidence of an arrangement, fees are fixed or determinable and collection of the related receivable is probable. Installation, project management and training revenue is deferred and recognized as these services are performed. Revenue from technical support and maintenance is deferred and recognized ratably over the period of the related agreements, generally twelve months. Customers are billed for installation, project management, training and maintenance at the time of the product sale. If a portion of the sales price is not due until installation of the system is complete, that portion of the sales price is deferred until installation is complete. Revenue from content fees, primarily movies, is recognized based on the volume of monthly purchases that are made by hotel guests. Revenue from product development contract services is recognized based on the time and materials incurred to complete the work. Shipping and handling costs are included in revenue and cost of revenues.

SeaChange's transactions frequently involve the sales of systems and services

under multiple element arrangements. Systems sales always include at least one year of free technical support and maintenance services. Revenue under multiple element arrangements is allocated to all elements except systems based upon the fair value of those elements. The amounts allocated to training, project management, technical support and maintenance and content fees is based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation revenue is based upon hourly rates and the estimated time required to complete the service. The amount allocated to systems is calculated on a residual method basis. Under this method, the total arrangement value is allocated first to undelivered elements, based on their fair values, with the remainder being allocated to systems revenue. Installation, training and project management 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.

### 3. Earnings Per Share

For the three and nine months ended October 31, 2001, common shares of 3,503,315 issuable upon the exercise of stock options are antidilutive because SeaChange recorded a net loss for the periods, and therefore, have been excluded from the diluted earnings per share computation.

6

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

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

	Three months ended		Nine months ended	
	October 31, 2001	October 31, 2000	October 31, 2001	October 31, 2000
<S>	<C>	<C>	<C>	<C>
Weighted average shares used in calculating earnings per share - Basic.....	22,939	21,855	22,796	21,668
Dilutive common stock equivalents.....	--	1,363	--	1,502
Weighted average shares used in calculating earnings per share - Diluted.....	22,939	23,218	22,796	23,170

</TABLE>

### 4. Inventories

Inventories consist of the following:

	October 31, 2001	January 31, 2001
<S>	<C>	<C>
Components and assemblies.....	\$ 7,398	\$ 18,695
Finished products .....	17,525	6,212
	\$ 24,923	\$ 24,907

</TABLE>

### 5. Comprehensive Income (Loss)

SeaChange's comprehensive income (loss) was as follows:

	Three months ended		Nine months ended	
	October 31, 2001	October 31, 2000	October 31, 2001	October 2000
<S>	<C>	<C>	<C>	<C>
Net income (loss) .....	\$ (1,212)	\$ 512	\$ (1,714)	\$ 5
Other comprehensive income (expense), net of tax:				
Foreign currency translation adjustment, net of tax of \$4, \$(9), \$(11) and \$(34), respectively .....	7	(18)	(22)	
Other comprehensive income (expense) .....	7	(18)	(22)	

--	-----	-----	-----	-----
Comprehensive income (loss) .....	\$ (1,205)	\$ 494	\$ (1,736)	\$ (67)
	=====	=====	=====	

=====  
</TABLE>

#### 6. Deferred Legal Costs

SeaChange defers legal costs associated with defending its existing patents. If the patent defense is successful, the costs are capitalized and amortized over their estimated remaining useful life. If the patent defense is unsuccessful, the amounts deferred are charged to operating expense. In July 2001, approximately \$2.7 million in deferred legal costs were capitalized into intangible assets as a result of the successful defense of patents.

7

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

#### 7. Change in Accounting Principle

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 summarizes certain areas of the Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. Historically, for some of SeaChange's sales transactions, a portion of the sales price, typically 25%, was not due until installation occurred. Under SAB 101 and the new accounting method adopted retroactive to February 1, 2000, SeaChange now defers the portion of the sales price not due until installation is complete. During the fourth quarter of the twelve months ended January 31, 2001, SeaChange implemented the SEC's SAB 101 guidelines, retroactive to the beginning of the year. This was reported as a cumulative effect of a change in accounting principle as of February 1, 2000. The cumulative effect of the change in accounting principle on prior years resulted in a charge to income of \$1.1 million (net of income taxes of \$732,000), or \$0.05 per diluted share, which has been included in income for the nine months ended October 31, 2000. The results for the nine months ended October 31, 2000 have been restated to conform with SAB 101.

#### 8. Segment Information

SeaChange has three reportable segments: broadband systems, broadcast systems and services. The broadband systems segment provides products to digitally manage, store and distribute digital video for television operators and telecommunications companies. The broadcast systems segment provides products for the storage, archival, on-air playback of advertising and other video programming for the broadcast television industry. The service segment provides installation, training, product management, post-contract support services for all of the above systems and content which is distributed by the broadband product segment. SeaChange does not measure the assets allocated to the segments. SeaChange measures results of the segments based on the respective gross profits. There were no inter-segment sales or transfers during the periods presented. Long-lived assets are principally located in the United States. The following summarizes the revenues and cost of revenues by reportable segment:

<TABLE>  
<CAPTION>

	Three months ended		Nine months ended	
	October 31, 2001	October 31, 2000	October 31, 2001	October 31, 2000
	<C>	<C>	<C>	<C>
Revenues				
Broadband.....	\$ 13,629	\$ 11,377	\$ 48,158	\$ 39,273
Broadcast.....	4,147	7,733	12,671	16,521
Services.....	7,445	5,916	21,572	16,892
Total.....	\$ 25,221	\$ 25,026	\$ 82,401	\$ 72,686
Costs of revenues				
Broadband.....	\$ 8,256	\$ 5,650	\$ 27,956	\$ 20,885
Broadcast.....	2,426	4,034	7,252	9,158
Services.....	5,201	4,582	15,644	13,271
Total.....	\$ 15,883	\$ 14,266	\$ 50,852	\$ 43,314

The following summarizes revenues by geographic locations:

Revenues

United States.....	\$ 21,635	\$ 17,622	\$ 71,313	\$ 57,969
Canada and South America.....	406	986	940	2,988
Europe.....	1,292	2,828	5,185	5,802
Asian Pacific and rest of world.....	1,888	3,590	4,963	5,927
	-----	-----	-----	-----
	\$ 25,221	\$ 25,026	\$ 82,401	\$ 72,686
	=====	=====	=====	=====

</TABLE>

8

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

For the three and nine months ended October 31, 2001 and 2000, certain customers each accounted for more than 10% of SeaChange's revenue. Individual customers each accounted for 38% of revenues in the three months ended October 31, 2001, 14% of revenues in the three months ended October 31, 2000, 20% and 17% of revenues in the nine months ended October 31, 2001, and 11%, 11%, 10% and 10% in the nine months ended October 31, 2000.

<TABLE>  
<CAPTION>

	Three months ended		Nine months ended	
	October 31, 2001	October 31, 2000	October 31, 2001	October 31, 2000
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Customer A.....		14%	20%	
Customer B.....	38%		17%	11%
Customer C.....				11%
Customer D.....				10%
Customer E.....				10%

</TABLE>

9. Legal Proceedings

On June 13, 2000, SeaChange filed in the United States District Court for the District of Delaware a lawsuit against one of its competitors, nCube Corp., whereby SeaChange alleged that nCube's MediaCube-4 product infringed a patent held by SeaChange (Patent No. 5,862,312) relating to SeaChange's MediaCluster technology. In instituting the claim, SeaChange sought both a permanent injunction and damages in an unspecified amount. nCube made a counterclaim against SeaChange that the patent held by SeaChange was invalid and that nCube's MediaCube-4 product did not infringe SeaChange's patent. On September 6, 2000, nCube conceded, based on a claim construction ruling, that nCube's MediaCube-4 product infringed SeaChange's patent. On September 25, 2000, a jury upheld the validity of SeaChange's patent. nCube has filed motions challenging both the jury's verdict and the District Court's claim construction ruling. The District Court has yet to rule on nCube's motions. At this time, SeaChange is awaiting the court's decision regarding a permanent injunction. Damages will be determined in future proceedings.

On January 8, 2001, nCube Corp. filed a complaint against SeaChange in the United States District Court for the District of Delaware alleging that SeaChange's use of SeaChange's Media Cluster, Media Express and Media Server technology each infringe a patent held by nCube (Patent No. 5,805,804). In instituting the claim, nCube has sought both an injunction and monetary damages in an unspecified amount. SeaChange responded on January 26, 2001, denying that claim of infringement. SeaChange also asserted a counterclaim seeking a declaration from the District Court that U.S. Patent No. 5,805,804 is invalid and not infringed. Currently discovery on this claim is scheduled to be completed in December 2001, following which will be a claim construction hearing.

On June 14, 1999, SeaChange filed a defamation complaint against Jeffrey Putterman, Lathrop Investment Management, Inc. and Concurrent Computer Corporation in the Circuit Court of Pulaski County, Arkansas alleging that the defendants conspired to injure SeaChange's business and reputation in the marketplace. The complaint further alleges that Mr. Putterman and Lathrop Investment Management, Inc. defamed SeaChange through false postings on an Internet message board. The complaint seeks unspecified amounts of compensatory and punitive damages. On June 14, 2000, Concurrent filed a counterclaim under seal against SeaChange seeking unspecified damages. On July 28, 2000, Concurrent filed a motion for summary judgement on the claim of civil conspiracy and on January 4, 2001, the trial court entered an order granting summary judgement for Concurrent on that claim. SeaChange immediately requested reconsideration of this order or, in the alternative, recertification for immediate appeal. On June 12, 2001, the trial court denied the motion for reconsideration but made findings which permitted an immediate appeal and on July 11, 2001 SeaChange



filed an appeal. The motions relating to these claims and counterclaims are currently pending and no trial date has been set.

SeaChange cannot be certain of the outcome of the foregoing litigation, but SeaChange plans to oppose allegations against it and assert its claims against other parties vigorously. In addition, as these claims are in the early stages of discovery and certain claims for damages are as yet unspecified, SeaChange is unable to estimate the impact to its business, financial condition, and results of operations or cash flows.

9

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

10. Comcast Equity Investment and Video-on-Demand Purchase Agreements

On December 1, 2000, SeaChange and Comcast Cable Communications, Inc. entered into a video-on-demand purchase agreement for SeaChange's interactive television video servers and related services. Under the terms of the video-on-demand purchase agreement, Comcast has committed to purchase SeaChange's equipment capable of serving a minimum of one million cable subscribers by approximately December 2002. In addition, Comcast may earn up to an additional 450,000 incentive common stock purchase warrants through December 2003 based on the number of cable subscribers in excess of one million who are served by SeaChange's equipment which has been purchased by Comcast. In connection with the execution of this commercial agreement, SeaChange entered into a common stock and warrant purchase agreement, dated as of December 1, 2000, with Comcast SC Investment, Inc., whereby Comcast SC agreed to purchase, subject to certain closing conditions including registration of the shares purchased thereby, 466,255 shares of SeaChange's common stock for approximately \$10 million and Comcast SC would receive a warrant to purchase 100,000 shares, exercisable at \$21.445 per share, of SeaChange's common stock. This stock and warrant purchase agreement was terminated by SeaChange and Comcast SC on February 28, 2001. The terms and conditions of the video-on-demand purchase agreement have not been modified.

On February 28, 2001, SeaChange and Comcast SC signed and closed a new common stock and warrant purchase agreement on terms similar to the prior agreement. Under the terms of this new agreement, SeaChange sold in a private placement to Comcast SC for approximately \$10,000,000 an aggregate of 756,144 shares of SeaChange's common stock and a warrant to purchase 100,000 shares of SeaChange's common stock with an exercise price of \$13.225 per share. Under certain conditions determined upon the effectiveness of the registration of the shares, the number of common shares purchased and the number of common stock purchase warrants and related exercise price are subject to adjustment. An additional number of shares of common stock shall be issued to Comcast SC without any additional consideration as is equal to the difference between 756,144, the number of shares of common stock issued on February 28, 2001, and the number of shares obtained by dividing \$10,000,000 by the lower of 1) 92% of the closing market price of SeaChange's common stock on the date of effectiveness of the registration statement, and 2) the average of the closing market price of SeaChange's common stock for the five trading days ending on the effective date of the registration statement, if either of such prices is lower than \$13.225. The warrant agreement contains an adjustment mechanism such that the warrant is exercisable for an additional 25,000 shares of SeaChange's common stock if the registration statement has not been declared effective on or before March 31, 2001 and an additional 333.33 shares of SeaChange's common stock per day beginning on and including May 1, 2001 for each day up to and including the day the registration statement is declared effective. The warrant agreement also provides that the exercise price of the warrant will be reduced on the effective date of the registration statement to the lower of 1) 92% of the closing market price of SeaChange's common stock on the effective date of the registration statement, and 2) the average of the closing market prices of SeaChange's common stock for the five trading days ending on the date of effectiveness of the registration statement, if either of such prices is lower than \$13.225, the exercise price as of the closing date.

SeaChange determined the intrinsic value of \$586,000 related to the 756,144 shares of common stock purchased on February 28, 2001 and measured the fair value of \$1.1 million related to the 100,000 common stock purchase warrants as of the closing date and recorded these amounts as contra-equity. On April 30, 2001, SeaChange recorded an additional contra-equity amount of \$325,000 for the fair value of the additional 25,000 common stock purchase warrants of SeaChange common stock as the registration statement had not been declared effective on or before March 31, 2001. As of June 13, 2001 SeaChange recorded an additional contra-equity amount of \$335,000 for the fair value of the additional 14,667 common stock purchase warrants of SeaChange common stock. Based on the closing market price on the date of effectiveness of the registration statement and the five trading days preceding the date of effectiveness of this registration statement, no additional shares were issued to Comcast SC pursuant to the terms of the purchase agreement and Comcast is not entitled to the issuance in the future of additional shares pursuant to the terms of the purchase agreement. The

contra-equity amount is being amortized as an offset to gross revenue in proportion to the revenue recognized from the sale of equipment with respect to the first one million subscribers Comcast has committed to under the video-on-demand purchase agreement. During the three and nine months ended October 31, 2001, SeaChange amortized \$18,000 and \$1.1 million, respectively, of the deferred equity discount. The fair value of the additional incentive common stock purchase warrants will also be recorded as an offset to gross revenue as the warrants are earned by Comcast, if any.

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(in thousands, except per share data)

11. New Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method. SeaChange believes that the adoption of SFAS 141 will not have a material impact on its current financial position and results of operations.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective for SeaChange on February 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization and includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, and reclassification of certain intangibles out of previously reported goodwill. SeaChange believes that the adoption of SFAS 142 will not have a material impact on its current financial position and results of operations.

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for obligations associated with the Retirement of Long-Lived Assets." SFAS 143 provides the accounting requirements for retirement obligations associated with tangible long-lived assets. SFAS 143 is effective for financial statements for fiscal years beginning after June 15, 2002. SeaChange believes that the adoption of SFAS 143 will not have a material impact on its current financial position and results of operations.

In October 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 requires one method of accounting for long-lived assets disposed of by sale. SFAS 144 is effective for financial statements for fiscal years beginning after December 15, 2001. SeaChange believes that the adoption of SFAS 144 will not have a material impact on its current financial position and results of operations.

12. Income Taxes

At October 31, 2001, SeaChange had net deferred tax assets of \$8.5 million. Although realizability is not assured, based on the weight of available evidence, SeaChange believes it is more likely than not that all remaining deferred tax assets will be realized. The amount of the deferred tax assets considered realizable is subject to change based on future events, including generating taxable income in future periods. SeaChange will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if SeaChange does not generate sufficient taxable income in future periods.

13. Debt Agreement

SeaChange has entered into a \$10.0 million revolving line of credit with a bank that expires in October 2003. Loans made under this revolving line of credit would generally bear interest at a rate per annum equal to the bank's prime rate, 5.50% at October 31, 2001. At October 31, 2001, SeaChange has outstanding borrowings of \$5.4 million under this revolving line of credit. Borrowings under this line of credit are collateralized by substantially all of SeaChange's assets. The loan agreement requires that SeaChange provide the bank with certain periodic financial reports and comply with certain financial ratios including a minimum level of earnings before interest, taxes and depreciation and amortization on a trailing twelve month basis. At October 31, 2001, SeaChange was in compliance with these financial covenants.

The line of credit replaces SeaChange's prior revolving line of credit and equipment line with a different bank. In conjunction with entering into the new bank line, SeaChange repaid to its prior lender all outstanding borrowings under the equipment line of financing in an amount of \$3.4 million.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

### Factors That May Affect Future Results

Any statements contained in this Form 10-Q that do not describe historical facts, including without limitation statements concerning expected revenues, earnings, product introductions and general market conditions, may constitute forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Any such forward-looking statements contained herein are based on current expectations, but are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. The factors that could cause actual future results to differ materially from current expectations include the following: the development of the video-on-demand market; SeaChange's significant concentration of customers; fluctuations in demand for SeaChange's products and services; SeaChange's ability to manage its growth; the sensitivity of the video-on-demand market to continued content licensing from content providers; SeaChange's ability to develop, market and introduce new and enhanced products and services on a timely basis; SeaChange's dependence on certain sole source suppliers and third party manufacturers; the ability of SeaChange to compete successfully in the future; the rapid technology change which characterizes SeaChange's markets; SeaChange's ability to protect its intellectual property and expenses incurred with defending these rights; the risks associated with international sales as SeaChange expands its markets; SeaChange's ability to integrate the operations of acquired subsidiaries; changes in the current regulatory environment in which SeaChange operates; SeaChange's ability to hire and retain skilled employees; and increasing political and social turmoil. Further information on factors that could cause actual results to differ from those anticipated is detailed in various filings made by SeaChange from time to time with the Securities and Exchange Commission, including but not limited to, those appearing under the caption "Risk Factors" in SeaChange's Registration Statement on Form S-3 filed with the Securities and Exchange Commission on December 5, 2001. Any forward-looking statements should be considered in light of those factors.

### Overview

SeaChange is a leading developer, manufacturer and marketer of systems, known as video storage servers, that automate the management and distribution of long-form video streams, such as movies or other feature presentations, and short-form video streams, such as advertisements.

SeaChange has three reportable segments: broadband systems, broadcast systems and services. The broadband systems segment includes products, such as digital advertising and video-on-demand products, that digitally manage, store and distribute digital video for cable system operators and telecommunications companies. The broadcast systems segment includes products for the storage, archival, on-air playback of advertising and other video programming for the broadcast television industry. System revenues are comprised of sales of SeaChange's broadband and broadcast systems. The service segment is comprised of revenue related to product development contracts, installation, training, product maintenance and technical support for all of the above systems, and content which is distributed by the broadband product segment.

Revenues from sales of systems are recognized upon shipment provided title and risk of loss has passed to the customer, there is evidence of an arrangement, fees are fixed or determinable and collection of the related receivable is probable. Installation, project management and training revenue is deferred and recognized as these services are performed. Revenue from technical support and maintenance is deferred and recognized ratably over the period of the related agreements, generally twelve months. Customers are billed for installation, project management, training and maintenance at the time of the product sale. Revenue from content fees, primarily movies, is recognized based on the volume of monthly purchases that are made by hotel guests. Revenue from product development contract services is recognized based on the time and materials incurred to complete the work.

SeaChange's transactions frequently involve the sales of systems and services under multiple element arrangements. Systems sales always include at least one year of free technical support and maintenance services. Revenue under multiple element arrangements is allocated to all elements except systems based upon the fair value of those elements. The amounts allocated to training, project management, technical support and maintenance and content fees is based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation revenue is based upon hourly rates and the estimated time required to complete the service. The amount allocated to systems is calculated on a residual method basis. Under this method, the total arrangement value is allocated first to undelivered elements, based on their fair values, with the remainder being allocated to systems revenue. Installation, training and project management 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.

SeaChange has experienced fluctuations in its systems revenues from quarter to quarter due to the timing of receipt of customer orders and the shipment of those orders. The factors that impact the timing of receipt of customer orders include among other factors: (1) the customer's obtaining authorized signatures on their purchase orders, (2) budgetary approvals within the customer's company for capital purchases and (3) the ability to process the purchase order within the customer's organization in a timely manner. Factors that may impact the shipment of customer orders include: (1) the availability of material to produce the product, and (2) the time required to produce and test the system before delivery. Because the average sales price of a SeaChange system is high, the delay in the timing of receipt and shipment of any one customer order can result in quarterly fluctuations in SeaChange's revenue.

SeaChange's results are significantly influenced by a number of factors, including SeaChange's pricing, the costs of materials used in SeaChange's products and the expansion of SeaChange's operations. SeaChange prices its products and services based upon its costs as well as in consideration of the prices of competitive products and services in the marketplace. The costs of SeaChange's products primarily consist of the costs of components and subassemblies that have generally declined over time. As a result of the growth of SeaChange's business, operating expenses of SeaChange have increased in the areas of research and development, selling and marketing, customer service and support and administration.

THREE MONTHS ENDED OCTOBER 31, 2001 COMPARED TO THE THREE MONTHS ENDED OCTOBER 31, 2000

#### Revenues

Systems. SeaChange's systems revenues consist of sales of SeaChange's broadband and broadcast products. Systems revenues decreased 7% to \$17.8 million in the three months ended October 31, 2001 as compared to \$19.1 million in the three months ended October 31, 2000. Revenues from the broadband segment, which accounted for 54% and 45% of total revenues in the three months ended October 31, 2001 and 2000, respectively, increased to \$13.6 million for the comparable periods in 2001 as compared to \$11.4 million for the comparable periods in 2000. Interactive television system revenues were \$10.2 million for the three months ended October 31, 2001 as compared to \$3.2 million in the comparable period in the prior year primarily due to the initial deployment of residential video-on-demand systems in the U.S. for cable operators. Included in the interactive television systems revenue was the amortization of \$18,000 related to the deferred equity discount associated with the Comcast equity investment. Digital advertising system revenues were \$3.4 million for the three months ended October 31, 2001 as compared to \$8.1 million in the prior year. The decrease resulted primarily from the decline in the number of expansion systems purchased by U.S. cable operators. Broadcast system segment revenues were \$4.1 million in the three months ended October 31, 2001 as compared to \$7.7 million in the three months ended October 31, 2000. The decrease in broadcast revenues is primarily attributable to the decrease in advertising revenues earned by the broadcast companies resulting in a decrease in their capital expenditures for new broadcast systems. We expect future revenue growth, if any, to come principally from our interactive television and broadcast system products as cable and telecommunications companies continue to offer new video-on-demand applications for their customers and the market for digital video servers within the broadcast industry continues to expand. As revenues from broadcast and interactive television products and broadcast increase, the digital advertising products will become a smaller portion of total system revenues. However, SeaChange believes that there will be a continuing demand for expansions to existing digital advertising insertion systems within the U.S.

Services. SeaChange's services revenues consist of fees for installation, training, product maintenance, technical support services, product development services and movie content fees. SeaChange's services revenues increased 26% to \$7.4 million in the three months ended October 31, 2001 from \$5.9 million in the three months ended October 31, 2000. This increase in services revenues primarily resulted from the renewals of technical support and maintenance services, price increases on certain technical support and maintenance services, the impact of a growing installed base of systems and a higher level of product development services.

For the three-month periods ended October 31, 2001 and October 31, 2000, a limited number of our customers each accounted for more than 10% of SeaChange's total revenues. Single customers accounted for 38% of total revenues in three months ended October 31, 2001 and 14% of total revenues in the three months ended October 31, 2000. Revenue from these customers was primarily in the broadband segment. SeaChange believes that a significant portion of SeaChange's revenues will continue to be derived from a limited number of large customers.

International sales accounted for approximately 14% and 30% of total revenues in the three-month periods ended October 31, 2001 and October 31, 2000,

respectively. SeaChange expects that international sales will remain a significant portion of SeaChange's business in the future. As of October 31, 2001, substantially all sales of SeaChange's products were made in United States dollars. Therefore, SeaChange has not experienced, nor does it expect to experience in the near term, any material impact from fluctuations in foreign currency exchange rates on its results of operations or liquidity. If this practice changes in the future, SeaChange will reevaluate its foreign currency exchange rate risk.

#### Gross Profit

Systems. Costs of systems revenues consist primarily of the cost of purchased components and subassemblies, labor and overhead relating to the final assembly and testing of complete systems and related expenses. Costs of systems revenues increased 10% to \$10.7 million in the three months ended October 31, 2001 as compared to \$9.7 million in the three months ended October 31, 2000. In the three months ended October 31, 2001, the increase in costs of systems revenues reflects higher material costs within the interactive television system products. SeaChange expects cost of systems revenues for the interactive television products within the broadband segment to be higher as a percentage of revenues as the products are first deployed and to decrease as a percentage of revenues as the revenue level increases and SeaChange improves its manufacturing and material purchasing efficiencies.

Systems gross profit as a percentage of systems revenues was 40% and 49% in the three months ended October 31, 2001 and October 31, 2000, respectively. The decrease in systems gross profit in the three months ended October 31, 2001 was primarily due to the shift within broadband product sales from higher gross profit ad insertion systems to lower gross profit interactive television systems. Gross profit for the broadband segment decreased to 39% for the three months ended October 31, 2001 from 50% for the three months ended October 31, 2000 primarily as a result of lower broadcast system revenues. Gross profit for the broadcast segment decreased to 42% for the three months ended October 31, 2001 compared to 48% for the three months ended October 31, 2000.

Services. Costs of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support services provided by SeaChange and costs associated with providing movie content. Costs of services revenues increased 14% to \$5.2 million in the three months ended October 31, 2001 from \$4.6 million in the three months ended October 31, 2000 primarily as a result of increased revenues and the costs associated with SeaChange hiring and training additional service personnel to provide worldwide support for the growing installed base of broadband and broadcast systems and costs associated with providing movie content. Services gross profit as a percentage of services revenue was 30% in the three months ended October 31, 2001 and 23% in the three months ended October 31, 2000. The increase in services gross profit was primarily due to the increase in services revenues. Product development service revenues contributed approximately \$1.0 million for the three months ended October 31, 2001 compared to \$524,000 for the three months ended October 31, 2000. SeaChange expects that it will continue to experience fluctuations in gross profit as a percentage of services revenue as a result of the timing of revenues from technical support and other services to support the growing installed base of systems and the timing of costs associated with SeaChange's ongoing investment required to build a service organization to support the installed base of systems and new products.

Research and Development. Research and development expenses consist primarily of compensation of development personnel, depreciation of equipment and an allocation of related facilities expenses. Research and development expenses increased 15% to \$5.9 million in the three months ended October 31, 2001 as compared to \$5.1 million in the three months ended October 31, 2000. The increase in the three months ended October 31, 2001 was primarily attributable to the hiring and contracting of additional development personnel which reflects SeaChange's continuing investment in new products. SeaChange expects that research and development expenses will continue to increase in dollar amount as SeaChange continues its development and support of new and existing products.

Selling and Marketing. Selling and marketing expenses consist primarily of compensation expenses, including sales commissions, travel expenses and certain promotional expenses. Selling and marketing expenses increased 8% to \$3.4 million in the three months ended October 31, 2001 from \$3.2 million in the three months ended October 31, 2000. The increase was primarily due to the hiring of additional sales personnel for SeaChange's interactive television and broadcast products and related commission costs.

General and Administrative. General and administrative expenses consist primarily of compensation of executive, finance, human resource and administrative personnel, legal and accounting services and an allocation of related facilities expenses. General and administrative expenses remained constant at \$1.7 million in the three months ended October 31, 2001 and October 31, 2000.

Interest expense, net. Interest expense, net was \$80,000 for the three months ended October 31, 2001 and \$54,000 for the three months ended October 31, 2000. The increase primarily resulted from interest expense on borrowings under SeaChange's lines of credit.

Provision (benefit) for Income Taxes. SeaChange's effective tax benefit rate was 32% in the three months ended October 31, 2001. The effective tax rate for the three months ended October 31, 2001 was favorably impacted by the utilization of research and development tax credits.

SeaChange had net deferred tax assets of \$8.5 million at October 31, 2001 and \$7.7 million at January 31, 2001. Although realizability is not assured, based on the weight of available evidence, SeaChange believes it is more likely than not that all remaining deferred tax assets will be realized. The amount of the deferred tax assets considered realizable is subject to change based on future events, including generating taxable income in future periods. SeaChange will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if SeaChange does not generate sufficient taxable income in future periods. Any reduction of the amount of the deferred tax assets would reduce net income in the period in which the reduction occurs.

NINE MONTHS ENDED OCTOBER 31, 2001 COMPARED TO THE NINE MONTHS ENDED OCTOBER 31, 2000

#### Revenues

Systems. Systems revenues increased 9% to \$60.8 million in the nine months ended October 31, 2001 from \$55.8 million in the nine months ended October 31, 2000. Revenues from the broadband segment, which accounted for 58% and 54% of total revenues in the nine months ended October 31, 2001 and 2000, respectively, increased to \$48.2 million in 2001 as compared to \$39.3 million in 2000. Interactive television system revenues were \$32.8 million for the nine months ended October 31, 2001 as compared to \$10.0 million in the comparable period in the prior year primarily due to the initial deployment of residential video-on-demand systems in the United States for cable operators. Included in the interactive television systems revenue for the nine months ended October 31, 2001 was the amortization of \$1.1 million related to the deferred equity discount associated with the Comcast equity investment. As of October 31, 2001, the balance of the deferred equity discount was 1.2 million. Digital advertising system revenues were \$15.4 million for the nine months ended October 31, 2001 as compared to \$29.3 million in the prior year. The decrease resulted primarily from the decline in the number of expansion systems purchased by U.S. cable operators. Broadcast system segment revenues were \$12.7 million in the nine months ended October 31, 2001 as compared to \$16.5 million in the nine months ended October 31, 2000. The decrease in broadcast revenues is primarily attributable to a decrease in capital expenditures by broadcast companies that we believe is tied to declining advertising revenues earned by those companies. We expect future revenue growth, if any, to come principally from our interactive television and broadcast system products as cable and telecommunications companies continue to offer new video-on-demand applications for their customers and the market for digital video servers within the broadcast industry continues to expand. As revenues from broadcast and interactive television products increase, the digital advertising products will become a smaller portion of total system revenues. However, SeaChange believes that there will be a continuing demand for expansions to existing digital advertising insertion systems within the United States.

Services. SeaChange's services revenues increased 28% to \$21.6 million in the nine months ended October 31, 2001 from \$16.9 million in the nine months ended October 31, 2000. This increase in services revenues primarily resulted from the renewals of technical support and maintenance services, price increases on certain technical support and maintenance services, the impact of a growing installed base of systems and a higher level of product development services.

For the nine month periods ended October 31, 2001 and October 31, 2000, a limited number of our customers each accounted for more than 10% of SeaChange's total revenues. Single customers accounted for 20% and 17% of total revenues in nine months ended October 31, 2001 and 11%, 11%, 10% and 10% of total revenues in the nine months ended October 31, 2000. Revenue from these customers was primarily in the broadband segment. SeaChange believes that a significant amount of its revenues will continue to be derived from a limited number of large customers.

International sales accounted for approximately 14% and 20% of total revenues in the nine-month periods ended October 31, 2001 and October 31, 2000, respectively. SeaChange expects that international sales will remain a significant portion of SeaChange's business in the future. As of October 31, 2001, substantially all sales of SeaChange's products were made in United States dollars. Therefore, SeaChange has not experienced, nor does it expect to

experience in the near term, any material impact from fluctuations in foreign currency exchange rates on its results of operations or liquidity. If this practice changes in the future, SeaChange will reevaluate its foreign currency exchange rate risk.

#### Gross Profit

Systems. Costs of systems revenues increased 17% to \$35.2 million in the nine months ended October 31, 2001 as compared to \$30.0 million in the nine months ended October 31, 2000. In the nine months ended October 31, 2001, the increase in costs of systems revenues reflects higher systems revenue and higher material costs within the interactive television products. SeaChange expects cost of systems revenues for the interactive television products within the broadband segment to be higher as a percentage of revenues as the products are first deployed and to decrease as a percentage of revenues as the revenue level increases and SeaChange improves its manufacturing and material purchasing efficiencies.

Systems gross profit as a percentage of systems revenues was 42% and 46% in the nine months ended October 31, 2001 and October 31, 2000, respectively. The decrease in systems gross profit in the nine months ended October 31, 2001 was primarily due to the shift within the broadband segment from product sales of higher gross profit ad insertion systems to lower gross profit interactive television systems. Gross profit for the broadband segment decreased to 42% for the nine months ended October 31, 2001 as compared to 47% for the nine months ended October 31, 2000 primarily due to lower ad insertion systems revenues. Gross profit for the broadcast segment decreased to 43% for the nine months ended October 31, 2001 as compared to 45% for the nine months ended October 31, 2000.

Services. Costs of services revenues increased 18% to \$15.6 million in the nine months ended October 31, 2001 from \$13.3 million in the nine months ended October 31, 2000 primarily as a result of increased revenues and the costs associated with SeaChange hiring and training additional service personnel to provide worldwide support for the growing installed base of broadband and broadcast systems and costs associated with providing movie content. Services gross profit as a percentage of services revenue was 27% in the nine months ended October 31, 2001 and 21% in the nine months ended October 31, 2000. The increase in gross profit was primarily due to the increase in services revenues. SeaChange expects that it will continue to experience fluctuations in services gross profit as a percentage of services revenue as a result of the timing of revenues from technical support and other services to support the growing installed base of systems and the timing of costs associated with SeaChange's ongoing investment required to build a service organization to support the installed base of systems and new products.

Research and Development. Research and development expenses increased 21% to \$17.6 million in the nine months ended October 31, 2001 as compared to \$14.5 million in the nine months ended October 31, 2000. The increase in the nine months ended October 31, 2001 was primarily attributable to the hiring and contracting of additional development personnel which reflects SeaChange's continuing investment in new products. The second quarter also included additional prototype expenses associated with new board development efforts. SeaChange expects that research and development expenses will continue to increase in dollar amount as SeaChange continues its development and support of new and existing products.

Selling and Marketing. Selling and marketing expenses increased 28% to \$10.6 million in the nine months ended October 31, 2001 from \$8.3 million in the nine months ended October 31, 2000. The increase was primarily due to the hiring of additional sales personnel for SeaChange's interactive television and broadcast products and related commission costs.

General and Administrative. General and administrative expenses increased 12% to \$5.6 million in the nine-month period ended October 31, 2001, as compared to \$5.0 million in the nine-month period ended October 31, 2000. This increase is primarily due to the amortization of capitalized patent costs and fees related to the registration statement covering the shares of SeaChange common stock in the Comcast transaction.

Interest expense, net. Interest expense, net was \$332,000 for the nine months ended October 31, 2001 and \$30,000 for the nine months ended October 31, 2000. The increase in interest expense, net in the nine months ended October 31, 2001 primarily resulted from interest expense on borrowings under SeaChange's lines of credit and construction loan.

Provision (benefit) for Income Taxes. SeaChange's effective tax benefit rate was 32% in the nine months ended October 31, 2001. The effective tax rate for the nine months ended October 31, 2001 was favorably impacted by the utilization of research and development tax credits.

SeaChange had net deferred tax assets of \$8.5 million at October 31, 2001 and \$7.7 million at January 31, 2001. Although realizability is not assured, based on the weight of available evidence, SeaChange believes it is more likely than not that all remaining deferred tax assets will be realized. The amount of the deferred tax assets considered realizable is subject to change based on future events, including generating taxable income in future periods. SeaChange will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if SeaChange does not generate sufficient taxable income in future periods. Any reduction of the amount of the deferred tax assets would reduce net income in the period in which the reduction occurs.

Cumulative effect change in accounting principle. During the fourth quarter of the twelve months ended January 31, 2001, SeaChange implemented the SEC's SAB 101 guidelines, retroactive to the beginning of the year. This was reported as a cumulative effect of a change in accounting principle as of February 1, 2000. Historically, for some of SeaChange's sales transactions, a portion of the sales price, typically 25%, was not due until installation occurred. SeaChange now defers the portion of the sales price not due until installation is complete. The cumulative effect of the change in accounting principle on prior years resulted in a charge to income of \$1.1 million (net of income taxes of \$732,000) or \$0.05 per diluted share which has been included in income for the nine months ended October 31, 2000.

#### LIQUIDITY AND CAPITAL RESOURCES

SeaChange has financed its operations and capital expenditures primarily with the proceeds of SeaChange's common stock, borrowings and cash flows generated from operations. Cash and cash equivalents increased \$1.1 million from \$6.1 million at January 31, 2001 to \$7.3 million at October 31, 2001. Working capital increased from approximately \$28.8 million at January 31, 2001 to approximately \$37.6 million at October 31, 2001.

Net cash provided by operating activities for the nine months ended October 31, 2001 was approximately \$2.0 million and net cash used in operating activities for the nine months ended October 31, 2000 was \$2.0 million. The net cash provided by operating activities in the nine months ended October 31, 2001 was the result of the net loss adjusted for non-cash expenses including depreciation and amortization of \$6.4 million and the changes in certain operating assets and liabilities. The significant net changes in assets and liabilities that provided cash from operations included a decrease in accounts receivable of \$2.8 million and an increase in deferred revenues of approximately \$900,000. These items that generated cash from operations were offset by a decrease in accounts payable of \$1.2 million, a decrease in customer deposits of \$3.0 million and an increase in inventories of approximately \$500,000. We expect that the broadcast segment and the interactive television products within the broadband segment will continue to require a significant amount of cash to fund future product development, to manufacture and deploy customer test and demonstration equipment and to meet higher revenue levels in both product segments.

Net cash used in investing activities was approximately \$8.3 million and \$9.6 million for the nine months ended October 31, 2001 and October 31, 2000, respectively. Intangible assets increased by \$2.7 million as a result of the successful defense of its patents. Investment activity consisted primarily of capital expenditures related to capital equipment required to support the expansion and growth of the business. SeaChange had no material capital expenditure commitments as of October 31, 2001.

Net cash provided by financing activities was approximately \$7.4 million and approximately \$16.1 million for the nine months ended October 31, 2001 and October 31, 2000, respectively. In the nine months ended October 31, 2001, the cash provided by financing activities included \$10.0 million in connection with the issuance of common stock issued on February 28, 2001, from a private placement sale of common stock and a warrant to Comcast SC Investment, Inc. (See Note 10 to the Consolidated Financial Statements) and an additional \$5.4 million in borrowings under the line of

credit with a bank. During the same period, cash used in financing activities included approximately \$4.0 million in repayments under SeaChange's revolving line of credit and \$5.0 million in principal payments under its equipment line of credit and capital lease obligations.

In October 2001, SeaChange entered into a \$10.0 million revolving line of credit with a bank that expires in October 2003. Loans made under this revolving line of credit will bear interest at a rate per annum equal to the bank's prime rate, 5.50% at October 31, 2001. As of October 31, 2001, SeaChange has borrowings of \$5.4 million under this revolving line of credit. Borrowings under this line of credit are collateralized by substantially all of SeaChange's assets. The loan agreement requires that SeaChange provide the bank with certain periodic financial reports and comply with certain financial ratios including a



minimum level of earnings before interest, taxes and depreciation and amortization on a trailing twelve month basis. As of October 31, 2001, SeaChange was in compliance with these financial covenants. The line of credit replaces SeaChange's prior revolving line of credit and equipment line with a different bank. In conjunction with entering into the new bank line, SeaChange repaid to its prior lender all outstanding borrowings under the equipment line of financing in an amount of \$3.4 million.

In October 2000, SeaChange entered into an agreement with a bank to finance \$1.2 million of the construction costs related to the purchase and renovation of a manufacturing mill in New Hampshire that SeaChange previously purchased in February 2000. During the construction period, interest was accrued and paid at a per annum rate of 8.875%. Upon occupancy of the building in November 2000, the loan converted into two promissory notes whereby SeaChange will pay principal and interest based upon a fixed interest rate per annum over a five and ten year period, respectively (8.875% at October 31, 2001). Borrowings under the loan are secured by the land and buildings of the renovated mill. The loan agreement requires that SeaChange provide the bank with certain periodic financial reports and comply with certain financial ratios. At October 31, 2001, SeaChange was in compliance with all covenants. As of October 31, 2001, borrowings outstanding under the loan were \$1.1 million.

It is typical for SeaChange to experience fluctuations in its monthly operating results primarily due to the timing of receiving customer orders and the related shipment of these customer orders. As a result of these monthly fluctuations, SeaChange may experience an increase in its inventories as a result of procurement of both short and long lead components for anticipated orders for both its product segments, a decrease in its accounts payable balance primarily due to the timing of payments for materials purchased for prior month shipments, a decrease in accounts receivable amounts as a result of customer payments without corresponding customer shipments and a resulting decrease in cash and cash equivalents.

SeaChange believes that existing funds are adequate to satisfy its working capital and capital expenditure requirements for the foreseeable future.

#### Effects of Inflation

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

#### Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interest method. SeaChange believes that the adoption of SFAS 141 will not have a material impact on its current financial position and results of operations.

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets", which is effective for SeaChange on February 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization and includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing

18

recognized intangibles, and reclassification of certain intangibles out of previously reported goodwill. SeaChange believes that the adoption of SFAS 142 will not have a material impact on its current financial position and results of operations.

In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143 ("SFAS 143"), "Accounting for obligations associated with the Retirement of Long-Lived Assets." SFAS 143 provides the accounting requirements for retirement obligations associated with tangible long-lived assets. SFAS 143 is effective for financial statements for fiscal years beginning after June 15, 2002. SeaChange believes that the adoption of SFAS 143 will not have a material impact on its current financial position and results of operations.

In October 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 requires one method of accounting for long-lived assets disposed of by sale. SFAS 144 is effective for financial statements for fiscal years beginning after December 15, 2001. SeaChange believes that the adoption of SFAS 144 will not have a material impact on its current financial position and results of operations.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

SeaChange faces 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 SeaChange's financial results. SeaChange's primary exposure has been related to local currency revenue and operating expenses in Europe and Asia. Historically, SeaChange has not hedged specific currency exposures as gains and losses on foreign currency transactions have not been material to date. At October 31, 2001, SeaChange had approximately \$6,500,000 outstanding related to variable rate U.S. dollar denominated debt. The carrying value of these short-term borrowings approximates fair value due to the short maturities of these instruments. Assuming a hypothetical 10% adverse change in the interest rate, interest expense on these short-term borrowings would increase by approximately \$36,000.

The carrying amounts reflected in the consolidated balance sheet of cash and cash equivalents, trade receivables, and trade payables approximates fair value at October 31, 2001 due to the short maturities of these instruments.

SeaChange maintains investment portfolio holdings of various issuers, types, and maturities. SeaChange's cash and marketable securities include cash equivalents, which SeaChange considers investments to be purchased with original maturities of three months or less given the short maturities and investment grade quality of the portfolio holdings at October 31, 2001, a sharp rise in interest rates should not have a material adverse impact on the fair value of SeaChange's investment portfolio. As a result, SeaChange does not currently hedge these interest rate exposures.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On June 13, 2000, SeaChange filed in the United States District Court for the District of Delaware a lawsuit against one of its competitors, nCube Corp., whereby SeaChange alleged that nCube's MediaCube-4 product infringed a patent held by SeaChange (Patent No. 5,862,312) relating to SeaChange's MediaCluster technology. In instituting the claim, SeaChange sought both a permanent injunction and damages in an unspecified amount. nCube made a counterclaim against SeaChange that the patent held by SeaChange was invalid and that nCube's MediaCube-4 product did not infringe SeaChange's patent. On September 6, 2000, nCube conceded, based on the District Court's prior claim construction ruling, that nCube's MediaCube-4 product infringed the SeaChange patent. On September 25, 2000, a jury upheld the validity of SeaChange's patent. nCube has filed motions challenging both the jury's verdict and the District Court's claim construction ruling. The District Court has yet to rule on nCube's motions. At this time, SeaChange is awaiting the court's decision regarding a permanent injunction. Damages will be determined in future proceedings.

On January 8, 2001, nCube Corp. filed a complaint against SeaChange in the United States District Court for the District of Delaware alleging that SeaChange's use of SeaChange's Media Cluster, Media Express and Media Server technology each infringe

19

a patent held by nCube (Patent No. 5,805,804). In instituting the claim, nCube has sought both an injunction and monetary damages in an unspecified amount. SeaChange responded on January 26, 2001, denying that claim of infringement. SeaChange also asserted a counterclaim seeking a declaration from the District Court that U.S. Patent No. 5,805,804 is invalid and not infringed. Currently discovery on this claim is scheduled to be completed in December 2001, following which will be a claim construction hearing.

On June 14, 1999, SeaChange filed a defamation complaint against Jeffrey Putterman, Lathrop Investment Management, Inc. and Concurrent Computer Corporation in the Circuit Court of Pulaski County, Arkansas alleging that the defendants conspired to injure SeaChange's business and reputation in the marketplace. The complaint further alleges that Mr. Putterman and Lathrop Investment Management, Inc. defamed SeaChange through false postings on an Internet message board. The complaint seeks unspecified amounts of compensatory and punitive damages. On June 14, 2000, Concurrent filed a counterclaim under seal against SeaChange seeking unspecified damages. On July 28, 2000, Concurrent filed a motion for summary judgement on the claim of civil conspiracy and on January 4, 2001, the trial court entered an order granting summary judgement for Concurrent on that claim. SeaChange immediately requested reconsideration of this order or, in the alternative, recertification for immediate appeal. On June 12, 2001, the trial court denied the motion for reconsideration but made findings which permitted an immediate appeal and on July 11, 2001 SeaChange filed an appeal. The motions relating to these claims and counterclaims are currently pending and no trial date has been set.

SeaChange cannot be certain of the outcome of the foregoing litigation, but SeaChange plans to oppose allegations against it and assert its claims against other parties vigorously. In addition, as these claims are in the early stages of discovery and certain claims for damages are as yet unspecified, SeaChange is

unable to estimate the impact to its business, financial condition, and results of operations or cash flows.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1 Loan and Security Agreement, dated October 22, 2001, by and between SeaChange and Citizens Bank of Massachusetts (filed as Exhibit 10.1 to SeaChange's Registration Statement on Form S-3 previously filed on December 5, 2001 with the Commission (File No. 333-74534) and incorporated herein by reference).

20

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, SeaChange International, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: December 13, 2001

SEACHANGE INTERNATIONAL, INC.

by: /s/ William L. Fiedler

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William L. Fiedler

Vice President, Finance and Administration,  
Chief Financial Officer, Treasurer and Secretary  
(Principal Financial and Accounting Officer;  
Authorized Officer)

21

EXHIBIT INDEX

Exhibit No. -----	Description -----
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