SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

_X_ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 1999

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 incorporation or organization) | (IRS Employer Identification No.) |

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 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 __X__ NO _______

The number of shares outstanding of the registrant's Common Stock on August 10, 1999 was 13,900,109.

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SEACHANGE INTERNATIONAL, INC.

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

<TABLE>
<CAPTION>

| | June 30, 1999 (unaudited) | December 31, 1998 |
|---|---|---|
| <S> | <C> | <C> |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 10,942 | $ 5,115 |
| Accounts receivable, net of allowance for doubtful accounts of $1,001 at June 30, 1999 and $870 at December 31, 1998 | 16,828 | 18,975 |
| Inventories | 12,748 | 16,157 |
| Income taxes receivable | 2,087 | 2,117 |
| Prepaid expenses | 2,002 | 1,701 |
| Deferred income taxes | 1,967 | 1,967 |
| Total current assets | 46,574 | 46,032 |
| Property and equipment, net | 9,303 | 7,981 |
| Goodwill and intangibles, net | 991 | 1,197 |
| Other assets | 222 | 176 |
| | $ 57,090 | $ 55,386 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Line of credit | $ - | $ 2,000 |
| Current portion of equipment line of credit and obligations under capital lease | 1,028 | 555 |
| Accounts payable | 10,513 | 10,103 |
| Accrued expenses | 3,129 | 3,374 |
| Customer deposits | 2,812 | 1,704 |
| Deferred revenue | 5,635 | 5,495 |
| Income taxes payable | 576 | 475 |
| Total current liabilities | 23,693 | 23,706 |
| Long term equipment line of credit and obligations under capital lease | 1,720 | 1,027 |
| Stockholders' Equity: | | |
| Common stock, $.01 par value; 50,000,000 shares authorized; 13,893,992 shares and 13,736,892 shares issued and outstanding at June 30, 1999 and December 31, 1998, respectively | 139 | 138 |
| Additional paid-in capital | 32,985 | 32,177 |
| Accumulated deficit | (1,393) | (1,603) |
| Accumulated other comprehensive income | (54) | (59) |
| Total stockholders' equity | 31,677 | 30,653 |
| | $ 57,090 | $ 55,386 |

</TABLE>

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



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

<TABLE>
<CAPTION>

Three months ended Six months ended

June 30, June 30,

| <S> | 1999 | 1998 | 1999 | 1998 |
|---|---|---|---|---|
| Revenues: | | | | |
| Systems | $ 17,443 | $ 13,207 | $ 34,367 | $ 28,014 |
| Services | 3,890 | 3,373 | 7,609 | 6,735 |
| | 21,333 | 16,580 | 41,976 | 34,749 |
| Costs of revenues: | | | | |
| Systems | 10,080 | 8,223 | 19,953 | 17,190 |
| Services | 3,514 | 3,108 | 6,887 | 6,151 |
| | 13,594 | 11,331 | 26,840 | 23,341 |
| Gross profit | 7,739 | 5,249 | 15,136 | 11,408 |
| Operating expenses: | | | | |
| Research and development | 4,274 | 3,900 | 8,394 | 7,903 |
| Selling and marketing | 1,947 | 2,081 | 3,857 | 3,926 |
| General and administrative | 1,265 | 1,721 | 2,554 | 3,283 |
| Restructuring of operations | - | - | - | 676 |
| | 7,486 | 7,702 | 14,805 | 15,788 |
| Income (loss) from operations | 253 | (2,453) | 331 | (4,380) |
| Interest income, net | (1) | 76 | 7 | 179 |
| Income (loss) before income taxes | 252 | (2,377) | 338 | (4,201) |
| Provision (benefit) for income taxes | 95 | (769) | 128 | (1,478) |
| Net income (loss) | $ 157 | $ (1,608) | $ 210 | $ (2,723) |
| Basic earnings (loss) per share | $ 0.01 | $ (0.13) | $ 0.02 | $ (0.23) |
| Diluted earnings (loss) per share | $ 0.01 | $ (0.13) | $ 0.01 | $ (0.23) |
| Shares used in calculating: | | | | |
| Basic earnings (loss) per share | 13,674,204 | 12,115,901 | 13,609,006 | 11,847,910 |
| Diluted earnings (loss) per share | 14,294,286 | 12,115,901 | 14,159,860 | 11,847,910 |

</TABLE>

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



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

<TABLE>
<CAPTION>

| | Six months ended June 30, 1999 | 1998 |
|---|---|---|
| <S> | <C> | <C> |
| Cash flows from operating activities | | |
| Net income (loss) | $ 210 | $ (2,723) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 2,034 | 2,467 |
| Inventory valuation allowance | 288 | 937 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 2,147 | (1,861) |
| Inventories | 1,076 | (2,472) |
| Prepaid expenses and other assets | (312) | (2,926) |
| Accounts payable | 410 | 922 |
| Accrued expenses | (245) | (153) |
| Customer deposits | 1,108 | (1,368) |
| Deferred revenue | 140 | 45 |
| Income taxes payable | 101 | 150 |
| Net cash provided by (used in) operating activities | 6,957 | (6,982) |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (769) | (1,154) |
| Proceeds from sale and maturity of marketable securities | - | 8,750 |
| Purchases of marketable securities | - | (902) |
| Net cash provided by (used in) investing activities | (769) | 6,694 |
| Cash flows from financing activities | | |
| Repayment of line of credit | (2,000) | - |
| Borrowings under equipment line of credit | 1,106 | - |
| Repayment of borrowings under equipment line of credit | (245) | - |
| Repayment of obligations under capital lease | (31) | - |
| Proceeds from issuance of common stock | 809 | 333 |
| Net cash provided by (used in ) financing activities | (361) | 333 |
| Net increase in cash and cash equivalents | 5,827 | 45 |
| Cash and cash equivalents, beginning of period | 5,115 | 2,973 |
| Cash and cash equivalents, end of period | $ 10,942 | $ 3,018 |
| Supplemental disclosure of noncash activities | | |
| Transfer of items originally classified as fixed assets to inventories | $ 109 | $ 513 |
| Transfer of items originally classified as inventories to fixed assets | $ 2,154 | $ - |
| Equipment acquired under capital leases | $ 336 | $ - |

</TABLE>

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



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

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its 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 and six month periods ended June 30, 1999 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 December 31, 1998, included in the Company's Annual Report on Form 10-K for such fiscal year.

2. Earnings Per Share

For the three and six months ended June 30, 1998, common shares of 331,995 and 273,318, respectively, issuable upon the exercise of stock options and unvested restricted common stock of 1,424,550 and 1,678,425, respectively, are antidilutive because the Company recorded a net loss for the periods, and therefore, have been excluded from the diluted earnings per share computation.

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

<TABLE>
<CAPTION>

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 1999 | 1998 | 1999 | 1998 |
| <S> | <C> | <C> | <C> | <C> |
| Weighted average number of shares outstanding | 13,674,204 | 12,115,901 | 13,609,006 | 11,847,910 |
| Unvested restricted common shares | 163,200 | - | 183,600 | - |
| Dilutive stock options | 456,882 | - | 367,254 | - |
| Shares used in calculating diluted earnings per share | 14,294,286 | 12,115,901 | 14,159,860 | 11,847,910 |

</TABLE>

3. Inventories

Inventories consist of the following:

<TABLE>
<CAPTION>

| | June 30, 1999 | December 31, 1998 |
|---|---|---|
| <S> | <C> | <C> |
| Components and assemblies | $ 11,897 | $ 14,592 |
| Finished products | 851 | 1,565 |
| | $ 12,748 | $ 16,157 |

</TABLE>



4. Restructuring of Operations

In March 1998, the Company recorded a charge of $676,000 as part of a planned consolidation of the operations of SeaChange Asia Pacific Operations Pte. Ltd. (SC Asia). The charge for restructuring included $569,000 related to the termination of 13 employees, a provision of $60,000 related to the planned vacating of premises at GSN and $47,000 of compensation expense associated with stock options for certain terminated employees. At March 31, 1998, all employees terminated in connection with such restructuring had been notified by the Company. As of December 31, 1998, the Company had paid all expenses related to the restructuring charge.

5. Comprehensive Income

For the three and six months ended June 30, 1999 and 1998, the Company's comprehensive income (loss) was as follows:

<TABLE>
<CAPTION>

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 1999 | 1998 | 1999 | 1998 |
| <S> | <C> | <C> | <C> | <C> |
| Net income (loss) | $ 157 | $ (1,608) | $ 210 | $ (2,723) |
| Other comprehensive income (expense), net of tax: | | | | |
| Foreign currency translation adjustment, net of tax of $5,$19, $2 and $16, respectively | (7) | 35 | 3 | (27) |
| Other comprehensive income (expense) | (7) | 35 | 3 | (27) |
| Comprehensive income (loss) | $ 150 | $ (1,573) | $ 213 | $ (2,750) |

</TABLE>

6. New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). SFAS 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The Company will adopt SFAS 133 as required by SFAS 137, "Deferral of the Effective Date of FASB Statement No. 133", in January 2001. To date the Company has not utilized derivative instruments or hedging activities and, therefore, the adoption of SFAS 133 is not expected to have a material impact on the Company's financial position or results of operations.

7. Segment Information

The Company has four reportable segments: digital advertising insertion, movies systems, broadcast systems, and services. The digital advertising insertion systems segment provides products to digitally manage, store and distribute digital video for television operators and telecommunications companies. The movie systems segment comprises products to provide long-form video storage and delivery for the pay-per-view markets for the hospitality and commercial property markets. 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 maintenance and technical support for the above systems and content which is distributed by the movie product segment. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the consolidated financial statements and related footnotes for the year ended December 31, 1998 included in the Company's Annual Report on Form 10-K for such fiscal year. The



Company does not measure the assets allocated to the segments. The Company measures results of the segments based on the respective gross profits. There were no intersegment sales or transfers. 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 June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 1999 | 1998 | 1999 | 1998 |
| <S> | <C> | <C> | <C> | <C> |

| | | | | |
|---|---|---|---|---|
| Revenues | | | | |
| Digital advertising insertion | $ 10,863 | $ 9,773 | $ 23,444 | $ 22,464 |
| Movies | 2,385 | 1,700 | 3,597 | 3,816 |
| Broadcast | 4,195 | 1,734 | 7,326 | 1,734 |
| Services | 3,890 | 3,373 | 7,609 | 6,735 |
| | $ 21,333 | $ 16,580 | $ 41,976 | $ 34,749 |
| Costs of revenues | | | | |
| Digital advertising insertion | $ 6,411 | $ 6,170 | $ 13,764 | $ 13,518 |
| Movies | 1,531 | 1,099 | 2,216 | 2,718 |
| Broadcast | 2,138 | 954 | 3,973 | 954 |
| Services | 3,514 | 3,108 | 6,887 | 6,151 |
| | $ 13,594 | $ 11,331 | $ 26,840 | $ 23,341 |

</TABLE>

The following summarizes revenues by geographic locations:

<TABLE>

| <S> | <C> | <C> | <C> | <C> |
|---|---|---|---|---|
| Revenues | | | | |
| United States | $ 15,436 | $ 12,843 | $ 32,766 | $ 29,585 |
| Canada and South America | 1,493 | 35 | 2,349 | 47 |
| Europe | 3,367 | 1,652 | 4,990 | 2,089 |
| Rest of world | 1,037 | 2,050 | 1,871 | 3,028 |
| | $ 21,333 | $ 16,580 | $ 41,976 | $ 34,749 |

</TABLE>

For the three and six months ended June 30, 1999 and 1998, certain customers accounted for more than 10% of the Company's revenues. Individual customers accounted for 27% and 10% of revenues in the three months ended June 30, 1999, 18% and 13% in the three months ended June 30, 1998, 22% and 13% in the six months ended June 30, 1999 and 22% and 13% in the six months ended June 30, 1998.



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 Company's ability to integrate the operations of acquired subsidiaries; fluctuations in demand for the Company's products and services; the Company's ability to manage its growth; the Company's ability to develop, market and introduce new and enhanced products and services on a timely basis; the rapid technological change which characterizes the Company's markets; the Company's significant concentration of customers; the Company's dependence on certain sole source suppliers and third-party manufacturers; the risks associated with international sales as the Company expands its markets; and the ability of the Company to compete successfully in the future. Further information on factors that could cause actual results to differ from those anticipated is detailed in various filings made by the Company from time to time with the Securities and Exchange Commission, including but not limited to, those appearing under the caption "Certain Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 1998. Any forward-looking statements should be considered in light of those factors.

Overview

The Company develops, markets, licenses and sells digital advertising insertion, movie and broadcast systems and related services and movie content to television operators, telecommunications companies, the hospitality and commercial property markets and broadcast television companies. Revenues from systems sales are recognized upon shipment provided that there are no uncertainties regarding customer acceptance and collection of the related receivables is probable. If such uncertainties exist, such as performance criteria beyond the Company's standard terms and conditions, revenue is recognized upon customer acceptance. Installation and training revenue is deferred and recognized as these services are performed. Revenue from technical support and maintenance contracts is deferred and recognized ratably over the period of the related agreements, generally twelve months. Customers are billed for installation, training and maintenance at the time of the product sale. Revenue from content fees, primarily movies, is recognized in the period earned based on noncancelable agreements.

The Company has experienced fluctuations in the number of orders being placed from quarter to quarter. The Company believes this is principally attributable to the buying patterns and budgeting cycles of television operators and broadcast companies, the primary buyers of digital advertising insertion systems and broadcast systems, respectively. The Company expects that there will continue to be fluctuations in the number and value of orders received and that at least in the near future, the Company's revenue and results of operations will reflect these fluctuations.

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



Results of Operations

Three Months Ended June 30, 1999 Compared to the Three Months Ended June 30, 1998

Systems. The Company's systems revenues consist of sales of its digital ad insertion, movie and broadcast system products. Systems revenues increased 32% from $13.2 million in the three months ended June 30, 1998 to $17.4 million in the three months ended June 30, 1999. The increased systems revenues in the three months ended June 30, 1999 resulted primarily from higher sales of broadcast systems, $4.2 million for the three months ended June 30, 1999 compared to $1.7 million for the three months ended June 30, 1998. These broadcast systems were introduced during the quarter ended June 30, 1998. In addition, digital ad insertion and movie system revenues increased $1.1 million and $700,000, respectively, in the three months ended June 30, 1999 as compared to the three months ended June 30, 1998.

For the three months ended June 30, 1999 and 1998, certain customers accounted for more than 10% of the Company's total revenues. Individual customers accounted for 27% and 10% of revenues in the three months ended June 30, 1999 and 18% and 13% in the three months ended June 30, 1998. The Company believes that revenues from current and future large customers will continue to represent a significant portion of total revenues.

International sales accounted for approximately 28% and 23% of total revenues for the three months ended June 30, 1999 and 1998, respectively. The Company expects that international sales will remain a significant portion of revenues of the Company in the future. As of June 30, 1999, all sales of the Company's products were made in United States dollars. Therefore, the Company 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, the Company will reevaluate its foreign currency exchange rate risk.

Services. The Company's services revenues consist of fees for installation, training, product maintenance, technical support services and movie content fees. The Company's services revenues increased 15% from approximately $3.4 million in the three months ended June 30, 1998 to $3.9 million in the three months ended June 30, 1999. The increase in services revenues primarily resulted from renewals of maintenance and support contracts and the impact of a growing installed base of systems.

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 23% from $8.2 million in the three months ended June 30, 1998 to $10.1 million in the three months ended June 30, 1999. For the three months ended June 30, 1999, the increase in cost of systems revenues primarily is the result of higher systems revenues and changes in the product mix.

Systems gross profit as a percentage of systems revenues was 42.2% and 37.7% in the three months ended June 30, 1999 and 1998, respectively. The increase in systems gross profit in 1999 was primarily due to higher systems revenue and lower material and manufacturing costs. The gross profits in the three months ended June 30, 1999 and 1998 were impacted by increases of approximately $ - and $310,000, respectively, in the Company's inventory valuation allowance. 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. Costs of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support services provided by the Company and costs associated with providing movie content. Costs of services revenues increased 13% from approximately $3.1 million in the three months ended June 30, 1998 to $3.5 million in the three months ended June 30, 1999, primarily as a result of higher service revenues and the costs associated with the Company hiring and training additional service personnel to provide worldwide support for the growing installed base of digital ad insertion, movie and broadcast systems. Services gross profit as a percentage of services revenue increased to 9.7% in the three months ended June 30, 1999 compared to a gross profit margin of 7.9% in the three months ended



June 30, 1998. The Company 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 product maintenance and technical support and other services to support the growing installed base of systems and the timing of costs associated with the Company'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 10% from approximately $3.9 million, or 24% of total revenues in the three months ended June 30, 1998 to $4.3 million, or 20% of total revenues in the three months ended June 30, 1999. The increase in the dollar amount was primarily attributable to the continuing investment in development personnel which reflects the Company's commitment to the development of new technology. The Company expects that research and development expenses will continue to increase in dollar amount as the Company 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 decreased 6% from approximately $2.1 million, or 13% of total revenues in the three months ended June 30, 1998 to $1.9 million, or 9% of total revenues in the three months ended June 30, 1999. The decrease in the dollar amount was attributable to the initial promotional activities incurred in the quarter ended June 30, 1998 to support the introduction of the Company's new broadcast products.

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 decreased 27% from $1.7 million, or 10% of total revenues in the three months ended June 30, 1998 to $1.3 million, or 6% of total revenues in the three months ended June 30, 1999. The decrease in the dollar amount was primarily attributable to lower payroll and related costs related to planned cost reduction measures.

Interest Income, net. Interest income, net, was approximately ($1,000) and $76,000 in the three months ended June 30, 1999 and June 30, 1998, respectively. The decrease in 1999 in interest income, net, primarily resulted from interest paid on borrowings, offset in part, by interest earned on invested balances.

Provision (Benefit) for Income Taxes. The Company's effective tax rate was 38% and 32% for the three months ended June 30, 1999 and June 30, 1998, respectively. The provision for income taxes in the three months ended June 30, 1999 was the result of an increase in taxable income offset by the Company's expected utilization in 1999 of previously generated net operating loss carry forwards.

The Company had net deferred tax assets of $1,967,000 at June 30, 1999 and December 31, 1998. The Company has made the determination it is more likely than not that it will realize the benefits of the net deferred tax assets. As a result of the acquisition of IPC in December 1997, the Company acquired deferred tax assets of $3.4 million, consisting primarily of net operating loss carry forwards.

Six Months Ended June 30, 1999 Compared to the Six Months Ended June 30, 1998

Systems. Systems revenues increased 23% from $28.0 million in the six months ended June 30, 1998 to $34.4 million in the six months ended June 30, 1999. The increased systems revenues in the six months ended June 30, 1999 resulted primarily from higher sales of broadcast systems, $7.3 million for the six months ended June 30, 1999 compared to $1.7 million for the six months ended June 30, 1998. These broadcast systems were introduced during the quarter ended June 30, 1998. In addition, digital ad insertion system revenues increased $1.0 million and movie system revenues decreased $200,000 in the six months ended June 30, 1999 as compared to the six months ended June 30, 1998.

For the six months ended June 30, 1999 and 1998, certain customers accounted for more than 10% of the Company's total revenues. Individual customers accounted for 22% and 13% of revenues in the six months ended



June 30, 1999 and 1998. The Company believes that revenues from current and future large customers will continue to represent a significant portion of total revenues.

International sales accounted for approximately 22% and 15% of total revenues for the six months ended June 30, 1999 and 1998, respectively. The Company expects that international sales will remain a significant portion of revenues of the Company in the future. As of June 30, 1999, all sales of the Company's products were made in United States dollars. Therefore, the Company 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, the Company will reevaluate its foreign currency exchange rate risk.

Services. The Company's services revenues increased 13% from approximately $6.7 million in the six months ended June 30, 1998 to $7.6 million in the six months ended June 30, 1999. These increases in services revenues primarily resulted from renewals of maintenance and support contracts and the impact of a growing installed base of systems.

Gross Profit

Systems. Costs of systems revenues increased 16% from $17.2 million in the six months ended June 30, 1998 to $20.0 million in the six months ended June 30, 1999. For the six months ended June 30, 1999, the increase in cost of systems revenues primarily is the result of higher systems revenues and changes in the product mix.

Systems gross profit as a percentage of systems revenues was 41.9% and 38.6% in the six months ended June 30, 1999 and 1998, respectively. The increase in systems gross profit in 1999 was primarily due to higher systems revenue and lower material and manufacturing costs. The gross profits in the six months ended June 30, 1999 and 1998 were impacted by increases of approximately $288,000 and $937,000, respectively, in the Company's inventory valuation allowance. 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. Costs of services revenues increased 12% from approximately $6.2 million in the six months ended June 30, 1998 to $6.9 million in the six months ended June 30, 1999, primarily as a result of higher service revenues and the costs associated with the Company hiring and training additional service personnel to provide worldwide support for the growing installed base of digital ad insertion, movie and broadcast systems. Services gross profit as a percentage of services revenue increased to 9.5% in the six months ended June 30, 1999 compared to a gross profit margin of 8.7% in the six months ended June 30, 1998. The Company 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 product and maintenance support and other services to support the growing installed base of systems and the timing of costs associated with the Company'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 6% from approximately $7.9 million, or 23% of total revenues in the six months ended June 30, 1998 to $8.4 million, or 20% of total revenues in the six months ended June 30, 1999. The increase in the dollar amount was primarily attributable to the continuing investment in development personnel which reflects the Company's commitment to the development of new technology. The Company expects that research and development expenses will continue to increase in dollar amount as the Company continues its development and support of new and existing products.

Selling and Marketing. Selling and marketing expenses remained flat at $3.9 million, or 11% and 9% of total revenues in the six months ended June 30, 1998 and 1999, respectively.

General and Administrative. General and administrative expenses decreased 22% from $3.3 million, or 9% of total revenues in the six months ended June 30, 1998 to $2.6 million, or 6% of total revenues in the six months ended June 30, 1999. The decrease in the dollar amount was primarily attributable to lower payroll and related costs related to planned cost reduction measures.



Restructuring of Operations. In March 1998, the Company recorded a charge of $676,000 for the restructuring of operations as part of a planned consolidation of the operations of SeaChange Asia Pacific Operations Pte. Ltd. (SC Asia). The charge for restructuring included $569,000 related to the termination of 13 employees, a provision of $60,000 related to the planned vacating of premises and $47,000 of compensation expense associated with stock options for certain terminated employees. At March 31, 1998, the Company had notified all terminated employees. All restructuring charges were paid as of December 31, 1998.

Interest Income, net. Interest income, net, was approximately $7,000 and $179,000 in the six months ended June 30, 1999 and June 30, 1998, respectively. The decrease in 1999 in interest income, net, primarily resulted from interest paid on borrowings, offset in part, by interest earned on lower invested balances.

Provision (Benefit) for Income Taxes. The Company's effective tax rate was 38% and 35% for the six months ended June 30, 1999 and June 30, 1998, respectively. The provision for income taxes in the six months ended June 30, 1999 was the result of an increase in taxable income offset by the Company's expected utilization in 1999 of previously generated net operating loss carry forwards.

Liquidity and Capital Resources

Cash and cash equivalents increased $5.8 million from $5.1 million at December 31, 1998 to $10.9 million at June 30, 1999. Working capital increased from approximately $22.3 million at December 31, 1998 to approximately $22.9 million at June 30, 1999.

Net cash provided by operating activities was approximately $7.0 million for the six months ended June 30, 1999, an increase of approximately $14.0 million from the same period in 1998. The net cash provided by operating activities during 1999 was the result of net income plus non-cash expenses including depreciation and amortization, the inventory valuation allowance and the changes in certain assets and liabilities. The significant net changes in assets and liabilities that provided cash from operations includes decreases in accounts receivable and inventories. The net decrease in accounts receivable in the six months ended June 30, 1999 of approximately $2.1 million is attributable to the collection of $47.4 million of customer balances, offset by the increase in revenues for the year. The net decrease in inventories in the six months ended June 30, 1999 of approximately $1.1 million is principally attributable to the on-going efforts of the Company to reduce inventory levels and the use of previously purchased materials to meet current customer demand.

Net cash used in investing activities was approximately $800,000 for the six months ended June 30, 1999. Net cash provided by investing activities was approximately $6.7 million in the six months ended June 30, 1998. Investment activity consisted primarily of capital expenditures related to the acquisition of computer equipment, office furniture, and other capital equipment required to support the expansion and growth of the business during the six months ended June 30, 1999.

Net cash used in financing activities was approximately $400,000 for the six months ended June 30, 1999. Net cash provided by financing activities was approximately $333,000 in the six months ended June 30, 1998. In the six months ended June 30, 1999, the cash used for financing activities included $2.0 million repayment of borrowings under the line of credit, offset in part, by a $1.1 million draw-down under an equipment line of credit with a bank and $800,000 received in connection with the issuance of common stock pursuant to the exercise of stock options and the Company's stock purchase plan.

The Company has a $6.0 million revolving line of credit and had a $3.0 million equipment line of credit with a bank. The revolving line of credit expires in October 1999 and the equipment line of credit expired in June 1999.

Borrowings under the lines of credit are secured by substantially all of the Company's assets. Loans made under the revolving line of credit generally bear interest at a rate per annum equal to the bank's base rate plus .5% (8.50 % at June 30, 1999). Loans made under the equipment loan bear interest at a rate per annum equal to the bank's base rate plus 1.0% (9.00 % at June 30, 1999). 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 including the maintenance of total liabilities, excluding deferred revenue, to net worth of at least .80 to 1.0. At June 30, 1999, the Company was in compliance with all covenants. As of June 30, 1999, the Company had borrowings outstanding of $2.1 million against the equipment line of credit.



The Company believes that existing funds together with available borrowings under the line of credit and equipment line facility are adequate to satisfy its working capital and capital expenditure requirements for the foreseeable future.

The Company had no material capital expenditure commitments as of June 30, 1999.

Year 2000 Issue/Year 2000 Readiness Disclosure

Overview. The Company is completing its process of analyzing and addressing what is known as the Year 2000 Issue. The Year 2000 Issue has arisen because many existing computer programs use only two digits to identify a year in the data field. These programs were designed and developed without considering the impact of the upcoming change in the century and, accordingly, could misconstrue dates such as "00" as the year 1900 rather than 2000. The failure of computer programs and systems to properly recognize dates beginning in the year 2000 could adversely affect the Company's business activities.

The Company's Year 2000 Compliance Program. The Company is executing its Year 2000 Compliance Program, the purpose of which is: to identify important systems that are not yet Year 2000 compliant; to initiate replacement or remedial action to assure that key systems will continue to operate in the Year 2000 and to test the replaced or remediated systems; to identify and contact key suppliers, vendors, customers and business partners to evaluate their ability to maintain normal operations in the Year 2000; and to develop appropriate contingency plans for dealing with foreseeable Year 2000 complications. The Company's Year 2000 Committee has made significant progress toward the completion of these goals. The Committee continues to execute the Company's Year 2000 Compliance Program and reports the results and status of the Company's Year 2000 efforts to the Board of Directors. The Company expects to substantially complete its Year 2000 Compliance Program activities by the end of 1999.

Information Technology Systems. The Company's critical internal information technology ("IT") systems consist of its Electronic Mail system, Corporate Communications system, Manufacturing database, desktop and file management systems, Software Development tools and I/S Management tools. The Company also uses a Call Center Management software tool for use in the Company's customer service department. The Company has contacted the vendors of these systems and obtained assurances that these IT systems are currently in material Year 2000 compliance. The Company continues to upgrade older versions of these systems that may not be compliant and intends to finish these upgrades to achieve material Year 2000 compliance. The Company is in the process of obtaining written statements confirming such compliance from these vendors. The Company is still in the process of evaluating other areas of its existing internal IT systems at this time and will seek further assurances from its vendors as necessary. The Company is testing its critical IT systems during 1999. The Company intends to evaluate the need for contingency plans for these internal IT systems given the assurances of compliance the Company has received for these systems. While the Company will work diligently with all of its IT system providers, there is no guarantee that these IT systems providers will meet Year 2000 compliance. The failure of any such IT system to be Year 2000 compliant could have a negative effect on the business activities of the Company.

Non-Information Technology Systems. The Company is conducting an assessment of its non-information technology systems (such as building security, voice mail, telephone and other systems containing embedded microprocessors) and is in the process of determining the nature and extent of any work that may be required to make any non-IT systems Year 2000 compliant. The Company has made Year 2000 compliance inquiries to the vendors of these systems, and intends to track the responses to its inquiries and have the inquiry process completed by the end of the third quarter of 1999.

Third Party Suppliers, Vendors and Customers. The Company's Year 2000 Compliance Program also includes an investigation of the Year 2000 compliance of its major suppliers, vendors, customers and business partners. All of the Company's products and services incorporate third party software and hardware. The Company is in the process of evaluating its product components. The Company has identified and contacted most of its third party suppliers of hardware and software components regarding Year 2000 compliance and has collected compliance statements from most of these suppliers. The Company has learned that some features or functions of such third party components are not Year 2000 compliant. However, in certain cases the Company does not use such features or functions in its products and, to that extent, the Company believes the non-compliance of such features and functions will not have a negative impact on its products. In those cases where the non-compliance of



third party components does affect features or functions used by the Company in its products, the Company intends to install upgrades (most of which are currently available) to achieve material compliance. In addition, the Company is completing the process of testing its application software. To date, the Company has found only a few minor problems with its application software, and has already created patches to this software. Given the number of components and the complexity of the software incorporated in the Company's products and services, the Company believes that in the course of conducting its Year 2000 Compliance Program it could reasonably discover that the Year 2000 problem may affect its software or components. However, the Company regularly develops software updates to its product offerings as a natural course of business and the Company does not expect that these Year 2000 updates will be excessively complex or expensive to implement. Still, there can be no assurances that there will be no service interruption on the part of any of the Company's third party suppliers due to the Year 2000 problem and this could have a material adverse effect on the Company.

Year 2000 Costs and Expenses. To date, the costs associated with the Year 2000 Issue and the Company's Year 2000 Compliance Program have not been material. The Company will incur costs that include internal resources, software and equipment upgrades and replacement. Based on currently available information, the Company believes that the expense associated with its ongoing efforts will not be material and will be funded through operations, but the Company has not completed its evaluation of its non-IT systems and its third party relationships. If unforeseen compliance efforts are required or if present compliance efforts are not completed on time, or if the cost of any required updating, modification or replacement of the Company's systems or equipment exceeds the Company's estimates, the Year 2000 Issue could result in material costs and have a material adverse effect on the Company.

Contingency Plans. At the present time, the Company has not felt it necessary to formulate any contingency plans for addressing problems due to the Year 2000 Issue. The Company has been assured that its critical internal IT systems are compliant by the vendors of those systems and the Company will evaluate the need for contingency plans for internal IT systems given those assurances. The Company is currently in the process of evaluating the Year 2000 Issue with respect to its non-IT systems and with respect to its major suppliers, vendors, customers and business partners. As this evaluation process proceeds, the Company will formulate appropriate contingency plans. The Company expects that any required contingency planning will be completed no later than the end of 1999.

Risks Associated with Year 2000 Issue. Various statements in this discussion of Year 2000 are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 as discussed above under "Factors That May Affect Future Results." These statements include statements of the Company's expectations, statements with regard to schedules and expected completion dates and statements regarding expected Year 2000 compliance. These forward-looking statements are subject to various risk factors which may materially affect the Company's efforts to achieve Year 2000 compliance. These risk factors include the inability of the Company to complete the plans and modifications that it has identified, the failure of software vendors to deliver the upgrades and repairs to which they have committed, the wide variety of information technology systems and components, both hardware and software, that must be evaluated and the large number of vendors and customers with which the Company interacts. The Company's assessments of the effects of Year 2000 on the Company are based, in part, upon information received from third parties and the Company's reasonable reliance on that information. Therefore, the risk that inaccurate information is supplied by third parties upon which the Company reasonably relied must be considered as a risk factor that might affect the Company's Year 2000 efforts. The Company is attempting to reduce the risks by utilizing an organized approach, extensive testing, and allowance of ample contingency time to address issues identified by tests.

Effects of Inflation

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



ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company 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 the Company's financial results. The Company's primary exposure has been related to local currency revenue and operating expenses in Europe and Asia. Historically, the Company has not hedged specific currency exposures as gains and losses on foreign currency transactions have not been material to date. At June 30, 1999, the Company had approximately $2.1 million outstanding related to variable rate U.S. dollar denominated short-term 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 $20,000 per year.

The carrying amounts reflected in the consolidated balance sheet of cash and cash equivalents, trade receivables, and trade payables approximates fair value at June 30, 1999 due to the short maturities of these instruments.

The Company maintains investment portfolio holdings of various issuers, types, and maturities. The Company's cash and marketable securities include cash equivalents, which the Company 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 June 30, 1999, a sharp rise in interest rates should not have a material adverse impact on the fair value of the Company's investment portfolio. As a result, the Company does not currently hedge these interest rate exposures.

## PART II. OTHER INFORMATION

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of the security holders of the Company was held on June 17, 1999. The following persons were elected as directors of the Company:

| Nominee | Total Votes for Nominee | Total Votes Withheld for Nominee |
|---|---|---|
| Paul H. Saunders | 11,074,908 | 379,112 |
| Carmine Vona | 11,366,638 | 87,382 |

In addition, after the annual meeting, the following persons continued to serve as directors of the Company: William C. Styslinger, III, Martin R. Hoffmann, and Edward J. McGrath.

### ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 27: Financial Data Schedule (For SEC Edgar Filing Only; Intentionally Omitted)



## 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: August 13, 1999

SEACHANGE INTERNATIONAL, INC.

By: /s/ William C. Styslinger, III

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

By: /s/ William L. Fiedler

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William L. Fiedler
Vice President, Finance and Administration,
Chief Financial Officer and Treasurer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

| Exhibit Number | Description | Page |
| --- | --- | --- |
| 27 | Financial Data Schedule (For SEC Edgar Filing Only; Intentionally Omitted) | |

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<ARTICLE> 5
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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS OF SEACHANGE INTERNATIONAL, INC. FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 1999 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
</LEGEND>
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