

SECURITIES AND EXCHANGE COMMISSION  
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 September 30, 1996

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 registration 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: (508) 897-0100

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 September 30, 1996 was 9,632,356.

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SEACHANGE INTERNATIONAL, INC.

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Item 1: Consolidated Financial Statements

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

<TABLE>  
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	December 31, 1995	September 30 1996	Pro forma September 30, 1996
	-----	-----	-----
<S>	<C>	<C>	<C>
Assets			
Current assets:		(Unaudited)	(Unaudited)
Cash and cash equivalents	\$ 6,184	\$ 2,049	\$ 26,449
Accounts receivable, net of allowance for doubtful accounts of \$40 at December 31, 1995 and \$173 at September 30, 1996	3,335	5,394	5,394
Inventories	2,439	7,506	7,506
Prepaid expenses	28	109	109
Deferred income taxes	151	597	597
	-----	-----	-----
Total current assets	12,137	15,655	40,055
Property and equipment, net	1,433	3,931	3,931
Other assets	25	577	577
	=====	=====	=====
	\$ 13,595	\$ 20,163	\$ 44,563
	=====	=====	=====
Liabilities, Redeemable Convertible Preferred Stock and Stockholders' Equity			
Current liabilities:			
Accounts payable	\$ 3,140	\$ 5,849	\$ 5,849
Accrued expenses	1,935	1,440	1,440
Customer deposits	2,082	4,249	4,249
Deferred revenue	767	1,600	1,600
Income taxes payable	720	217	217
	-----	-----	-----
Total current liabilities	8,644	13,355	13,355
	-----	-----	-----
Series B redeemable convertible preferred stock, \$.01 par value; 1,000,000 shares of preferred stock authorized; 650,487 shares designated, issued and outstanding at December 31, 1995 and September 30, 1996, at issuance price, net of issuance costs; none outstanding on a pro forma basis at September 30, 1996	4,008	4,008	--
	-----	-----	-----
Stockholders' Equity:			
Series A convertible preferred stock, \$.01 par value; 1,000,000 shares of preferred stock authorized: 30,000 shares designated, 11,808 shares issued at December 31, 1995 and September 30, 1996: at issuance price; none outstanding on a pro forma basis at September 30, 1996	--	--	--
Common stock, \$.01 par value; 15,000,000 shares authorized; 9,625,740 shares, 9,632,356 shares and 13,703,212 shares issued at December 31, 1995, September 30, 1996 and September 30, 1996 on a pro forma basis, respectively	96	96	137
Additional paid-in capital	374	415	28,782
Retained earnings	1,272	4,820	4,820
Treasury stock, 424,950 shares of common at December 31, 1995; 856,200 shares of common and 1,286 shares of Series A convertible preferred at September 30, 1996 and on a pro forma basis at September 30, 1996, respectively, at cost	(4)	(2,531)	(2,531)
Notes receivable from stockholders	(795)	--	--
	-----	-----	-----
Total stockholders' equity	943	2,800	31,208
	-----	-----	-----
	\$ 13,595	\$ 20,163	\$ 44,563
	=====	=====	=====

</TABLE>

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SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF OPERATIONS  
(Unaudited; In thousands, except share-related data)

<TABLE>  
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	Three months ended September 30,		Nine months ended September 30,	
	1995	1996	1995	1996
<S>	<C>	<C>	<C>	<C>
Revenues:				
Systems	\$ 5,340	\$ 11,738	\$ 16,355	\$ 34,644
Services	281	1,188	843	2,636
	-----	-----	-----	-----
	5,621	12,926	17,198	37,280
	-----	-----	-----	-----
Cost of revenues:				
Systems	3,598	6,665	10,650	21,095
Services	480	1,055	1,029	2,871
	-----	-----	-----	-----
	4,078	7,720	11,679	23,966
	-----	-----	-----	-----
Gross profit	1,543	5,206	5,519	13,314
	-----	-----	-----	-----
Operating expenses:				
Research and development	626	1,256	1,673	3,242
Selling and marketing	356	1,125	1,137	3,035
General and administrative	234	648	635	1,510
	-----	-----	-----	-----
	1,216	3,029	3,445	7,787
	-----	-----	-----	-----
Income from operations	327	2,177	2,074	5,527
Interest income, net	11	37	58	137
	-----	-----	-----	-----
Income before income taxes	338	2,214	2,132	5,664
Provision for income taxes	125	788	790	2,116
	=====	=====	=====	=====
Net income	\$ 213	\$ 1,426	\$ 1,342	\$ 3,548
	=====	=====	=====	=====
Net income per share	\$ 0.02	\$ 0.12	\$ 0.11	\$ 0.31
	=====	=====	=====	=====
Weighted average common shares and equivalent common shares outstanding	12,207,985	11,590,450	12,003,464	11,587,933
	=====	=====	=====	=====

</TABLE>

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SEACHANGE INTERNATIONAL, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
INCREASE (DECREASE) IN CASH FLOWS  
(Unaudited; In thousands)

<TABLE>  
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	Nine months ended September 30,	
	1995	1996
<S>	<C>	<C>
Cash flows from operating activities		
Net income	\$ 1,342	\$ 3,548
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	146	1,022

Inventory valuation allowance	--	794
Compensation expense associated with stock options	--	36
Deferred income taxes	10	(446)
Changes in assets and liabilities:		
Accounts receivable	(2,199)	(2,059)
Inventories	(1,358)	(8,107)
Prepaid expenses and other assets	6	(91)
Accounts payable	433	2,709
Accrued expenses	1,383	(695)
Customer deposits	(843)	2,167
Deferred revenue	316	833
Income taxes payable	577	(503)
	-----	-----
Net cash used in operating activities	(187)	(792)
	-----	-----
Cash flows from investing activities		
Purchase of software	--	(450)
Purchases of property and equipment	(311)	(1,166)
	-----	-----
Net cash used in investing activities	(311)	(1,616)
	-----	-----
Cash flows from financing activities		
Repayment of notes payable	(8)	--
Proceeds from issuance of common stock	7	5
Purchase of treasury stock	--	(2,022)
Repayments of note receivable from stockholders	--	290
	-----	-----
Net cash used in financing activities	(1)	(1,727)
	-----	-----
Net decrease in cash and cash equivalents	(499)	(4,135)
Cash and cash equivalents, beginning of period	871	6,184
	-----	-----
Cash and cash equivalents, end of period	\$ 372	\$ 2,049
	-----	-----
Supplemental disclosure of noncash activity:		
Transfer of items originally classified as inventories to fixed assets	\$ 46	\$ 2,246
Purchase of treasury stock in lieu of cash payment of notes receivable from stockholders	--	\$ 505

</TABLE>

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SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED; IN THOUSANDS, EXCEPT SHARE-RELATED DATA)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The Company believes that the unaudited consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments), necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. The results of operations for the three-month and nine-month periods ended September 30, 1996 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 six months ended June 30, 1996 and for the year ended December 31, 1995, included in the Company's Registration Statement on Form S-1 (No. 333-12233) filed on September 18, 1996, as amended.

Unaudited Pro Forma Information

The unaudited pro forma information at September 30, 1996 included in the unaudited consolidated balance sheet reflects the issuance of 1,810,000 shares of the Company's common stock in exchange for \$24,400, net of estimated stock issuance costs, in connection with the closing of the Company's initial public offering on November 8, 1996. The unaudited pro forma information also reflects the automatic conversion of the Series A and Series B preferred stock into 2,260,856 shares of common stock that occurred upon the closing of the Company's initial public offering.

2. NET INCOME PER SHARE

Net income per share was determined by dividing net income by the weighted average number of common shares and common share equivalents outstanding

during the period. Common share equivalents are comprised of common stock options and convertible preferred stock. Pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 83, common share equivalents issued at prices below the initial public offering price in the twelve months preceding the initial public offering have been included in the calculation for all periods presented.

3. COMMON STOCK

On September 6, 1996, the Board of Directors authorized a 3-for-2 stock split of the Company's common stock, which became effective on October 30, 1996. All shares of common stock, common stock options and per share amounts included in the accompanying unaudited consolidated financial statements have been adjusted to give retroactive effect to the stock split for all periods presented.

SEACHANGE INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED; IN THOUSANDS, EXCEPT SHARE-RELATED DATA)

4. INVENTORIES

Inventories consist of the following:

<TABLE>  
<CAPTION>

	DECEMBER 31, 1995 -----	SEPTEMBER 30, 1996 -----
<S>	<C>	<C>
Components and assemblies	\$ 2,261	\$ 5,403
Finished products	178	2,103
	-----	-----
	\$ 2,439	\$ 7,506
	=====	=====

</TABLE>

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

RESULTS OF OPERATIONS

**REVENUES.** The Company's systems revenues consist of sales of its digital video insertion products. Systems revenues increased by 119.8% to \$11,738,000 for the quarter ended September 30, 1996, from \$5,340,000 in the comparable quarter in 1995. Systems revenues increased by 111.8% to \$34,644,000 for the nine-month period ended September 30, 1996, from \$16,355,000 in the comparable period in 1995. The increased systems revenues reflect the Company's introduction, in January 1996, of the second generation of its digital video insertion system which significantly improved the scalability and performance of the Company's products, and the subsequent increase in the number of systems sold.

The Company's services revenues consist of fees for installation, training, product maintenance and technical support services. The Company's services revenues increased by 322.8% to \$1,188,000 for the quarter ended September 30, 1996, from \$281,000 in the comparable quarter in 1995. The Company's services revenues increased by 212.7% to \$2,636,000 for the nine-month period ended September 30, 1996, from \$843,000 in the comparable period in 1995. These increases in services revenues primarily resulted from the increase in product sales and renewals of maintenance and support contracts related to the growing installed base of systems.

For the quarter and nine-month periods ended September 30, 1996 and 1995, certain customers accounted for more than 10% of the Company's total revenues. Individual customers accounted for 35.9% and 11.5% of total revenues in the quarter ended September 30, 1996 and 44.6%, 15.8% and 15.8% of total revenues in the quarter ended September 30, 1995. Individual customers accounted for 30.2%, 12.6%, and 11.0% of total revenues in the nine-month period ended September 30, 1996 and 30.1%, 27.4%, and 13.2% of total revenues in the nine-month period ended September 30, 1995.

International revenues accounted for approximately 7.6% and 7.3% of total revenues in the quarter ended and in the nine-month period ended September 30,

1996, respectively. There were no international sales prior to 1996.

**GROSS PROFIT.** Systems gross profit as a percentage of systems revenues was 43.2% and 32.6% for the quarters ended September 30, 1996 and 1995, respectively. Systems gross profit as a percentage of systems revenues was 39.1% and 34.9% for the nine-month periods ended September 30, 1996 and 1995, respectively. These increases in systems gross profit resulted from design improvements in the second generation video insertion product, lower costs of certain purchased components and subassemblies and the Company achieving certain manufacturing efficiencies as a result of increased volume. These increases were partially offset by increases of \$794,000 and \$380,000 in the Company's inventory valuation allowance in the nine-month period and the quarter ended September 30, 1996, respectively. The Company evaluates inventory levels and expected usage on a periodic basis and provides a valuation allowance for estimated inactive, obsolete and surplus inventory.

Services gross profit as a percentage of services revenues was 11.2% for the quarter ended September 30, 1996 compared to a loss of 70.8% for the quarter ended September 30, 1995. Costs of services revenues exceeded services revenue by 8.9% and 22.1% for the nine-month periods ended September 30, 1996 and 1995, respectively, primarily as a result of the costs associated with the Company building a service organization to support the installed base of systems. Improvements in services gross profit resulted from the growing installed base of systems with ongoing product maintenance and support agreements.

**RESEARCH AND DEVELOPMENT.** Research and development expenses consist primarily of compensation of development personnel, depreciation of equipment, and an allocation of related facility expenses. Research and development expenses increased to \$1,256,000, or 9.7% of total revenues in the quarter ended September 30, 1996, from \$626,000, or 11.1% of total revenues in the comparable quarter in 1995. Research and development expenses increased to \$3,242,000, or 8.7% of total revenues in the nine-month period ended September 30, 1996, from \$1,673,000, or 9.7% of total revenues in the comparable period in 1995. These increases were primarily attributable to the hiring of additional development

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personnel. All software development costs were expensed in the three and nine-month periods ended September 30, 1996. The Company anticipates that it will continue to devote substantial resources to its research and development efforts.

**SELLING AND MARKETING.** Selling and marketing expenses consist primarily of compensation expenses, including sales commissions and travel expenses and certain promotional expenses. Selling and marketing expenses increased to \$1,125,000, or 8.7% of total revenues in the quarter ended September 30, 1996, from \$356,000, or 6.3% of total revenues in the comparable quarter in 1995. Selling and marketing expenses increased to \$3,035,000, or 8.1% of total revenues for the nine-month period ended September 30, 1996, from \$1,137,000, or 6.6% of total revenues in the comparable period in 1995. The increases in the dollar amounts as well as the percentages of total revenues were attributable to hiring of additional selling and marketing personnel, expanded promotional activities, and an increase in commissions relating to increased revenues. The Company expects that selling and marketing expenses will continue to increase in dollar amount as the Company hires additional personnel and expands selling and marketing activities for the remainder of 1996 and in 1997.

**GENERAL AND ADMINISTRATIVE.** General and administrative expenses consist primarily of compensation of executive, finance, human resource and administrative personnel, legal and accounting services as well as an allocation of related facility expenses. General and administrative expenses increased to \$648,000, or 5.0% of total revenues in the quarter ended September 30, 1996, from \$234,000, or 4.2% of total revenues in the comparable quarter in 1995. General and administrative expense increased to \$1,510,000, or 4.1% of total revenues for the nine-month period ended September 30, 1996, from \$635,000, or 3.7% of total revenues in the comparable period in 1995. The increases in the dollar amount as well as the percentages of total revenues were attributable to increased staffing to support the Company's growth. The Company believes that its general and administrative expenses will continue to increase as a result of an expansion of the Company's administrative staff to support its growing operations and as a result of expenses associated with being a public company.

**PROVISION FOR INCOME TAXES.** The Company's effective tax rate was 35.6% and 37.0% for the quarters ended September 30, 1996 and 1995, respectively. The Company's effective tax rate was 37.4% and 37.1% for the nine months ended September 30, 1996 and 1995, respectively. The decrease in the effective tax rate in 1996 was due to benefits of foreign sales corporation exempt income in 1996 and the reinstatement of the research and development tax credit, effective July 1996.

#### LIQUIDITY AND CAPITAL RESOURCES

Through November 1996, the Company funded its operations primarily through cash provided by operations and the private sale of equity securities. In November 1996, in connection with the initial public offering of the Company's

common stock, the Company issued 1,810,000 shares of its common stock in exchange for approximately \$24,400,000, net of estimated issuance costs.

As of September 30, 1996, the Company had cash and cash equivalents of \$2,049,000, a \$4,135,000 decrease from the \$6,184,000 on hand at December 31, 1995. Working capital decreased to \$2,300,000 at September 30, 1996 from \$3,493,000 at December 31, 1995.

Net cash used in operating activities was \$792,000 for the nine months ended September 30, 1996 compared with net cash used in operating activities of \$187,000 during the comparable period in 1995. Net cash used in operating activities during the nine month period September 30, 1996 consisted of cash provided by net income adjusted for non-cash expenses including depreciation and amortization and increased current liabilities, offset by increased accounts receivable and inventories. Accounts receivable increased from \$3,335,000 at December 31, 1995 to \$5,394,000 at September 30, 1996, an increase of \$2,059,000, or 61.7%. The increase in accounts receivable is primarily attributable to the increased revenue levels. Total revenues recognized in the quarter ended December 31, 1995 were \$6,004,000, compared to \$12,926,000 in the quarter ended September 30, 1996, a 115.3% increase. The inventories increased from \$2,439,000 at December 31, 1995 to \$7,506,000 at September 30, 1996, an increase of \$5,067,000, or

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207.8%. The increase in inventories is attributable to additional inventory to support the Company's revenue growth, the increase in systems shipped to customers for which revenue was not yet recognized and the growing installed base of systems.

Net cash used in investing activities was \$1,616,000 for the nine months ended September 30, 1996 compared with net cash used in investing activities of \$311,000 during the comparable period in 1995. Investment activity consisted primarily of purchases of property and equipment to support the Company's growth. In addition, in June 1996 the Company paid \$450,000 for a software license. Investment activity for the comparable period in 1995 consisted of purchases of property and equipment.

Net cash used in financing activities was \$1,727,000 for the nine months ended September 30, 1996 compared with net cash used in financing activities of \$1,000 during the comparable period in 1995. For the nine months ended September 30, 1996, cash used in financing activities consisted primarily of the repurchase of shares of the Company's common stock and Series A convertible preferred stock from certain employees and directors of the Company, net of the repayment of notes receivable from stockholders.

The Company has a \$6.0 million revolving line of credit and a \$1.5 million equipment line of credit with a bank. The revolving line of credit expires in September 1997 and the equipment line expires in March 1997. Borrowings under the lines of credit are secured by substantially all of the Company's assets. The loan agreement relating to the lines of credit requires that the Company provide the bank with certain periodic financial reports and comply with certain financial ratios. As of September 30, 1996, the Company had not borrowed against either of these lines.

The Company believes that its existing cash, together with the net proceeds of \$24,400,000 from the initial public offering of the Company's common stock and available borrowings under the lines of credit, are sufficient to meet the Company's requirements for the foreseeable future.

#### FACTORS THAT MAY AFFECT FUTURE RESULTS

Any statements contained in this Form 10-Q that do not describe historical facts may constitute forward looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. Any forward looking statements contained herein are based on current expectations, but are subject to a number of risks and uncertainties. The factors that could cause actual future results to differ materially from current expectations include the following: fluctuations in customer demand; the Company's ability to manage its growth; the risk of new product introductions and customer acceptance of new products; the rapid technological change which characterizes the Company's markets; the Company's significant concentration of customers; the risks associated with international sales as the Company expands its markets; and the ability of the Company to compete successfully in the future, as well as other risks identified in the Company's Securities and Exchange Commission filings, including but not limited to those appearing under the caption "Risk Factors" in the Company's Prospectus dated November 4, 1996.

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#### PART II. OTHER INFORMATION

##### Item 6. Exhibits and Reports on Form 8-K

###### (a) Exhibits

- Exhibit 11: Computation of Net Income Per Share.
- Exhibit 27: Financial Data Schedule (For SEC Edgar Filing Only; Intentionally Omitted)

###### (a) Reports on Form 8-K

No reports on Form 8-K were filed during the period.

## 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 3, 1996

SEACHANGE INTERNATIONAL, INC.

by:

/s/ William C. Styslinger, III  
-----

William C. Styslinger, III  
President, Chief Executive Officer,  
Chairman of the Board and Director

/s/ Joseph S. Tibbetts, Jr.  
-----

Joseph S. Tibbetts, Jr.  
Vice President, Finance and Administration,  
Chief Financial Officer, and Treasurer  
(Principal Financial and Accounting Officer)

SEACHANGE INTERNATIONAL, INC.

## EXHIBIT INDEX

<TABLE>  
<CAPTION>

EXHIBIT NUMBER -----	DESCRIPTION -----	PAGE ----
<S> 11	<C> Computation of Net Income Per Share	<C> 14
27	Financial Data Schedule (For SEC Edgar Filing Only; Intentionally Omitted)	

</TABLE>



## EXHIBIT 11

## SEACHANGE INTERNATIONAL, INC.

## COMPUTATION OF NET INCOME PER SHARE (1)

(UNAUDITED)

<TABLE>  
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	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1996	1995	1996
<S>	<C>	<C>	<C>	<C>
Weighted average common and common equivalent shares:				
Weighted average common shares outstanding during the period.....	9,206,025	8,588,490	9,098,775	8,585,973
Weighted average common equivalent shares .....	1,771,200	1,771,200	1,771,200	1,771,200
Dilutive effect of common equivalent shares issued subsequent to September 1995 (2) .....	1,230,760	1,230,760	1,133,489	1,230,760
	12,207,985	11,590,450	12,003,464	11,587,933
Net income	\$ 212,967	\$ 1,425,965	\$ 1,342,094	\$ 3,548,042
Primary net income per share	\$ 0.02	\$ 0.12	\$ 0.11	\$ 0.31

&lt;/TABLE&gt;

- (1) Fully diluted net income per share has not been separately presented, as the amounts would not be materially different from primary net income per share.
- (1) Common share equivalents issued subsequent to September 1995 are comprised of common stock options and Series B convertible preferred stock and have been included in the calculation pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 83. Common share equivalents issued at prices below the initial public price of \$15.00 in the twelve months preceding the initial public offering have been included in the calculation for all periods presented.

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<F1> (PREFERRED)	
Series B redeemable convertible preferred stock, \$.01 par value; 1,000,000 shares of preferred stock authorized; 650,487 shares designated, issued and outstanding at September 30, 1996, at issuance price, net of issuance costs:.....	4,008      --
	-----
Stockholders' Equity:	
Series A convertible preferred stock, \$.01 par value; 1,000,000 shares of preferred stock authorized; 30,000 shares designated, 11,808 shares issued at September 30, 1996, at issuance price.....	--      --
<F2> (OTHER - SE)	
Additional paid-in capital .....	415
Retained earnings.....	4,820
</FN>	

</TABLE>