



2007 ANNUAL REPORT AND PROXY

**SEACHANGE INTERNATIONAL, INC.**  
**50 Nagog Park**  
**Acton, Massachusetts 01720**

**NOTICE OF 2007 ANNUAL MEETING OF STOCKHOLDERS**  
**TO BE HELD ON JULY 18, 2007**

The Annual Meeting of Stockholders of SeaChange International, Inc. (“SeaChange” or the “Company”) will be held at SeaChange’s offices, located at 50 Nagog Park, Acton, Massachusetts 01720, on Wednesday, July 18, 2007 at 10:00 a.m., local time, to consider and act upon each of the following matters:

1. To elect two members to the Board of Directors to serve for three-year terms as Class II Directors.
2. To approve the amendment of SeaChange’s 2005 Equity Compensation and Incentive Plan (the “2005 Plan”) to increase the total authorized shares under the 2005 Plan and to increase the number of shares that may be used for grants of restricted stock, restricted stock units or other equity awards.
3. To ratify the appointment of SeaChange’s independent registered public accounting firm.
4. To transact such other business as may properly come before the meeting and any adjournments thereof.

Stockholders entitled to notice of and to vote at the meeting shall be determined as of the close of business on May 21, 2007, the record date fixed by the Board of Directors for such purpose.

**IF YOU PLAN TO ATTEND:**

Please call Martha Schaefer at (978) 897-0100 if you plan to attend. Please bring valid picture identification, such as a driver’s license or passport. Stockholders holding stock in brokerage accounts (“street name” holders) will also need to bring a copy of a brokerage statement reflecting stock ownership as of the record date. Cameras, cell phones, recording devices and other electronic devices will not be permitted at the meeting.

By Order of the Board of Directors

Kevin M. Bisson  
*Chief Financial Officer, Secretary, Treasurer and Senior  
Vice President, Finance and Administration*

Acton, Massachusetts  
May 25, 2007

**Whether or not you expect to attend the meeting, please complete, date and sign the enclosed proxy and mail it promptly in the enclosed envelope to ensure representation of your shares. No postage need be affixed if the proxy is mailed in the United States. If you are the registered holder of the shares, you may rather choose to vote via the Internet or by telephone. If your shares are held in a bank or brokerage account, you may be eligible to vote electronically or by telephone. Please refer to the enclosed form for instructions.**



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**SEACHANGE INTERNATIONAL, INC.**  
**50 Nagog Park**  
**Acton, Massachusetts 01720**

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**PROXY STATEMENT**  
**FOR THE ANNUAL MEETING OF STOCKHOLDERS**  
**TO BE HELD ON JULY 18, 2007**

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*May 25, 2007*

Proxies in the form enclosed with this proxy statement are solicited by the Board of Directors (the “Board”) of SeaChange International, Inc. for use at the Annual Meeting of Stockholders (the “Annual Meeting”) to be held on Wednesday, July 18, 2007, at 10:00 A.M. Eastern Time, at SeaChange’s offices, located at 50 Nagog Park, Acton, Massachusetts 01720. This proxy statement and the accompanying proxy were first mailed to stockholders on or about June 8, 2007.

Only stockholders of record as of the close of business on May 21, 2007 (the “Record Date”), will be entitled to vote at the Annual Meeting and any adjournments thereof.

All properly completed proxy forms returned in time to be cast at the Annual Meeting will be voted. With respect to the election of the Class II Directors, any stockholder submitting a proxy has a right to withhold authority to vote for the nominee by indicating this in the space provided on the proxy. The stockholders will also consider and vote upon proposals put forth by the Board to approve the amendment of the 2005 Plan and to ratify the selection of SeaChange’s independent registered public accounting firm. Where a choice has been specified on the proxy card with respect to each proposal, the shares represented by the proxy will be voted in accordance with your specifications. If no specification is indicated on the proxy card, the shares represented by the proxy will be voted **FOR** each nominee for election to the Board of Directors to serve as a Class II Director, **FOR** the proposal to approve the amendment of the 2005 Plan, and **FOR** the proposal to approve the ratification of the selection of SeaChange’s independent registered public accounting firm. Stockholders may vote in one of the following three ways: (1) by completing, signing and dating the enclosed proxy card and returning it in the enclosed postage paid envelope by return mail, (2) by completing a proxy using the toll-free telephone number listed on the proxy card, or (3) by completing a proxy on the Internet at the address listed on the proxy card. Any proxy may be revoked by a stockholder at any time before its exercise by either delivering written revocation or a later dated proxy to the Secretary of SeaChange, entering a new vote by Internet or telephone, or attending the Annual Meeting of Stockholders and voting in person.

A majority in interest of the outstanding shares represented at the Annual Meeting in person or by proxy shall constitute a quorum for the transaction of business. Votes withheld from any nominee, abstentions and broker “non-votes” are counted as present or represented for purposes of determining the presence or absence of a quorum for the meeting. A “non-vote” occurs when

a nominee holding shares for a beneficial owner votes on one proposal, but does not vote on another proposal because the nominee does not have discretionary voting power and has not received instructions from the beneficial owner. Directors are elected by a plurality of the votes cast by stockholders entitled to vote at the meeting. On all other matters being submitted to stockholders, an affirmative vote of at least a majority of the shares present, in person or represented by proxy, and voting on that matter is required for approval or ratification. An automated system administered by SeaChange's transfer agent tabulates the votes. The vote on each matter submitted to stockholders is tabulated separately. Abstentions, as well as broker "non-votes" are not considered to have been voted for such matters and have the practical effect of reducing the number of affirmative votes required to achieve a majority for such matters by reducing the total number of shares from which the majority is calculated.

The Board of Directors knows of no other matter to be presented at the Annual Meeting. If any other matter should be presented at the Annual Meeting upon which a vote properly may be taken, shares represented by all proxies received by the Board of Directors will be voted with respect thereto in accordance with the judgment of the persons named as proxies and in accordance with the Securities and Exchange Commission's ("SEC's") proxy rules. The persons named as proxies, William C. Styslinger, III and Kevin M. Bisson, were selected by the Board of Directors and are officers of SeaChange. See "Stockholder Proposals" herein at page 8.

## OWNERSHIP OF SECURITIES

### Securities Ownership Of Certain Beneficial Owners And Management

The following table sets forth information regarding the beneficial ownership of SeaChange common stock as of May 21, 2007 by:

- each person or entity who is known by SeaChange to beneficially own more than 5% of the common stock of SeaChange;
- each of the directors named in the Director Compensation Table on page 12 and each of the executive officers of SeaChange named in the Summary Compensation Table on page 23; and
- all of the directors and executive officers of SeaChange as a group.

Except for the named executive officers and directors, none of these persons or entities has a relationship with SeaChange. Unless otherwise indicated, the address of each person or entity named in the table is c/o SeaChange International, Inc., 50 Nagog Park, Acton, Massachusetts 01720, and each person or entity has sole voting power and investment power (or shares such power with his or her spouse), with respect to all shares of capital stock listed as owned by such person or entity.

The number and percentage of shares beneficially owned is determined in accordance with the rules of the SEC, and is not necessarily indicative of beneficial ownership for any other purpose. Under these rules, beneficial ownership includes any shares as to which a person has sole or shared voting power or investment power and also any shares of common stock underlying options or warrants that are exercisable by that person within 60 days of May 21, 2007. However, these shares underlying options or warrants are not treated as outstanding for the purpose of computing the percentage ownership of any other person or entity. Percentage of beneficial ownership is based on 29,453,903 shares of SeaChange's common stock outstanding as of May 21, 2007.

Name	Amount and Nature of Beneficial Ownership(1)	Percent of Common Stock Outstanding
William C. Styslinger, III (2) .....	2,220,428	7.5%
Kevin M. Bisson .....	12,965	*
William L. Fiedler .....	215,428	*
Steven M. Davi .....	99,658	*
Ira Goldfarb .....	189,868	*
Yvette M. Kanouff .....	130,879	*
Martin R. Hoffmann .....	190,797	*
Thomas F. Olson .....	35,894	*
Mary Palermo Cotton .....	15,832	*
Carmine Vona .....	57,772	*



<b>Name</b>	<b>Amount and Nature of Beneficial Ownership(1)</b>	<b>Percent of Common Stock Outstanding</b>
Columbia Wanger Asset Management, L.P. (3) 227 West Monroe Street, Suite 3000 Chicago, Illinois 60606 .....	2,065,000	7.0%
Wellington Management Company, LLP (4) 75 State Street Boston, MA 02109 .....	3,631,800	12.3%
Dimensional Fund Advisors LP (5) 1299 Ocean Avenue Santa Monica, CA 90401 .....	2,448,830	8.3%
David J. Greene and Company, LLC (6) 599 Lexington Avenue New York, NY 10022 .....	2,095,241	7.1%
All executive officers and directors as a group (13 persons) (7) .....	3,725,578	13.3%

\* Less than 1%

- (1) Includes shares of Common Stock which have not been issued but are subject to options which either are presently exercisable or will become exercisable within 60 days of May 21, 2007, as follows: Mr. Styslinger, 384,218 shares; Mr. Fiedler, 210,428 shares; Mr. Davi, 98,400 shares; Mr. Goldfarb, 128,900 shares; Ms. Kanouff, 123,250 shares; Mr. Hoffmann, 32,563 shares; Mr. Olson, 27,562 shares; Ms. Cotton, 5,000 shares; and Mr. Vona, 32,563 shares. Excludes restricted stock units that will not have vested within 60 days of May 21, 2007, as follows: Mr. Styslinger, 19,717 unvested restricted stock units; Mr. Bisson, 54,500 unvested restricted stock units; Mr. Davi, 27,061 unvested restricted stock units; Mr. Goldfarb, 19,402 unvested restricted stock units; Ms. Kanouff, 21,827 unvested restricted stock units; Mr. Hoffmann, 16,668 unvested restricted stock units; Mr. Olson, 16,668 unvested restricted stock units; Ms. Cotton, 16,668 unvested restricted stock units; and Mr. Vona, 16,668 unvested restricted stock units. Messrs. Styslinger, Bisson, Fiedler, Davi and Goldfarb and Ms. Kanouff are each Named Executive Officers of SeaChange. Messrs. Styslinger, Hoffmann, Olson and Vona and Ms. Cotton are each directors of SeaChange.
- (2) Includes (i) 17,500 shares of common stock owned by Merrill Lynch, Trustee f/b/o William C. Styslinger, III, IRA and (ii) 171,500 shares of common stock owned by CGM IRA Rollover Custodian f/b/o William C. Styslinger, III, IRA. Excludes (i) 86,429 shares of common stock owned by Thomas and Emily Franeta as Trustees of The Styslinger Family Trust; (ii) 11,342 shares of common stock held by Thomas Franeta as Custodian for Kimberly J. Styslinger; (iii) 52,985 shares of common stock owned by his wife, Joyce Styslinger, and (iv) 6,800 shares of Common Stock owned by his daughter, Kimberly J. Styslinger. Mr. Styslinger disclaims beneficial ownership of the shares held by The Styslinger Family Trust; by Thomas Franeta as Custodian for Kimberly J. Styslinger; by his wife, Joyce Styslinger; and by his daughter, Kimberly J. Styslinger.
- (3) According to an amended Schedule 13G filed on January 10, 2007, Columbia Acorn Trust, a client of Columbia Wanger Asset Management, L.P. may be deemed to share voting and investment power with respect to 1,875,149 of the above-mentioned shares, as it is entitled to receive dividends from, and all proceeds from the sale of, such shares.
- (4) According to an amended Schedule 13G filed on February 14, 2007, Wellington Management Company, LLP shares voting power with respect to 1,889,100 of the above-mentioned shares with its clients and shares dispositive power over all of the above-mentioned shares with its clients.
- (5) According to a Schedule 13G filed on February 9, 2007, Dimensional Fund Advisors LP serves as investment advisor to four investment companies and serves as investment manager to certain other commingled group trusts and investment accounts, which own the above-mentioned shares.
- (6) According to a Schedule 13G filed on February 8, 2007, David J. Greene and Company, LLC shares voting power with respect to 1,567,741 of the above-mentioned shares and shares dispositive power over all of the above-mentioned shares.

- (7) This group is comprised of those individuals named in the Summary Compensation Table on page 23, the remaining executive officers of SeaChange and those persons who were directors of SeaChange as of May 21, 2007. Includes an aggregate of 1,253,883 shares of Common Stock which the directors and executive officers, as a group, have the right to acquire by exercise of stock options or will acquire upon vesting of restricted stock units within 60 days of May 21, 2007. Excludes an aggregate of 221,233 restricted stock units held by directors and executive officers, as a group, that will not have vested within 60 days of May 21, 2007.

## PROPOSAL NO. I

### ELECTION OF DIRECTOR

SeaChange's Board of Directors currently consists of five members, four of whom are independent, non-employee directors. The Board of Directors is divided into three classes. Each class serves for a term of three years, with the terms of office of the directors in the respective classes expiring in successive years. The present term of the Class II Directors expires at the Annual Meeting. The Board of Directors, based on the recommendation of the Corporate Governance and Nominating Committee, has nominated Messrs. Hoffmann and Olson for re-election as the Class II Directors. The Board of Directors knows of no reason why the nominees should be unable or unwilling to serve, but if that should be the case, proxies will be voted for the election of some other person or persons, or for fixing the number of directors at a lesser number. Each of Messrs. Hoffmann and Olson has consented to being named in this proxy statement as a nominee to be a Class II Director and to serving in that capacity, if elected.

**The Board of Directors unanimously recommends a vote "FOR" the Nominees listed below.**

The following table sets forth, for each nominee to be elected at the Annual Meeting and the other current directors, the year each nominee or director was first appointed or elected a director, the principal occupation of each nominee and director during at least the past five years and the age of each nominee and director.

#### **Class II Directors (Terms Expire at 2010 Annual Meeting)**

<b>Director's Name and Year First Became Director</b>	<b>Position and Principal Occupation and Business Experience During the Past Five Years</b>
Martin R. Hoffmann (1995)	Director  Martin R. Hoffmann, 75, has served as a Director of SeaChange since January 1995. Mr. Hoffmann served as a full-time consultant to the U.S. Department of Defense from October 2004 to December 2006. Mr. Hoffmann served as Of Counsel to the Washington D.C. office of Skadden, Arps, Slate, Meagher & Flom LLP from January 1996 until July 2000. From April 1995 to January 1996, Mr. Hoffmann maintained a law practice and business consulting practice. He was a Visiting Senior Fellow at the Center for Policy, Industry and Industrial Development at Massachusetts Institute of Technology from May 1993 to April 1995, prior to which, from April 1989, he served as Vice President and General Counsel for Digital Equipment Corporation. Mr. Hoffmann is a former member of the Board of Directors of Castle Energy Corporation, an oil and gas exploration and production company, and former Chairman of the Board of Mitretek Systems, a non-profit technology consulting and services company.
Thomas F. Olson (2001)	Director  Thomas F. Olson, 58, has served as a Director of SeaChange since May 2001. In addition, from January 1999 to December 2003, Mr. Olson served as the Chief Executive Officer of National Cable Communications, a company specializing in cable television

advertising time sales. From January 1995 to May 1998, Mr. Olson was Managing Partner of National Cable Communications and Chief Executive Officer of Katz Media Group, a radio, broadcast television and cable television national sales representation firm. Mr. Olson was with Katz Media Group for 23 years.

### **Class I Director (Term Expires at 2009 Annual Meeting)**

<b>Director's Name and Year First Became Director</b>	<b>Position and Principal Occupation and Business Experience During the Past Five Years</b>
William C. Styslinger, III (1993)	President, Chief Executive Officer, Chairman of the Board and Director  William C. Styslinger, III, 61, is a founder of SeaChange and has served as the President, Chief Executive Officer and a Director since the inception of SeaChange in July 1993 and as Chairman of the Board since January 1995. Prior to forming SeaChange in 1993, Mr. Styslinger was employed at Digital Equipment Corporation since March 1978, most recently as manager of the Cable Television Business Unit from October 1991 to May 1993.

### **Class III Directors (Terms Expire at 2008 Annual Meeting)**

<b>Director's Name and Year First Became Director</b>	<b>Position and Principal Occupation and Business Experience During the Past Five Years</b>
Mary Palermo Cotton (2004)	Director  Mary Palermo Cotton, 49, has served as a Director of SeaChange since September 2004. In addition, Ms. Cotton is a Senior Vice President of SAP, an enterprise software provider, as a result of SAP's June 2006 acquisition of Frictionless Commerce. Prior to the acquisition, Ms. Cotton had been the Chief Executive Officer of Frictionless Commerce, a company providing supplier relationship management software, since February 2005. Previously, Ms. Cotton was from February 2003 to July 2004 a Senior Advisor to Aspen Technology, a software service provider, and previously served as Aspen's Chief Operating Officer from January 2001 to January 2003 and its Executive Vice President from August 1998 to December 2000. Ms. Cotton additionally served on the Board of Directors of Precise Software Solutions from June 2000 to June 2003 when Precise Software Solutions was acquired by VERITAS Software.
Carmine Vona (1995)	Director  Carmine Vona, 69, has served as a Director of SeaChange since January 1995. In addition, Mr. Vona has been President and Chief Executive Officer of Vona Information Systems, Inc., a consulting firm, since June 1996. Since December 2001, Mr. Vona has served as Chairman of Metrosoft, Inc., a New Jersey based company specializing in providing software products to the mutual funds industry. He also served as Metrosoft's Chief Executive Officer from December 2001 through December 2002. From August 2000 to December 2002, he also served as a member of the Board of Directors of E-LAB, an Italian bank wholly owned by Banca INTESA. From November 1969 to June 1996, Mr. Vona was employed by Bankers Trust Co., during which time he held positions as Executive Vice President and Senior Managing

Director for worldwide technology. From August 1986 to June 1996 Mr. Vona was Chairman of BT-FSIS, a software development company and a wholly-owned subsidiary of Bankers Trust Co.

## **CORPORATE GOVERNANCE AND THE BOARD OF DIRECTORS**

### **Determination of Director Independence**

The Board of Directors has determined that Messrs. Hoffmann, Olson, and Vona and Ms. Cotton are “independent” directors, meeting all applicable independence requirements promulgated by the SEC, including Rule 10A-3(b)(1) pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and by the National Association of Securities Dealers, Inc. (“NASD”). In making this determination, the Board of Directors affirmatively determined that none of such directors has a relationship that, in the opinion of the Board of Directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

### **Stockholder Proposals**

Proposals of stockholders intended to be presented at the 2008 Annual Meeting of Stockholders must be received no later than the close of business on February 8, 2008 at SeaChange’s principal executive offices in order to be included in the SeaChange proxy statement for that meeting. Any such stockholder proposals should be submitted to SeaChange International, Inc., 50 Nagog Park, Acton, Massachusetts, 01720, Attention: Secretary. Under the By-Laws of SeaChange, stockholders who wish to make a proposal at the 2008 Annual Meeting - other than one that will be included in SeaChange’s proxy materials - must notify SeaChange no earlier than January 9, 2008, and no later than February 8, 2008. If a stockholder who wishes to present a proposal fails to notify SeaChange by February 8, 2008, the stockholder would not be entitled to present the proposal at the meeting. If, however, notwithstanding the requirements of the By-Laws of SeaChange, the proposal is brought before the meeting, then under the SEC’s proxy rules the proxies solicited by management with respect to the 2008 Annual Meeting will confer discretionary voting authority with respect to the stockholder’s proposal on the persons selected by management to vote the proxies. If a stockholder makes a timely notification, the proxies may still exercise discretionary voting authority under circumstances consistent with the SEC’s proxy rules.

In order to curtail controversy as to the date on which a proposal will be marked as received by SeaChange, it is suggested that stockholders submit their proposals by Certified Mail—Return Receipt Requested.

### **Availability of Corporate Governance Documents**

SeaChange’s Code of Ethics and Business Conduct (“Ethics Policy”) for all directors and all employees of SeaChange, including executive officers, and the charters for SeaChange’s Board of Directors standing committees (Audit, Compensation and Option, Corporate Governance and Nominating) are available on SeaChange’s website at [www.schange.com](http://www.schange.com) under the “Corporate Governance” section of the “Investor Relations” link.

## **Board Meetings**

The Board of Directors of SeaChange met eleven times and acted by written consent one time during the fiscal year ended January 31, 2007. During the fiscal year ended January 31, 2007, each director attended at least 75% of the total number of meetings of the Board of Directors and meetings of all the committees of the Board on which they serve. SeaChange has a policy that its Board of Directors attend SeaChange's Annual Meeting of Stockholders. Last year, all of the directors attended the Annual Meeting of Stockholders that was held on July 12, 2006.

## **Lead Director**

The Board of Directors has appointed an independent director to serve as Lead Director. The purpose of the Lead Director is to facilitate and improve communication between the independent directors and SeaChange by serving as the interface between SeaChange's Chief Executive Officer, senior management and the Board of Directors. The Lead Director's responsibilities include working with the chairperson of the Compensation and Option Committee to establish goals for the Chief Executive Officer each fiscal year and to conduct the annual Chief Executive Officer evaluation. Mr. Olson currently serves as Lead Director.

## **Board Committees**

The Board has three standing committees: an Audit Committee, a Compensation and Option Committee, and a Corporate Governance and Nominating Committee. The members of each committee are appointed by the Board based on the recommendation of the Corporate Governance and Nominating Committee, and are set forth below in this proxy statement. Actions taken by any committee of the Board are reported to the Board, usually at the next Board meeting following a committee meeting. Each standing committee is governed by a committee-specific charter that is reviewed periodically by the applicable committee pursuant to the rules set forth in each charter. The Board annually conducts a self-evaluation of each of its committees. All members of all committees are independent directors.

### *Audit Committee*

The Audit Committee members are Messrs. Hoffmann, Olson and Vona and Ms. Cotton (Chair), each of whom meet the independence requirements promulgated by the SEC and the NASD, as described above. In addition, SeaChange's Board has determined that each member of the Audit Committee is financially literate and that Ms. Cotton satisfies the requirement of the NASD applicable to Nasdaq-listed companies that at least one member of the Audit Committee possess financial sophistication and that Ms. Cotton is an "audit committee financial expert" as defined in the rules and regulations promulgated under the Exchange Act. The Audit Committee's oversight responsibilities include matters relating to SeaChange's financial disclosure and reporting process, including the system of internal controls, the performance of SeaChange's internal audit function, compliance with legal and regulatory requirements, and the appointment and activities of SeaChange's independent auditors. The Audit Committee met eight times during fiscal year 2007. The responsibilities of the Audit Committee and its activities during

fiscal year 2007 are more fully described in the Audit Committee Report contained in this proxy statement.

#### *Compensation and Option Committee*

The Compensation and Option Committee members are Messrs. Hoffmann, Olson (Chair) and Vona, each of whom meet the independence requirements promulgated by the SEC and the NASD, as described above. Among other things, the Compensation and Option Committee determines the compensation, including stock options, restricted stock units and other equity compensation, of SeaChange's management and key employees, and administers and makes recommendations concerning SeaChange's equity compensation plans. The Compensation and Option Committee met eight times and acted by unanimous written consent ten times during fiscal year 2007. The responsibilities of the Compensation and Option Committee and its activities during fiscal year 2007 are more fully described in the Compensation Discussion and Analysis contained in this proxy statement.

#### *Corporate Governance and Nominating Committee*

The Corporate Governance and Nominating Committee members are Messrs. Hoffmann (Chair), Olson and Vona, each of whom meet the independence requirements promulgated by the SEC and the NASD, as described above. The Corporate Governance and Nominating Committee is responsible for oversight of corporate governance at SeaChange, recommending to the Board of Directors persons to be nominated for election or appointment as directors of SeaChange and monitoring compliance with SeaChange's Ethics Policy. The Corporate Governance and Nominating Committee identifies Board candidates through numerous sources, including recommendations from existing Board members, executive officers, and stockholders of SeaChange. Additionally, the Corporate Governance and Nominating Committee may identify candidates through engagements with executive search firms. The Corporate Governance and Nominating Committee met three times during fiscal year 2007.

#### *Qualifications of Director Candidates*

In evaluating the suitability of individuals for Board membership, the Corporate Governance and Nominating Committee takes into account many factors, including whether the individual meets the requirements for independence, his or her professional expertise and educational background, and other factors that promote diversity of views and experience. The Corporate Governance and Nominating Committee evaluates each individual in the context of the entire Board, with the objective of recommending nominees who can best further the success of SeaChange's business and represent stockholder interests. As part of the review in fiscal year 2007 by the Corporate Governance and Nominating Committee of SeaChange's corporate governance documents, these criteria were reviewed. No changes to these criteria were recommended as a result of such review.

#### *Procedures for Stockholders to Recommend Director Candidates*

Stockholders wishing to suggest candidates to the Corporate Governance and Nominating Committee for consideration as potential director nominees may do so by submitting the candidate's name, experience, and other relevant information to the SeaChange Corporate

Governance and Nominating Committee, 50 Nagog Park, Acton, Massachusetts 01720. SeaChange stockholders wishing to nominate directors may do so by submitting a written notice to the Secretary of SeaChange at the same address in accordance with the nomination procedures set forth in SeaChange's By-Laws. The procedures are summarized in this proxy statement under the heading "Stockholder Proposals." The Secretary will provide the notice to the Corporate Governance and Nominating Committee. The Corporate Governance and Nominating Committee does not distinguish between nominees recommended by stockholders and other nominees. All nominees must meet, at a minimum, the qualifications described in "Qualifications of Director Candidates" above. The Committee did not receive any stockholder nominee recommendations for this annual meeting.

#### *Process for Stockholders to Communicate with Directors*

Stockholders may write to the Board or a particular Board member by addressing such communication to the Board or Board member, as applicable, care of SeaChange's Chief Financial Officer, at SeaChange's offices at 50 Nagog Park, Acton, Massachusetts 01720. Unless such communication is addressed to an individual director, SeaChange will forward any such communication to each of the directors.

#### **Compensation of Directors**

During the fiscal year ended January 31, 2007, directors who were employees of SeaChange received no cash compensation for their services as directors, except for reimbursement of expenses incurred in connection with attending meetings. In fiscal year 2007, SeaChange directors who are not employees of SeaChange earned a fee of \$4,000 per quarter and a fee of \$1,000 for each meeting of the Board of Directors that they attended in person or by phone and such directors were reimbursed for their reasonable out-of-pocket expenses incurred in attending such meetings. In addition, effective with the third quarter of fiscal 2007, SeaChange implemented a policy for the Lead Director to receive a cash payment of \$10,000 per quarter in consideration of service as Lead Director, for a total \$40,000 per annum. Accordingly, for fiscal 2007, Mr. Olson earned \$20,000 for his service as Lead Director in addition to earning \$30,000 for his service as a director. The Chairperson of the Audit Committee of the Board of Directors is also entitled to receive a cash payment of \$2,000 per quarter for a total payment of \$8,000 per annum in addition to earning \$30,000 for service as a director.

In accordance with the compensation policy for non-employee directors adopted by the Compensation and Option Committee in December 2005, each non-employee director is entitled to receive an annual grant of 10,000 restricted stock units in lieu of a quarterly option grant to purchase 2,500 shares of SeaChange's common stock. Accordingly, in the fiscal year ended January 31, 2007, Messrs. Hoffmann, Olson and Vona and Ms. Cotton each received 10,000 restricted stock units on January 17, 2007. These grants are made pursuant to SeaChange's 2005 Plan and vest ratably over three years, with the first tranche vesting December 1, 2007.



**Director Compensation  
Fiscal Year 2007**

Name	Fees Earned or Paid in Cash (\$)	Stock Awards(1)(2) (\$)	Total (\$)
Mary Palermo Cotton	38,000	28,267	66,267
Carmine Vona	30,000	28,267	58,267
Martin R. Hoffmann	30,000	28,267	58,267
Thomas F. Olson	50,000	28,267	78,267

- (1) Reflects compensation expense for restricted stock unit grants recognized for financial reporting purposes (exclusive of any assumptions for forfeitures) under Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment," (FAS 123R) for the fiscal year ended January 31, 2007. During fiscal 2007, each director named in the table above received a grant on January 17, 2007 of 10,000 restricted stock units with a grant date fair value under FAS 123R of \$105,500, based on the closing price of our common stock on that date of \$10.55.
- (2) The table below shows the aggregate number of stock awards and options outstanding for each non-employee director as of January 31, 2007. Stock awards consist of unvested restricted stock units. Upon vesting, the units are paid in the form of shares of our common stock.

Name	Aggregate Stock Awards Outstanding (#)	Aggregate Stock Options Outstanding (#)
Mary Palermo Cotton	16,668	5,000
Carmine Vona	16,668	32,563
Martin R. Hoffmann	16,668	32,563
Thomas F. Olson	16,668	27,562

## Report of the Audit Committee

The Audit Committee currently consists of Ms. Cotton (chair) and Messrs. Hoffmann, Olson and Vona.

The Audit Committee's primary duties and responsibilities are to:

- Appoint, compensate and retain SeaChange's independent registered public accounting firm, and oversee the work performed by the independent registered public accounting firm.
- Assist the Board of Directors in fulfilling its responsibilities by reviewing the financial reports provided by SeaChange to the SEC and SeaChange's stockholders.
- Monitor the integrity of SeaChange's financial reporting process and systems of internal controls regarding finance, accounting, and legal compliance.
- Recommend, establish and monitor procedures designed to improve the quality and reliability of the disclosure of SeaChange's financial condition and results of operations.
- Provide an avenue of communication among the independent registered public accounting firm, management and the Board of Directors.

The Board of Directors has adopted a written charter setting out the functions the Audit Committee is to perform. A copy of this may be found on SeaChange's website at [www.schange.com](http://www.schange.com) under the "Corporate Governance" section of the "Investor Relations" link.

Management has primary responsibility for SeaChange's consolidated financial statements and the overall reporting process, including SeaChange's system of internal controls.

The independent registered public accounting firm audits the annual consolidated financial statements prepared by management, expresses an opinion as to whether those consolidated financial statements fairly present, in all material respects, the financial position, results of operations and cash flows of SeaChange in conformity with accounting principles generally accepted in the United States of America, provides an attestation report on management's assessment of SeaChange's internal control over financial reporting in SeaChange's annual report on Form 10-K and discusses with the Audit Committee any issues the independent registered public accounting firm believes should be raised with SeaChange.

For fiscal year 2007, the Audit Committee reviewed the audited consolidated financial statements of SeaChange and met with both management and Grant Thornton LLP, SeaChange's independent registered public accounting firm, to discuss those consolidated financial statements. Management has represented to the Audit Committee that the consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America and that there were no material deficiencies in the design or operation of internal controls which could adversely affect SeaChange's ability to record, process, summarize and report financial data and that there was no fraud, whether or not material, that involved management or other employees who have a significant role in SeaChange's internal controls.

The Committee has received from and discussed with Grant Thornton LLP the written disclosure and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees). These items relate to Grant Thornton LLP's independence from SeaChange. The Committee also discussed with Grant Thornton LLP the matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees), as amended by Statement on Auditing Standards No. 90 (Audit Committees Communications).

Based on these reviews and discussions, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements of SeaChange be included in its Annual Report on Form 10-K for the fiscal year ended January 31, 2007. The Audit Committee also decided to retain Grant Thornton LLP as SeaChange's independent registered public accounting firm for the 2008 fiscal year.

RESPECTFULLY SUBMITTED BY THE AUDIT  
COMMITTEE OF THE BOARD OF DIRECTORS

Mary Palermo Cotton (Chairman)  
Thomas F. Olson  
Martin R. Hoffmann  
Carmine Vona

The information contained in this Audit Committee Report shall not be deemed to be "soliciting material." No portion of this Audit Committee Report shall be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended (the "Securities Act"), or the Exchange Act, through any general statement incorporating by reference in its entirety the Proxy Statement in which this report appears, except to the extent that SeaChange specifically incorporates this report or any portion of it by reference. In addition, this report shall not be deemed to be filed under either the Securities Act or the Exchange Act.

## INFORMATION CONCERNING EXECUTIVE OFFICERS

In addition to Mr. Styslinger, SeaChange's President, Chief Executive Officer, Chairman of the Board and Director, whose biographical information is set forth above at page 7, SeaChange's executive officers are:

Executive Officer's Name	Position and Principal Occupation and Business Experience During the Past Five Years
Andrew Thomas Birchall	<p>Senior Vice President</p> <p>Andrew Birchall, 62, has served as Senior Vice President of SeaChange since September 2005, concurrent with SeaChange's acquisition of ODG. Mr. Birchall also serves as Executive Chairman of ODG, a position he has held since October 2002. Mr. Birchall was a founder of ODG in 1995. Prior to founding ODG, Mr. Birchall served as Head of Acquisitions and Managing Director of The Movie Channel at British Satellite Broadcasting from March 1987 to November 1990. Prior to that, from September 1984 to February 1987, Mr. Birchall served as Chief Executive Officer of Premiere International, the first pay TV film channel in the UK.</p>
Kevin M. Bisson	<p>Chief Financial Officer, Treasurer, Secretary and Senior Vice President, Finance and Administration</p> <p>Kevin M. Bisson, 45, joined SeaChange on March 13, 2006 as the Senior Vice President, Finance and Administration, Secretary and Treasurer. Following the filing of SeaChange's Annual Report on Form 10-K for the year ended January 31, 2006, Mr. Bisson assumed the role of Chief Financial Officer. Prior to joining SeaChange, Mr. Bisson served from May 2003 until March 2006 as the Senior Vice President and Chief Financial Officer of American Superconductor Corporation, an energy technologies company, and was also the Treasurer of American Superconductor Corporation from January 2004 until March 2006. Prior to joining American Superconductor Corporation, Mr. Bisson served from 2000 to 2003 as Vice President, Controller and Treasurer for Axcelis Technologies, Inc., a semiconductor equipment manufacturing company.</p>
Steven M. Davi	<p>Senior Vice President, Software Engineering</p> <p>Steven M. Davi, 43, joined SeaChange in November 1997 and, since July 2005, has served as Senior Vice President, Software Engineering. Mr. Davi previously served as Vice President, Engineering from August 2003 to July 2005, as Manager, Engineering from August 1998 to August 2003 and as Consulting Software Engineer from November 1997 to August 1998. Prior to joining SeaChange, Mr. Davi served from September 1990 until November 1997 in various engineering and managerial positions at Banyan Systems Inc., a network operating system software company that specialized in enterprise scale directory and messaging products. Prior to joining Banyan Systems, Mr. Davi served from June 1985 until September 1990 in various engineering positions within the networking division at Data General.</p>

William L. Fiedler	<p>Chief Financial Officer (resigned as of April 18, 2006), Treasurer, Secretary and Senior Vice President, Finance and Administration (resigned as of March 13, 2006)</p> <p>Through the above-mentioned dates, William L. Fiedler, 62, served as SeaChange's Chief Financial Officer and Treasurer since September 1998, Senior Vice President, Finance and Administration, since August 2003, and Secretary since May 2000. Prior to assuming the role of Senior Vice President, Finance and Administration in August 2003, Mr. Fiedler served as Vice President, Finance and Administration, since September 1998. Prior to joining SeaChange, Mr. Fiedler served from July 1984 to June 1998 as the Chief Financial Officer, Treasurer and Senior Vice President, Finance and Administration of Matrix One, Inc., a developer of product data management systems. Prior to that, Mr. Fiedler served as the Chief Financial Officer of Hendrix Electronics Inc., a developer of text processing and graphics publishing systems, and had also held controllership positions at Bose Corporation and GTE Sylvania.</p>
Ira Goldfarb	<p>Senior Vice President, Worldwide Sales</p> <p>Ira Goldfarb, 49, has served as Senior Vice President, Worldwide Sales since August 2003. Prior to that, Mr. Goldfarb served as Vice President, Worldwide Sales since January 1998, Vice President, U.S. Systems Sales from August 1997 to January 1998, as Vice President, Eastern Region from January 1997 to August 1997, and as Vice President, Central Region, from August 1994 to January 1997. Prior to joining SeaChange, Mr. Goldfarb held several sales management positions at Digital Equipment Corporation from September 1983 to July 1994.</p>
Yvette Kanouff	<p>Chief Strategy Officer</p> <p>Yvette Kanouff, 41, joined SeaChange in September 1997 and, since March 2006, has served as SeaChange's Chief Strategy Officer. Previously, Ms. Kanouff served from July 2005 to March 2006 as Senior Vice President, Strategic Planning and Business Development, and as Vice President, Interactive Television Management from August 2003 to July 2005. Prior to that, Mr. Kanouff served as Vice President, Technology from July 2001 to August 2003, and as Director, Interactive Technology from September 1997 to July 2001.</p>
Anthony William Kelly	<p>Senior Vice President</p> <p>Anthony Kelly, 45, has served as Senior Vice President of SeaChange since September 2005, concurrent with SeaChange's acquisition of ODG. Mr. Kelly also serves as Chief Executive Officer of ODG, a position he has held since 1996. Prior to assuming the role of Chief Executive Officer of ODG, Mr. Kelly served as a director of the Lambie Nairn Group from May 1992 to December 1994 and as an executive at Video Networks Limited from December 1992 to April 1995. Prior to that, from July 1990 to April 1992, Mr. Kelly served as CEO of the Palace Group, a major UK independent film producer and distributor. Before joining Palace, Mr. Kelly was Head of Program Finance at British Satellite Broadcasting from 1987 to June 1990.</p>

Bruce E. Mann

Senior Vice President, Network Storage Engineering

Bruce E. Mann, 59, joined SeaChange in September 1994 as Vice President, Network Storage Engineering. In August 2003, Mr. Mann assumed the role of Senior Vice President, Network Storage Engineering. Prior to joining SeaChange, Mr. Mann served as Director of Engineering at Ungermann-Bass, Inc., a subsidiary of Tandem Computers Inc., from March 1993 to September 1994. Prior to that, from September 1976 to March 1993, Mr. Mann was an engineer at Digital Equipment Corporation, most recently as Senior Consulting Engineer.

Executive officers of SeaChange are appointed by, and serve at the discretion of, the Board of Directors, and serve until their successors have been duly elected and qualified. There are no family relationships among any of the executive officers or directors of SeaChange. Each executive officer is a full time employee of SeaChange.

## **COMPENSATION DISCUSSION AND ANALYSIS**

### **Overview**

The Compensation and Option Committee (the “Committee”) of the Board has responsibility for establishing, implementing and continually monitoring adherence with SeaChange’s compensation philosophy. The Committee endeavors to ensure that the total compensation paid to the named executive officers is fair, reasonable and competitive. Generally, the types of compensation and benefits provided to the named executive officers is similar to that provided to other executive officers of SeaChange.

Throughout this proxy statement, the individuals who served as SeaChange’s Chief Executive Officer and Chief Financial Officer during fiscal 2007, as well as the other individuals included in the Summary Compensation Table on page 23, are referred to as the “named executive officers.”

### **Compensation Philosophy and Objectives**

The Committee believes that the most effective executive compensation program is one that is designed to reward the achievement of specific semi-annual and annual financial and long-term and strategic goals, and which aligns executives’ interests with those of the stockholders by rewarding performance above established goals, with the ultimate objective of improving stockholder value. The Committee evaluates both performance and compensation to ensure that SeaChange maintains its ability to attract and retain superior employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly situated executives of our peer companies. To that end, the Committee believes executive compensation packages provided by SeaChange to its executives, including the named executive officers, should include both cash and stock-based compensation that reward performance as measured against established goals.

## **Role of Executive Officers in Compensation Decisions**

The Committee makes all compensation decisions for the named executive officers. The Chief Executive Officer makes recommendations of both base salary and metrics for performance-based incentive compensation for the executive officers, which recommendations are reviewed and approved by the Committee, and the Chief Executive Officer also makes recommendations of compensation based on these established metrics for executive officers, other than himself, which recommendations are reviewed and approved by the Committee. The Committee can exercise its discretion in modifying any recommended adjustments or awards to executives, and exercises this discretion in active consultation with the Chief Executive Officer.

## **Setting Executive Compensation**

In fiscal 2007, SeaChange engaged Ben S. Cole Financial (Cole Financial) to prepare a competitive assessment of compensation practices for SeaChange's executive officers and directors. In completing this analysis, included in the list of peer companies reviewed were the following:

- Avid Technology Inc.
- C-COR Incorporated
- Concurrent Computer Corporation
- Harmonic Inc.
- Mercury Computer Systems, Inc.
- OpenTV Corp.
- Terayon Communications Systems, Inc.
- Think Partnership Inc.

Among the recommendations made in the report were, with respect to executive compensation, an increase in base salaries, as appropriate, to market and individual performance levels, a standardization of bonus opportunities to executives and a linking of performance metrics and payout opportunities to milestone achievements by SeaChange, and a continued monitoring of marketplace trends regarding long-term incentives, particularly in the continued use of restricted stock and restricted stock units. With respect to director compensation, the report recommended an increase in board and committee meeting fees to market levels and an increase in equity grants to market levels.

## **Fiscal 2007 Executive Compensation Components**

For the fiscal year ended January 31, 2007, the principal components of compensation for named executive officers were:

- base salary;
- performance-based incentive compensation;
- change in control and termination benefits; and
- general employee welfare benefits.

### *Base Salary*

SeaChange provides named executive officers and other employees with base salary to compensate them for services rendered during the fiscal year. Base salary ranges for named executive officers are determined for each executive based on his or her position and responsibility by using market data.

During its review of base salaries for executives, the Committee primarily considers:

- market data regarding peer companies;
- SeaChange's past operating and financial performance and future expectations;
- internal review of the executive's compensation, both individually and relative to other executive officers; and
- individual performance of the executive.

Salary levels are typically considered annually as part of SeaChange's performance review process as well as upon a promotion or other change in job responsibility. SeaChange tries to provide an allocation between base and performance-based incentive compensation that reflects market conditions and appropriately ensures alignment of individual performance with SeaChange's objectives.

### *Performance-Based Incentive Compensation*

The Committee established performance-based incentive compensation plans for each of Messrs. Davi, Goldfarb and Styslinger and Ms. Kanouff. These plans provided for a cash base salary and eligibility for an equity and/or cash-based incentive bonus. In addition, compensation for Ms. Kanouff and Mr. Goldfarb includes sales commissions. The level of bonus payable to each of these executive officers is dependent on a number of performance factors relating to both the executive officer and to SeaChange overall, including:

- SeaChange's earnings before interest, taxes, depreciation and amortization (EBITDA);
- cash position;
- completion by the recipient of employee development objectives; and
- other specific goals, such as customer satisfaction and key account acquisitions.

The achievement of these goals at the target levels required exceptional performance from both the executive and SeaChange.

The bonuses are based on full and half-year performance with the recipient being eligible to earn a half-year bonus upon achievement of certain goals for the first six months of the fiscal year. The equity component of these plans provides for the award of restricted stock units (RSUs). Both the half and full fiscal year RSU bonus is issuable upon completion of the full fiscal year and vests in equal annual installments over three years. The first tranche of the RSU relating to half year performance vests 6 months after completion of the 2007 fiscal year and the first tranche of the RSU relating to full year performance vests at the end of the 2008 fiscal year.



Grants of the RSUs were made pursuant to SeaChange's 2005 Plan. SeaChange has made and continues to make grants of stock options and RSUs from time to time to eligible employees based upon SeaChange's overall financial performance and their contribution thereto. Stock options and restricted stock units are designed to align the interests of SeaChange's executives and other employees with those of its stockholders by encouraging them to enhance the value of SeaChange, the price of the common stock and, hence, the stockholders' return. In addition, the vesting of stock options and RSUs over a period of time is designed to defer the receipt of compensation by the recipient, creating an incentive for the person to remain with SeaChange. SeaChange does not have a program, plan or practice to select equity grant dates in connection with the release of favorable or negative news.

The Committee believes that this performance-based incentive compensation motivates the performance of critical annual performance metrics aimed at enhancing stockholder value. In addition, the equity-based component of this incentive compensation ensures additional focus by the named executive officers on stock price performance, increases executive ownership of SeaChange's stock, and enhances executive retention in a challenging business environment and competitive labor market.

In determining an allocation between equity and cash incentive-based compensation (other than with respect to incentive-based compensation in the form of sales commissions), the Committee generally seeks to have recipients earn greater value from equity awards than from cash awards. This weighting toward equity awards is done to provide incentive for future performance at the same time as rewarding prior performance. The Committee is limited, however, in the amount of equity compensation by the 2005 Plan that historically provided that no more than 25%, or 375,000 shares, of the awards made under the 2005 Plan be in the form of restricted stock, restricted stock units or other non-stock option awards. The Committee is also limited by its commitment that it would not grant equity awards in excess of two percent (2.0%) per fiscal year, subject to reasonable adjustments as may be necessary to account for unusual corporate events such as acquisitions and new hires of executive officers.

#### *Change in Control and Termination Benefits*

SeaChange has entered into change-in control severance agreements with each of its named executive officers. The change-in-control agreements are designed to provide an incentive to remain with SeaChange leading up to and following a change in control. For purposes of these agreements, a "change in control" means either:

- the members of the Board of Directors of SeaChange at the beginning of any consecutive 24- or 12-calendar month period ("Incumbent Directors") ceasing for any reason other than death to constitute at least a majority of the Board, provided that any director whose election, or nomination for election, was approved by at least a majority of the members of the Board then still in office who were members of the Board at the beginning of the 24- or 12-calendar month period shall be deemed to be an Incumbent Director;

- any consolidation or merger whereby the stockholders of SeaChange immediately prior to the consolidation or merger do not, immediately after the consolidation or merger, beneficially own shares representing 50% or more of the combined voting power of the securities of the corporation (or its ultimate parent corporation) issuing cash or securities in the consolidation or merger;
- any sale or other transfer of all or substantially all of the assets of SeaChange to another entity, other than an entity of which at least 50% of the combined voting power is owned by stockholders in substantially the same proportion as their ownership of SeaChange prior to the transaction;
- any approval by the stockholders of SeaChange of a plan for liquidation or dissolution of SeaChange; or
- any corporation or other person acquiring 40% or more of the combined voting power of SeaChange.

Upon a change in control, all of the executive's unvested stock options and stock appreciation rights will automatically vest and become immediately exercisable, and any and all restricted stock and restricted stock rights then held by the executive shall fully vest and become immediately transferable free of restriction, other than those imposed by applicable law. In the event of a subsequent termination of the executive's employment for any reason, all of the stock options and stock appreciation rights then held by the executive and which were granted after the date of entering into the agreement, shall become exercisable for the lesser of (i) the remaining applicable term of the particular stock option or (ii) three years from the date of termination. If within one or two years following a Change in Control the employment of the executive is terminated (i) by SeaChange other than for specified causes, death or disability, or (ii) by the executive for specified good reason, the executive shall be entitled to the following:

- two times his or her annual base salary plus one times his or her bonus for the preceding year;
- for a period of two years, continued health, life and disability benefits;
- outplacement services for up to one year following termination;
- up to \$5,000 of financial planning services; and
- accrued vacation pay.

If all or any portion of the benefits and payments provided to the executive would constitute an excess parachute payment within the meaning of Section 280G of the Internal Revenue Code resulting in the imposition on the executive of an excise tax, the payments and benefits will be "grossed-up" so as to place the executive in the same after-tax position as if no excise tax had been imposed.

As a condition to the receipt by the executive of any payment or benefit under the change-in-control agreement, the executive must first execute a valid, binding and irrevocable general release in favor of SeaChange and in a form reasonably acceptable to SeaChange.

### *General Employee Welfare Benefits*

SeaChange also has various broad-based employee benefit plans. Executive officers participate in these plans on the same terms as eligible, non-executive employees, subject to any legal limits on the amounts that may be contributed or paid to executive officers under these plans.

SeaChange offers a stock purchase plan, under which employees may purchase common stock at a discount, and a 401(k) retirement plan, which permits employees to invest in a choice of mutual funds on a pre-tax basis. SeaChange also maintains medical, disability and life insurance plans and other benefit plans for its employees.

### **Tax and Accounting Implications**

#### *Deductibility of Executive Compensation*

In general, under Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”), SeaChange cannot deduct, for federal income tax purposes, compensation in excess of \$1,000,000 paid to certain executive officers. This deduction limitation does not apply, however, to compensation that constitutes “qualified performance-based compensation” within the meaning of Section 162(m) of the Code and the regulations promulgated thereunder. The Committee has considered the limitations on deductions imposed by Section 162(m) of the Code, and will continue to consider such deduction limitations of Section 162(m) of the Code when structuring its executive compensation arrangements.

#### *Nonqualified Deferred Compensation*

On October 22, 2004, the American Jobs Creation Act of 2004 was signed into law, changing the tax rules applicable to nonqualified deferred compensation arrangements. While the final regulations have not become effective yet, the Company will continue to monitor these regulations in order to be in compliance should it, in the future, elect to make payments of nonqualified deferred compensation.

#### *Accounting for Stock-Based Compensation*

Beginning on January 1, 2006, the Company began accounting for stock-based payments in accordance with the requirements of FASB Statement 123(R).

## Summary Compensation Table

The following table sets forth summary information concerning the compensation awarded to, paid to or earned by each of SeaChange's named executive officers for all services rendered in all capacities to SeaChange in fiscal 2007.

Name and Principal Position	Year	Salary (\$)	Bonus(1) (\$)	Stock Awards (2)(3)(6) (\$)	Option Awards (4)(7) (\$)	Non-Equity Incentive Plan Compensation (3)(5)(8) (\$)	Total (\$)
William C. Styslinger, III <i>President, Chief Executive Officer, Chairman of the Board and Director</i>	2007	375,000	-	77,625	28,759	67,582	548,966
Kevin M. Bisson <i>Chief Financial Officer, Senior Vice President, Finance and Administration, Treasurer and Secretary</i>	2007	265,962	35,000	172,881	-	-	473,843
William L. Fiedler <i>Chief Financial Officer (resigned as of April 18, 2006), Treasurer, Secretary and Senior Vice President, Finance and Administration (resigned as of March 13, 2006)</i>	2007	226,790	-	-	3,666	-	230,455
Steven M. Davi <i>Senior Vice President, Software Engineering</i>	2007	205,125	-	87,274	7,309	122,014	421,722
Ira Goldfarb <i>Senior Vice President, Worldwide Sales</i>	2007	150,000	-	64,657	7,884	337,053	559,594

Name and Principal Position	Year	Salary (\$)	Bonus(1) (\$)	Stock Awards (2)(3)(6) (\$)	Option Awards (4)(7) (\$)	Non-Equity Incentive Plan Compensation (3)(5)(8) (\$)	Total (\$)
Yvette Kanouff <i>Chief Strategy Officer</i>	2007	203,867	–	70,719	6,920	457,527	739,033

- (1) Reflects a \$35,000 bonus to Mr. Bisson in accordance with his initial employment offer.
- (2) Compensation expense for restricted stock unit awards is included in the Stock Awards column. This expense represents the value of restricted stock unit awards for financial statement reporting purposes for fiscal 2007, as computed in accordance with FAS 123R, disregarding any estimates of forfeitures related to service-based vesting conditions. The amounts were calculated based on the closing prices of the common stock on the date of grant.
- (3) Compensation expense for restricted stock units and cash related to our performance-based compensation plan are included in the Stock Awards and Non-Equity Incentive Plan Compensation columns, respectively. Compensation expense is based on the payout values corresponding to the number of units earned for the fiscal 2007 performance period.
- (4) The amounts in the Option Awards column represent the 123R compensation expense, excluding an estimate of forfeitures related to service-based vesting conditions. The option awards expense was determined using the Black-Scholes option valuation model, which estimates the value of an equity award using subjective assumptions which can vary over time. For a complete discussion of our adoption of FAS123R and the relevant assumptions we use to calculate the grant date fair value of option awards, see “Note 5, Stock-Based Compensation and Stock Incentive Plans” of the “Notes to Consolidated Financial Statements” in our fiscal 2007 Annual Report on Form 10-K.
- (5) Compensation earned pursuant to the fiscal 2007 performance-based compensation was determined by the Compensation and Option Committee pursuant to the individual plans previously established for the named executive officer.
- (6) The Stock Awards column includes compensation for restricted stock units earned by the named executive officers in connection with their fiscal 2007 performance-based incentive plan. Under this plan, Mr. Styslinger earned 6,383 restricted stock units with a related FAS 123R value of \$15,958; Mr. Bisson earned 11,165 restricted stock units with a related FAS 123R value of \$27,913; Mr. Davi earned 18,934 restricted stock units with a related FAS 123R value of \$49,990; Mr. Goldfarb earned 10,735 restricted stock units with a related FAS 123R value of \$27,373; and Ms. Kanouff earned 13,160 restricted stock units with a related FAS 123R value of \$33,435. Mr. Bisson's restricted stock unit grant will be effective upon approval of the amendment to the 2005 Plan being sought hereby. The fair value of these restricted stock units was based on the closing price of our common stock at January 31, 2007 of \$10.00. The fair value of these restricted stock units is amortized over the fiscal 2007 performance period and three year vesting period. The compensation for these stock awards is that portion of the expense that is attributable to the 2007 performance period. The compensation for Mr. Bisson also reflects the FAS 123R value of the 65,000 restricted stock units received by Mr. Bisson in accordance with his initial employment offer on March 15, 2006. The fair value of these restricted stock units is amortized over the three year vesting period. The balance of the FAS 123R expenses reflected in that column related to the compensation expense of other equity awards made to the named executive officers, including those disclosed in the Grants of Plan-Based Award Table.

- (7) The Option Awards column in the Summary Compensation Table reflects the FAS 123R expense of awards of stock options made to the named executive officers prior to fiscal 2007. No awards of stock options were made to the named executive officers in fiscal 2007.
- (8) The Non-Equity Incentive Plan Compensation column in the Summary Compensation Table reflects the cash awards made to the named executive officers under the fiscal 2007 performance-based compensation plans. The Non-Equity Incentive Plan Compensation column also includes \$407,527 in sales commissions earned by Ms. Kanouff and \$262,053 in sales commissions earned by Mr. Goldfarb.

### Grants of Plan-Based Awards

No grants were made under the fiscal year 2007 performance-based incentive plan during fiscal 2007. Awards under the fiscal year 2007 performance-based incentive plan were made on May 7, 2007, and these awards are reflected in the Summary Compensation Table above. However, SeaChange did make certain other grants to its named executive officers in fiscal 2007, as detailed below, in recognition of the executive officer's contributions to SeaChange's fiscal year 2006 operations and performance and as an incentive for future performance. As detailed in SeaChange's 2006 proxy statement, other of SeaChange's executive officers received grants of restricted stock units in fiscal 2006 with respect to fiscal year 2006 operations and performance.

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units(1) (#)	Grant Date Fair Value of Stock and Option Awards (\$)
William C. Styslinger, III	2/9/2006	20,000	189,800
Kevin M. Bisson	—	—	—
William L. Fielder	—	—	—
Steven M. Davi	2/9/2006	6,000	56,940
Ira Goldfarb	2/9/2006	6,000	56,940
Yvette Kanouff	2/9/2006	6,000	56,940

- (1) In addition to incentive plan-based awards, Mr. Bisson received 65,000 restricted stock units in accordance with his initial employment offer on March 15, 2006. The grant date fair value of these awards was \$494,650.

As discussed above in Compensation Discussion and Analysis, none of the named executive officers has an employment agreement with the company, and the compensation for each named executive officer is a mix of base salary and performance-based incentive compensation.

## Outstanding Equity Awards at Fiscal Year-End

The following table sets forth summary information regarding the outstanding equity awards at January 31, 2007 granted to each of SeaChange's named executive officers.

Name	Option Awards(1)				Stock Awards(2)	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
William C. Styslinger, III	2,000	-	14.12	4/24/07	20,000	200,000
	24,045	-	7.88	4/26/09		
	298	-	7.17	4/26/09		
	41,000	-	26.75	5/24/10		
	2,380	-	18.75	4/20/11		
	52,620	-	18.75	4/20/11		
	55,000	-	13.76	4/4/12		
	42,188	4,688	7.00	3/5/13		
	40,000	-	15.59	11/4/13		
	20,000	-	14.56	12/4/13		
	20,000	-	15.62	3/4/14		
	40,000	-	12.21	5/24/14		
	20,000	-	14.47	8/4/14		
	20,000	-	17.39	11/4/14		
Kevin M. Bisson					65,000	650,000
William L. Fielder	65,750	-	4.00	12/14/08	-	-
	15,000	-	7.17	4/26/09		
	7,668	-	34.00	4/14/10		
	10,332	-	26.75	5/24/10		
	2,880	-	23.31	11/30/10		
	11,520	-	23.31	11/30/10		
	316	-	18.75	4/20/11		
	14,684	-	18.75	4/20/11		
	19,000	-	13.76	4/4/12		
	4,500	-	13.24	5/24/12		
	4,500	-	6.20	8/5/12		
	4,500	-	6.05	11/4/12		
	4,688	313	7.00	3/5/13		
	5,000	-	10.72	5/27/13		
	5,000	-	10.33	8/4/13		
	5,000	-	15.59	11/4/13		
	7,500	-	15.62	3/4/14		
	7,500	-	12.21	5/24/14		
	7,500	-	14.47	8/4/14		
	7,500	-	17.39	11/4/14		

Name	Option Awards(1)				Stock Awards(2)	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
Steven M. Davi	7,500	-	7.17	4/26/09	10,667	106,670
	3,195	-	34.00	4/14/10		
	4,305	-	26.75	5/24/10		
	7,571	-	23.31	11/30/10		
	6,829	-	23.31	11/30/10		
	9,000	-	13.76	4/4/12		
	4,500	-	13.24	5/24/12		
	4,500	-	6.20	8/5/12		
	4,500	-	6.05	11/4/12		
	13,594	906	7.00	3/5/13		
	4,500	-	10.72	5/27/13		
	4,500	-	10.33	8/4/13		
	4,500	-	15.59	11/4/13		
	3,165	-	15.62	3/4/14		
	1,335	-	15.62	3/4/14		
	4,500	-	12.21	5/24/14		
	4,500	-	14.47	8/4/14		
	4,500	-	17.39	11/4/14		
Ira Goldfarb	7,500	-	5.83	8/20/08	10,667	106,670
	7,500	-	7.17	4/26/09		
	1,500	-	12.83	7/5/09		
	7,668	-	34.00	4/14/10		
	10,332	-	26.75	5/24/10		
	14,400	-	23.31	11/30/10		
	9,000	-	13.76	4/4/12		
	4,500	-	13.24	5/24/12		
	4,500	-	6.20	8/5/12		
	4,500	-	6.05	11/4/12		
	15,000	1,000	7.00	3/5/13		
	4,500	-	10.72	5/27/13		
	4,500	-	10.33	8/4/13		
	4,500	-	15.59	11/4/13		
	6,250	-	15.62	3/4/14		
	6,250	-	12.21	5/24/14		
	205	-	14.47	8/4/14		
	6,045	-	14.47	8/4/14		
	6,250	-	17.39	11/4/14		



Name	Option Awards(1)				Stock Awards(2)	
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
Yvette Kanouff	15,000	-	7.50	10/6/07	10,667	106,670
	6,000	-	5.50	1/23/08		
	7,500	-	5.83	8/20/08		
	3,750	-	4.00	12/14/08		
	7,500	-	7.17	4/26/09		
	4,260	-	34.00	4/14/10		
	5,740	-	26.75	5/24/10		
	3,865	-	23.31	11/30/10		
	4,135	-	23.31	11/30/10		
	7,000	-	13.76	4/4/12		
	3,500	-	13.24	5/24/12		
	3,500	-	6.20	8/5/12		
	3,500	-	6.05	11/4/12		
	13,594	906	7.00	3/5/13		
	4,500	-	10.72	5/27/13		
	4,500	-	10.33	8/4/13		
	4,500	-	15.59	11/4/13		
	5,000	-	15.62	3/4/14		
	2,882	-	12.21	5/24/14		
	2,118	-	12.21	5/24/14		
	5,000	-	14.47	8/4/14		
	5,000	-	17.39	11/4/14		

- (1) All options in the table above were granted under the Company's Amended and Restated 1995 Stock Option Plan. Under this plan, one quarter of the options vest and become exercisable after one year and the balance vest and become exercisable over the next three years quarterly in equal installments. In fiscal 2006, the Company accelerated the vesting of certain unvested stock options with exercise prices equal to or greater than \$9.00 per share that were previously awarded under the Company's equity compensation plans.
- (2) These columns show the number of shares of Common Stock represented by unvested restricted stock units at January 31, 2007. The vesting dates for these unvested restricted stock units are as follows:

Name	Number of Restricted Stock Units That Have Not Vested	Date of Grant	Vesting Dates
William C. Styslinger, III	20,000	2/9/2006	2/9/2007, 2/9/2008 and 2/9/2009
Kevin M. Bisson	65,000	3/15/2006	3/15/2007, 3/15/2008 and 3/15/2009
William L. Fielder	-	-	-
Steven M. Davi	4,667 6,000	12/8/2005 2/9/2006	12/8/2007 and 12/8/2009 2/9/2007, 2/9/2008 and 2/9/2009

Ira Goldfarb	4,667 6,000	12/8/2005 2/9/2006	12/8/2007 and 12/8/2009 2/9/2007, 2/9/2008 and 2/9/2009
Yvette Kanouff	4,667 6,000	12/8/2005 2/9/2006	12/8/2007 and 12/8/2009 2/9/2007, 2/9/2008 and 2/9/2009

## Option Exercises and Stock Vested

The following table summarizes the option exercises and vesting of stock awards for each of SeaChange's named executive officers for fiscal 2007.

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise(1) (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting(2) (\$)
William C. Styslinger, III	-	-	-	-
Kevin M. Bisson	-	-	-	-
William L. Fielder	-	-	-	-
Steven M. Davi	500	2,511	2,333	19,481
Ira Goldfarb	-	-	2,333	19,481
Yvette Kanouff	-	-	2,333	19,481

- (1) The value realized upon exercise of stock options reflects the price at which shares acquired upon exercise of the stock options were sold or valued for income tax purposes, net of the exercise price for acquiring the shares.
- (2) The value realized upon vesting of the restricted stock units shown in the table above was calculated as the product of the closing price of a share of our common stock on the vesting date multiplied by the number of shares vested.

## Pension Benefits

The Company does not offer defined benefit plans to its employees.

## Nonqualified Deferred Compensation

The Company does not offer nonqualified defined contribution or other nonqualified deferred compensation plans to its employees.

## Potential Payments upon Termination or Change in Control

As explained above, SeaChange has entered into change-in control severance agreements with each of its named executive officers. If within one or two years following a Change in Control the employment of a named executive officer is terminated (i) by SeaChange other than for specified causes, death or disability, or (ii) by the executive for specified good reason, the executive shall be entitled to the following:

- two times his or her annual base salary plus one times his or her bonus for the preceding year;
- for a period of two years, continued health, life and disability benefits;
- outplacement services for up to one year following termination;
- up to \$5,000 of financial planning services; and
- accrued vacation pay.

If all or any portion of the benefits and payments provided to the executive would constitute an excess parachute payment within the meaning of Section 280G of the Internal Revenue Code resulting in the imposition on the executive of an excise tax, the payments and benefits will be “grossed-up” so as to place the executive in the same after-tax position as if no excise tax had been imposed.

### Potential Payments Upon Termination or Change in Control

Name	Salary(1) (\$)	Bonus(2) (\$)	Benefits(3) (\$)	Excise Taxes(4) (\$)	Equity Awards(5) (\$)
William C. Styslinger, III	750,000	67,582	35,902	–	198,068
Kevin M. Bisson	600,000	–	35,902	52,099	433,420
William L. Fielder	431,400	–	35,902	–	938
Steven M. Davi	410,000	122,014	35,902	–	215,309
Ira Goldfarb	300,000	337,053	35,902	–	156,218
Yvette Kanouff	405,802	457,527	35,902	–	174,124

(1) Reflects two times the executive’s base salary.

(2) Reflects the executive’s annual bonus. For executives other than Mr. Styslinger, the bonus payment is capped so that the sum of the salary and bonus payment is limited to the amount to which Mr. Styslinger is entitled.

- (3) Reflects the continuation of each named executive officer's benefits under group benefit plans consisting of medical, dental, group life and disability and outplacement and financial planning services.
- (4) Reflects the amount necessary to cover any excise taxes for excess parachute payments.
- (5) Reflects the value of all unvested stock options and restricted stock units that would vest as a result of the termination. The amounts are based on the excess of the SeaChange January 31, 2007 closing common stock price over (a) the applicable exercise price in the case of accelerated options or (b) the SeaChange closing common stock price as of the date of grant in the case of accelerated restricted stock units.

### **Compensation and Option Committee Report**

The Compensation and Option Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation and Option Committee recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement.

#### **THE COMPENSATION AND OPTION COMMITTEE**

Thomas F. Olson, Chair  
Martin R. Hoffmann  
Carmin Vona

### **Compensation Committee Interlocks and Insider Participation**

The Compensation and Option Committee consists of Messrs. Hoffmann, Olson and Vona. No person who served as a member of the Compensation and Option Committee was, during the past fiscal year, an officer or employee of SeaChange or any of its subsidiaries, was formerly an officer of SeaChange or any of its subsidiaries, or had any relationship requiring disclosure herein. No executive officer of SeaChange served as a member of the compensation committee of another entity (or other committee of the Board of Directors performing equivalent functions or, in the absence of any such committee, the entire Board of Directors), one of whose executive officers served as a director of SeaChange.

## PROPOSAL NO. II

### APPROVAL OF AMENDMENT TO THE 2005 EQUITY COMPENSATION AND INCENTIVE PLAN

At the Annual Meeting, SeaChange's stockholders will be asked to approve an amendment to the 2005 Plan that would:

- increase the total number of authorized shares under the 2005 Plan by 1,300,000 shares, so that the aggregate number of awards that may be granted under the 2005 Plan is 2,800,000 shares, and permit all of these additional shares to be used for any form of award under the 2005 Plan; and
- prohibit "liberal share counting", meaning that the number of shares available for grant under the 2005 Plan would not be increased by the tendering of shares in payment of a stock option, the withholding of shares to satisfy a tax withholding obligation, or shares repurchased with option proceeds.

The Board of Directors believes that approval of the amendment is fundamental to SeaChange's ongoing ability to recruit, retain and motivate employees, as **SeaChange currently has no further ability to make grants of restricted stock, restricted stock units or other non-stock option awards under the 2005 Plan.** As discussed below, the 2005 Plan was approved prior to effectiveness of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), when the common practice was for equity awards to be in the form of stock options. Accordingly, the 2005 Plan permitted all of the awards to be in the form of stock options, while only a relatively small proportion of the awards were permitted to be granted as restricted stock, restricted stock units or other non-stock option awards. However, with the change in accounting rules, the equity compensation practices of SeaChange – and many other companies – have changed to shift towards an increased use of restricted stock units. **The Board of Directors believes that without a continued ability to make grants of restricted stock units, SeaChange would suffer a severe competitive disadvantage in the recruitment, retention and motivation of its employees.**

On May 22, 2007, the Board of Directors approved this amendment, subject to stockholder approval. The amendment is reflected in the Amended and Restated 2005 Equity Compensation and Incentive Plan, a copy of which is attached hereto as Appendix A.

**The Board of Directors unanimously recommends a vote "FOR" the approval of the proposed amendment to the 2005 Plan.**

#### **Purpose of the Plan and Reasons for Amendment**

Currently, the 2005 Plan has only 416,000 shares that remain available for future awards. None of these shares may be used for the awards of restricted stock, restricted stock units or other non-stock option awards. The original 2005 Plan provided for only a limited subset of shares that may be used for these full-value awards, and SeaChange has already granted awards using these shares.

Approval of the amendment and the flexibility to use the new shares for full-value awards is fundamental to SeaChange's ongoing ability to recruit, retain and motivate employees. **Without this amendment being approved, SeaChange would have no ability to grant full-value awards, such as restricted stock units.** With the adoption of SFAS 123R, SeaChange has shifted to primarily making equity awards in the form of restricted stock units, other than in the case of new hires which continue to typically receive stock options. This shift has been consistent with what SeaChange believes many of its competitors have done. **SeaChange would be at a significant competitive disadvantage were it not able to continue granting restricted stock units.** The Board strongly believes that the grant of restricted stock units is in the stockholder's best interests due to both the accounting implications of grants of RSUs as compared with stock options and the enhanced ability to recruit, retain and motivate SeaChange's employees.

SeaChange has dramatically reduced the number of equity awards it grants on an annual basis – commonly referred to as “burn rate” – complying with the commitment made by SeaChange at the time of initial adoption of the 2005 Plan to grant equity ownership opportunities under the 2005 Plan, including stock options and restricted stock units, in an amount not greater than two percent (2.0%) per fiscal year, subject to reasonable adjustments as may be necessary to account for unusual corporate events such as acquisitions and new hires of executive officers that may occur in the future. The amendment to increase the overall size of the 2005 Plan reflects compliance with this past commitment. SeaChange intends to continue to grant equity ownership opportunities under the 2005 Plan in an amount no greater than two percent (2%) per fiscal year, subject as before to reasonable adjustments as may be necessary to account for unusual corporate events such as acquisitions and new hires of executive officers that may occur in the future. The amendment provides that the number of shares available for grant under the 2005 Plan would not be increased by the tendering of shares in payment of a stock option, the withholding of shares to satisfy a tax withholding obligation, or shares repurchased with option proceeds.

SeaChange believes that it has a strong business model, and that in order to achieve future success, SeaChange will need to attract, retain and motivate key personnel and potential hires. The Board believes that equity-based compensation that includes restricted stock units will continue to be essential to permit SeaChange to successfully continue the pursuit of these objectives.

As discussed above, SeaChange believes that these amendments will enable SeaChange to continue to use the 2005 Plan as an effective part of the overall compensation offered by SeaChange to its employees. Without approval of this amendment, SeaChange believes that it would suffer a severe competitive disadvantage in the recruitment, retention and motivation of its employees.

Other than the limit on the total shares authorized and the shares available for non-stock option awards, the principal features of the 2005 Plan, as amended, include:

- **Three-Year Minimum Vesting Period:** Stock options, restricted stock, restricted stock units and other awards granted under the 2005 Plan may not vest more rapidly than one-third of the total grant in any one twelve month period,

subject to exceptions for new hires, disability, death and other limited circumstances.

- **No Discount Stock Options:** The 2005 Plan prohibits the grant of a stock option with an exercise price less than the fair market value of SeaChange's stock on the date of grant.
- **Maximum Seven-Year Option Term:** The 2005 Plan provides that stock options may not have a term greater than seven years.
- **No Liberal Share Counting:** The 2005 Plan does not permit the number of shares available for grant to be increased by actions such as the tendering of shares in payment of a stock option, the withholding of shares to satisfy tax withholding obligations, and shares repurchased with option proceeds.
- **No Repricing of Stock Options:** The 2005 Plan prohibits the repricing of stock options without stockholder approval.
- **Independent Committee Administration:** The 2005 Plan is administered by a committee of the Board whose members satisfy the independence requirements of Rule 10A-3(b)(1) of the Securities Exchange Act of 1934, as amended.
- **Material Amendments to the Plan Require Stockholder Approval:** The 2005 Plan provides that a material amendment to the Plan, such as those being sought hereby, is not effective unless approved by SeaChange's stockholders.

### **Summary of the 2005 Plan**

The following description of the 2005 Plan is a summary only. SeaChange strongly recommends that you read the complete text of the 2005 Plan which is attached as Appendix A hereto.

The purpose of the 2005 Plan is to provide stock options and other equity ownership opportunities in SeaChange (each, an "Award") to employees, officers, directors, consultants and advisors of SeaChange and its subsidiaries, all of whom are eligible to receive Awards under the 2005 Plan. Any person to whom an Award is granted will be called a "Participant."

### *Administration*

The 2005 Plan is administered by a committee (the "Committee") composed solely of members of SeaChange's board of directors that are "independent," as defined pursuant to Rule 10A-3(b)(1) of the Securities Exchange Act, as amended. SeaChange's Compensation and Option Committee is used to administer the 2005 Plan. The Committee has the authority to grant and amend Awards, to adopt, amend and repeal rules relating to the 2005 Plan and to interpret and correct the provisions of the 2005 Plan and any Award. The 2005 Plan also provides that authority to grant Awards to employees may be delegated to one or more officers of SeaChange.

### *Exercise Price*

The Committee shall establish the exercise price of options (or determine the method by which the exercise price shall be determined) at the time each option is granted, provided that the minimum exercise price for an option will not be less than 100% (110% for an incentive stock option granted to a 10% or more stockholder) of the fair market value of the Common Stock on the date of grant. The exercise price, if applicable, of other stock-based Awards shall be set by the Committee.

### *Authorized Shares*

Upon approval of the amendment, the number of shares (the “Authorized Shares”) of Common Stock that may be delivered in satisfaction of Awards granted under the 2005 Plan would be 2,800,000 shares of Common Stock. As mentioned above, the amendment provides that the number of shares available for grant under the 2005 Plan would not be increased by the tendering of shares in payment of a stock option, the withholding of shares to satisfy a tax withholding obligation, or shares repurchased with option proceeds. The number of shares available for grant under the 2005 Plan would be increased, however, were there a stockholder-approved option repurchase. The Compensation and Option Committee intends to grant equity ownership opportunities, including stock options and RSUs, in an amount not greater than two percent (2.0%) per fiscal year, subject to reasonable adjustments as may be necessary to account for unusual corporate events such as acquisitions and hires of executive officers that may occur in the future. Currently, there are 416,000 shares of Common Stock that remain available for grant pursuant to the 2005 Plan. As discussed, none of these shares remain available for awards of restricted stock, restricted stock units or other non-stock option awards.

### *Eligibility*

Employees, officers, directors, consultants and advisors of SeaChange and its subsidiaries are eligible to be granted Awards under the 2005 Plan. Under present law, however, incentive stock options within the meaning of Section 422 of the Code may only be granted to employees of SeaChange and parent or subsidiaries of SeaChange. The maximum number of shares with respect to which Awards may be granted to any participant under the 2005 Plan may not exceed 120,000 in any fiscal year, other than Awards made to a new hire. Approximately 811 persons were eligible to participate in the 2005 Plan as of January 31, 2007.

### *Exercise of Options*

No more than one-third of the shares of Common Stock covered by an option may vest in any twelve (12) month period; provided, however, that alternative vesting may be established by the Committee in the agreement evidencing an option granted in connection with a person assuming status as a Participant and upon such person’s disability, death, cessation of status as a Participant and other similar circumstances. Each option or installment may be exercised at any time or from time to time, in whole or in part, for up to the total number of shares with respect to which it is then exercisable, by delivery of a properly signed written notice of exercise to SeaChange at its principal office address or to such transfer agent as SeaChange shall designate, or by notification of SeaChange-designated third party commercial provider. The Committee



has the right to accelerate the date of exercise of any installment of any option despite the fact that such acceleration may disqualify all or part of any option as an incentive stock option.

### *Types of Awards*

Awards under the 2005 Plan may be in the form of incentive stock options, non-qualified stock options, restricted stock, restricted stock units, and any other equity-based interests as the Committee shall determine, or any combination thereof.

### *Stock Options*

Stock options represent the right to purchase shares of Common Stock within a specified period of time at a specified price. As detailed above, the exercise price for options will be not less than 100% (110% for an incentive stock option granted to a 10% or more stockholder) of the fair market value of Common Stock on the date of grant. The aggregate fair market value, determined on the date the option is granted, of the stock for which any person may be granted incentive stock options which become exercisable for the first time by such person in any calendar year cannot exceed the sum of \$100,000 (determined on the date such option is granted). No incentive stock option will be granted to a person who is not an “employee” as defined in the applicable provisions of the Internal Revenue Code of 1986, as amended, (the “Code”), and regulations issued thereunder. Options shall expire in seven years (five years in the case of an incentive stock option granted to a 10% or more stockholder) after the date of grant. No stock options can be granted under the 2005 Plan after July 13, 2015, but options granted before that date may be exercised thereafter.

Payment for the exercise of options under the 2005 Plan may be made by one or any combination of the following forms of payment:

- by cash or by check payable to the order of SeaChange;
- at the discretion of the Committee through delivery of shares of Common Stock having fair market value equal as of the date of exercise to the cash exercise price of the Option; or
- at the discretion of the Committee, by delivery of a sufficient amount of the proceeds from the sale of the Common Stock acquired upon exercise of the option by the optionee’s broker or selling agent.

### *Restricted Stock, Restricted Stock Units and Other Awards*

The 2005 Plan provides the flexibility to grant other forms of Awards based upon the Common Stock, having the terms and conditions established at the time of grant by the Committee. Restricted stock is Common Stock that is subject to a risk of forfeiture or other restrictions that will lapse upon satisfaction of specified conditions. Restricted stock units represent the right to receive shares of Common Stock in the future, with the right to future delivery of the shares subject to a risk of forfeiture or other restrictions that will lapse upon satisfaction of specified conditions. Upon approval of the amendment, all of the additional 1,300,000 shares being approved for issuance under the 2005 Plan may be granted as Awards of restricted stock,

restricted stock units or other non-stock option awards. The 2005 Plan also provides that no more than one-third of the shares of Common Stock covered by an Award of restricted stock, restricted stock units or other non-stock option awards may vest in any twelve (12) month period. Subject to any restrictions applicable to the award, a participant holding restricted stock, whether vested or unvested, will be entitled to enjoy all rights of a stockholder with respect to such restricted stock, including the right to receive dividends and to vote the shares.

#### *Eligibility Under Section 162(m)*

In general, under Section 162(m) of the Code, SeaChange cannot deduct, for federal income tax purposes, compensation in excess of \$1,000,000 paid to certain executive officers. This deduction limitation, however, does not apply to compensation that constitutes “qualified performance-based compensation” within the meaning of Section 162(m) of the Code and the regulations promulgated thereunder. The regulations under Section 162(m) of the Code contain a “safe harbor” that treats stock options granted at fair market value as qualified performance-based compensation (assuming certain other requirements are satisfied).

#### *Transferability*

Except as the Committee may otherwise determine or provide in an Award, Awards may be transferred only by will or by the laws of descent and distribution; provided, however, that nonstatutory stock options may be transferred pursuant to a qualified domestic relations order or to a grantor-retained annuity trust or a similar estate-planning vehicle under which the trust is bound by all provisions of the option which are applicable to the holder thereof.

#### *Adjustment*

In the event of any stock split, stock dividend, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, combination, exchange of shares, liquidation, spin-off, split-up, or other similar change in capitalization or event, the following shall be equitably adjusted:

- the number and class of securities available for Awards under the 2005 Plan and the per-participant share limit;
- the number and class of securities, vesting schedule and exercise price per share subject to each outstanding option;
- the repurchase price per security subject to repurchase; and
- the terms of each other outstanding stock-based Award shall be adjusted by SeaChange (or substituted Awards may be made) to the extent the Committee shall determine, in good faith, that such an adjustment (or substitution) is appropriate.

### *Treatment upon Acquisition*

Unless otherwise expressly provided in the applicable Award, upon the occurrence of an acquisition of SeaChange, appropriate provision is to be made for the continuation or the assumption by the surviving or acquiring entity of all Awards. In addition to or in lieu of the foregoing, the Committee may provide that one or more Awards granted under the 2005 Plan must be exercised by a certain date or shall be terminated, or that any such Awards shall be terminated in exchange for a cash payment.

### *Effect of Termination, Disability or Death*

The Committee determines the effect on an Award of the disability, death, retirement, authorized leave of absence or other change in the employment or other status of a participant and the extent to which, and the period during which, the participant, or the participant's legal representative, conservator, guardian or designated beneficiary, may exercise rights under the Award, subject to applicable law and the provisions of the Code related to incentive stock options.

### *Amendment of Awards*

The Committee may, without stockholder approval, amend, modify or terminate any outstanding Award, *provided that*, the Participant's consent to such action shall be required unless the Committee determines that the action, taking into account any related action, would not materially and adversely affect the Participant, *provided, further*, that previously-issued options may not be amended without stockholder approval to reduce the price at which such previously issued options are exercisable.

### *Termination of 2005 Plan; Amendments*

Awards may be granted under the 2005 Plan at any time prior to July 13, 2015. The Committee may amend, suspend or terminate the 2005 Plan or any portion thereof at any time, *provided, however*, that any material amendment to the 2005 Plan will not be effective unless approved by SeaChange's stockholders. If any Award expires, or is terminated, surrendered or forfeited, in whole or in part, the unissued shares covered by such Award shall again be available for the grant of Awards under the 2005 Plan.

## **Federal Income Tax Consequences**

### *Incentive Stock Options*

The following general rules are applicable under current United States federal income tax law to incentive stock options ("ISOs") granted under SeaChange's 2005 Plan.

1. In general, no taxable income results to the optionee upon the grant of an ISO or upon the issuance of shares to him or her upon the exercise of the ISO, and no corresponding federal tax deduction is allowed to SeaChange upon either grant or exercise of an ISO.
2. If shares acquired upon exercise of an ISO are not disposed of within (i) two years following the date the option was granted or (ii) one year following the date the shares

are issued to the optionee pursuant to the ISO exercise (the “Holding Periods”), the difference between the amount realized on any subsequent disposition of the shares and the exercise price will generally be treated as long-term capital gain or loss to the optionee.

3. If shares acquired upon exercise of an ISO are disposed of before the Holding Periods are met (a “Disqualifying Disposition”), then in most cases the lesser of (i) any excess of the fair market value of the shares at the time of exercise of the ISO over the exercise price or (ii) the actual gain on disposition will be treated as compensation to the optionee and will be taxed as ordinary income in the year of such disposition.

4. In any year that an optionee recognizes ordinary income as the result of a Disqualifying Disposition, SeaChange generally should be entitled to a corresponding deduction for federal income tax purposes.

5. Any excess of the amount realized by the optionee as the result of a Disqualifying Disposition over the sum of (i) the exercise price and (ii) the amount of ordinary income recognized under the above rules will be treated as capital gain to the optionee.

6. Capital gain or loss recognized by an optionee upon a disposition of shares will be long-term capital gain or loss if the optionee’s holding period for the shares exceeds one year.

7. An optionee may be entitled to exercise an ISO by delivering shares of SeaChange’s Common Stock to SeaChange in payment of the exercise price. If an optionee exercises an ISO in such fashion, special rules will apply.

8. In addition to the tax consequences described above, the exercise of an ISO may result in additional tax liability to the optionee under the alternative minimum tax rules. The Code provides that an alternative minimum tax (at a maximum rate of 28%) will be applied against a taxable base which is equal to “alternative minimum taxable income” reduced by a statutory exemption. In general, the amount by which the value of the Common Stock received upon exercise of the ISO exceeds the exercise price is included in the optionee’s alternative minimum taxable income. A taxpayer is required to pay the higher of his or her regular tax liability or the alternative minimum tax. A taxpayer that pays alternative minimum tax attributable to the exercise of an ISO may be entitled to a tax credit against his or her regular tax liability in later years.

9. Special rules apply if the stock acquired is subject to vesting, or is subject to certain restrictions on resale under federal securities laws applicable to directors, officers or 10% stockholders.

### *Nonstatutory Stock Options*

The following general rules are applicable under current federal income tax law to options that do not qualify as ISOs (“Nonstatutory Stock Options”) granted under the 2005 Plan:

1. The optionee generally does not realize any taxable income upon the grant of a Nonstatutory Stock Option, and SeaChange is not allowed a federal income tax deduction by reason of such grant.
2. The optionee generally will recognize ordinary income at the time of exercise of a Nonstatutory Stock Option in an amount equal to the excess, if any, of the fair market value of the shares on the date of exercise over the exercise price.
3. When the optionee sells the shares acquired pursuant to a Nonstatutory Stock Option, he or she generally will recognize a capital gain or loss in an amount equal to the difference between the amount realized upon the sale of the shares and his or her basis in the shares (generally, the exercise price plus the amount taxed to the optionee as ordinary income). If the optionee's holding period for the shares exceeds one year, such gain or loss will be a long-term capital gain or loss.
4. SeaChange generally should be entitled to a corresponding tax deduction for federal income tax purposes when the optionee recognizes ordinary income.
5. An optionee may be entitled to exercise a Nonstatutory Stock Option by delivering shares of SeaChange's Common Stock to SeaChange in payment of the exercise price. If an optionee exercises a Nonstatutory Stock Option in such fashion, special rules will apply.
6. Special rules apply if a Nonstatutory Stock Option has an exercise price less than the fair market value of the shares on the date of grant, or if the stock acquired is subject to vesting, or is subject to certain restrictions on resale under federal securities laws applicable to directors, officers or 10% stockholders.

#### *Awards and Purchases*

The following general rules are applicable under current federal income tax law to awards of restricted stock, restricted stock units ("Restricted Awards") or the granting of opportunities to make direct stock purchases under the 2005 Plan ("Purchases"):

1. Persons receiving Common Stock pursuant to a Restricted Award or Purchase generally will recognize ordinary income equal to the fair market value of the shares received, reduced by any purchase price paid.
2. SeaChange generally should be entitled to a corresponding deduction for federal income tax purposes when such person recognizes ordinary income. When such Common Stock is sold, the seller generally will recognize capital gain or loss equal to the difference between the amount realized upon the sale and the seller's tax basis in the Common Stock (generally, the amount that the seller paid for such stock plus the amount taxed to the Seller as ordinary income).

3. Special rules apply if the stock acquired pursuant to an award of stock or direct stock purchase is subject to vesting, or is subject to certain restrictions on resale under federal securities laws applicable to directors, officers or 10% stockholders.

**The Board of Directors unanimously recommends a vote “For” the approval of the amendments to the 2005 Plan.**

## **PROPOSAL NO. III**

### **RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

As previously disclosed in a Current Report on Form 8-K filed with the SEC on October 18, 2006, Grant Thornton LLP currently serves as SeaChange's independent registered public accounting firm. The Board of Directors is seeking ratification of the Audit Committee's selection of Grant Thornton LLP to serve as the registered public accounting firm for the fiscal year ending January 31, 2008. Prior to October 12, 2006, PricewaterhouseCoopers LLP had served as SeaChange's independent registered public accounting firm.

#### **Change in Independent Registered Accounting Firm**

On October 12, 2006, PricewaterhouseCoopers LLP was dismissed as SeaChange's independent registered public accounting firm. The dismissal of PricewaterhouseCoopers LLP was approved by SeaChange's Audit Committee.

The reports of PricewaterhouseCoopers LLP on SeaChange's financial statements as of and for the fiscal years ended January 31, 2005 and 2006 did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principle.

During SeaChange's fiscal years ended January 31, 2005 and 2006 and through October 12, 2006 there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the satisfaction of PricewaterhouseCoopers LLP, would have caused them to make reference to the subject matter of the disagreement in connection with their reports on the financial statements for such years. During SeaChange's fiscal years ended January 31, 2005 and 2006 and through October 12, 2006 there were no reportable events as defined in Item 304(a)(1)(v) of Regulation S-K.

Effective as of October 17, 2006, SeaChange's Audit Committee engaged Grant Thornton LLP as its new independent registered public accounting firm to audit SeaChange's financial statements for SeaChange's fiscal year ending January 31, 2007. The decision to engage Grant Thornton LLP as SeaChange's independent registered public accounting firm was the result of a competitive selection process.

Prior to the engagement of Grant Thornton LLP, neither SeaChange nor anyone on behalf of SeaChange consulted with Grant Thornton LLP during SeaChange's fiscal years ended January 31, 2005 and 2006 and through October 12, 2006, in any manner regarding: (A) either the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on SeaChange's financial statements, and neither was a written report provided to SeaChange nor was oral advice provided that Grant Thornton LLP concluded was an important factor considered by SeaChange in reaching a decision as to the accounting, auditing, or financial reporting issue, or (B) the subject of either a

disagreement or a reportable event, as defined in Item 304(a)(1)(iv) and (v), respectively, of Regulation S-K.

### **Independent Registered Public Accounting Firm for Fiscal Year 2008**

The Audit Committee of the Board of Directors has selected the firm of Grant Thornton LLP, independent accountants, to serve as the registered public accounting firm for the fiscal year ending January 31, 2008.

A representative of Grant Thornton LLP is expected to be present at the Annual Meeting, will have the opportunity to make a statement if they desire to do so and is expected to be available to respond to appropriate questions.

The Board of Directors has put the ratification of the selection of Grant Thornton LLP before the stockholders because the Board believes that seeking stockholder ratification of the selection of the independent registered public accounting firm is good corporate practice. If the appointment of Grant Thornton LLP is not ratified, the Audit Committee will first review the basis for the stockholder vote and SeaChange's relationship with Grant Thornton LLP and will then take such action as it deems necessary.

**The Board of Directors unanimously recommends a vote "FOR" ratification of the appointment of SeaChange's independent registered public accounting firm.**

### **Principal Accountant Fees and Services**

#### *Fees for Services Provided by PricewaterhouseCoopers LLP and Grant Thornton LLP*

The following table sets forth the aggregate fees for services provided by PricewaterhouseCoopers LLP and Grant Thornton LLP, SeaChange's independent registered public accounting firms for the fiscal years ended January 31, 2007 and January 31, 2006. All fees for fiscal 2006 were billed by PricewaterhouseCoopers LLP. Both PricewaterhouseCoopers LLP and Grant Thornton LLP billed fees for services during fiscal 2007.

	<u>2007(1)</u>	<u>2006(2)</u>
Audit Fees .....	\$1,307,636	\$1,287,857
Audit-Related Fees.....	0	0
Tax Fees .....	262,563	431,700
All Other Fees .....	0	0
Total: .....	<u>1,570,199</u>	<u>1,719,557</u>

- (1) Includes (a) fees billed and estimated to be billed by Grant Thornton LLP in 2007 as follows: audit fees of \$990,405; audit-related fees of \$0; tax fees of \$15,987; and other fees of \$0; and (b) fees billed by PricewaterhouseCoopers LLP as follows: audit fees of \$317,231; audit-related fees of \$0; tax fees of \$246,576; and other fees of \$0.
- (2) Consists solely of fees billed by PricewaterhouseCoopers LLP.



### *Audit Fees*

These are aggregate fees billed for professional services rendered by PricewaterhouseCoopers LLP and by Grant Thornton for the fiscal years ended January 31, 2007 and January 31, 2006, for (a) the annual audit of SeaChange's financial statements for each such fiscal year including statutory audits of foreign subsidiaries and the accompanying attestation report regarding SeaChange's internal control over financial reporting contained in SeaChange's annual report on Form 10-K, (b) reviews of the quarterly financial information included in SeaChange's Quarterly Reports on Form 10-Q for each such fiscal year and (c) reviews of SEC filings.

### *Tax Fees*

These are fees billed for professional services for tax compliance, tax advice and tax planning for the fiscal years ended January 31, 2007 and January 31, 2006. The Tax Fees for each of the foregoing fiscal years related to tax planning and compliance services, including the preparation of original and amended tax returns and claims for refunds.

The Audit Committee of the Board of Directors has determined that the provision of the services as set out above is compatible with maintaining Grant Thornton LLP's independence.

### *Audit Committee Pre-Approval Policy*

The Audit Committee's policy is to pre-approve all audit, audit-related, tax and other non-audit services that may be provided by Grant Thornton LLP, the independent registered public accounting firm. The policy identifies the principles that must be considered by the Audit Committee in approving these services to ensure that Grant Thornton LLP's independence is not impaired; describes the audit and audit-related, tax and other services that may be provided; and sets forth pre-approval requirements for all permitted services. To date, Audit Committee pre-approval has been sought for the provision of all services by Grant Thornton LLP.

## **OTHER MATTERS**

### **Expenses and Solicitation**

All costs of solicitation of proxies will be borne by SeaChange. In addition to solicitations by mail, certain of SeaChange's directors, officers and regular employees, without additional remuneration, may solicit proxies by telephone, facsimile, e-mail and personal interviews. Brokers, custodians and fiduciaries will be requested to forward proxy soliciting material to the owners of stock held in their names, and SeaChange will reimburse them for their reasonable out-of-pocket costs. SeaChange has retained Morrow & Co., Inc., New York, New York to assist in the solicitation of proxies at a cost estimated not to exceed \$15,000.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act, requires SeaChange's directors, executive officers and holders of more than 10% of SeaChange's common stock (collectively, "Reporting Persons") to file with the SEC initial reports of ownership and reports of changes in ownership of common stock of SeaChange. Such persons are required by regulations of the SEC to furnish SeaChange

with copies of all such filings. Based on its review of the copies of such filings received by it with respect to the fiscal year ended January 31, 2007 and written representations from certain Reporting Persons, SeaChange believes that all Reporting Persons complied with all Section 16(a) filing requirements in the fiscal year ended January 31, 2007.

### **Certain Relationships and Related Transactions**

SeaChange has adopted a written policy pursuant to the Amended and Restated Charter of the Audit Committee and the Charter of the Corporate Governance and Nominating Committee that all transactions between SeaChange and its officers, directors, principal stockholders and affiliates will be approved by a majority of the Board of Directors, including a majority of the independent and disinterested outside directors on the Board of Directors, and will be on terms no less favorable to SeaChange than could be obtained from unaffiliated third parties.

On September 23, 2005, SeaChange entered into an Agreement for the Sale and Purchase of Share Capital of ODG (the “Share Purchase Agreement”) by and among SeaChange, Anthony William Kelly, Andrew Thomas Birchall, Judith Kelly and Michael Kelly (collectively, the “ODG Stockholders”) providing for the purchase by SeaChange of the remaining 72.4% of the outstanding capital stock of On Demand Group Limited, a corporation incorporated under the laws of the United Kingdom (“ODG”), not then owned by SeaChange. Prior to that date, SeaChange had previously purchased a 27.6% interest in ODG for an aggregate of \$3,100,000. At the closing of the Share Purchase Agreement, SeaChange paid the ODG Stockholders approximately \$13,400,000 in cash, with Mr. Birchall receiving \$6,700,000 and Mr. Kelly and his immediate family receiving \$6,700,000. Mr. Kelly and Mr. Birchall became executive officers of SeaChange following the closing of the Share Purchase Agreement. The Share Purchase Agreement also provides for additional payments to be made to the ODG Stockholders based on their prior holdings of ODG capital stock both if ODG meets certain annual performance goals through the period ending January 31, 2008 and if ODG sells its interest in Filmflex. On May 10, 2006, SeaChange paid to the ODG Stockholders an aggregate of \$2,800,000 in cash pursuant to the terms of the Share Purchase Agreement and based on the performance of ODG through January 31, 2006, with Mr. Birchall receiving \$1,400,000 and Mr. Kelly and his immediate family receiving \$1,400,000.

On June 30, 2006, SeaChange and the ODG Stockholders entered into an amendment to the Share Purchase Agreement that accelerated the second earnout payment of \$2,286,416 otherwise payable in cash within seventy-five business days of January 31, 2007 under the Share Purchase Agreement. The amendment provided that the second earnout payment be satisfied as of June 30, 2006 by the issuance to the sellers of shares of SeaChange’s common stock having a fair market value of \$2,286,416 as of the date of the amendment, resulting in the issuance of an aggregate of 341,360 shares of SeaChange’s common stock. SeaChange entered into this amendment to support ODG’s long-term operational focus and to enable SeaChange to reduce its future cash expenditures. The amounts received by Mr. Kelly and Mr. Birchall pursuant to the Share Purchase Agreement and the amendment thereto are not considered compensation and thus are not included in the Summary Compensation Table.

SEACHANGE INTERNATIONAL, INC.

**AMENDED AND RESTATED**  
**2005 EQUITY COMPENSATION AND INCENTIVE PLAN**

1. Purpose and Eligibility.

The purpose of this **Amended and Restated** 2005 Equity Compensation and Incentive Plan (the “Plan”) of SeaChange International, Inc. is to provide equity ownership opportunities in the Company (each an “Award”) to employees, officers, directors, consultants and advisors of the Company and its Subsidiaries, all of whom are eligible to receive Awards under the Plan. Any person to whom an Award has been granted under the Plan is called a “Participant”. Additional definitions are contained in Section 10.

2. Administration.

a. Administration by Committee of Independent Members of the Board of Directors.

The Plan will be administered by a committee (the “Committee”) composed solely of members of the Board of Directors of the Company that are “independent”, as defined pursuant to Rule 10A-3(b)(1) of the Securities Exchange Act of 1934, as amended; *provided, however*, that at any time and on any one or more occasions the Board may itself exercise any of the powers and responsibilities assigned the Committee under the Plan and when so acting shall have the benefit of all of the provisions of the Plan pertaining to the Committee’s exercise of its authorities hereunder. The Committee, in its sole discretion, shall have the authority to grant and amend Awards, to adopt, amend and repeal rules relating to the Plan and to interpret and correct the provisions of the Plan and any Award. All decisions by the Committee shall be final and binding on all interested persons. Neither the Company nor any member of the Committee shall be liable for any action or determination relating to the Plan.

b. Delegation to Executive Officers. To the extent permitted by applicable law, the Committee may delegate to one or more executive officers of the Company the power to grant Awards and exercise such other powers under the Plan as the Committee may determine; *provided, however*, that the Committee shall fix the maximum number of Awards to be granted and the maximum number of shares issuable to any one Participant pursuant to Awards granted by such executive officer or officers. The Committee may, by a resolution adopted by the Committee, authorize one or more officers of the Company to do one or both of the following: (i) designate employees of the Company or of any of its subsidiaries to be recipients of Awards created by the Company and (ii) determine the number of such Awards to be received by such employees; *provided, however*, that the resolution so authorizing such officer or officers shall specify the maximum number of Awards such officer or officers may so award. The Committee may not authorize an officer to designate himself or herself as a recipient of any such Awards and the Committee may not authorize an officer to grant Awards to other executive officers of the Company.

### 3. Stock Available for Awards.

a. Number of Shares. Subject to adjustment under Section 3(c), the aggregate number of shares (the “Authorized Shares”) of the Company’s common stock, \$0.01 par value per share (the “Common Stock”) that may be issued pursuant to the Plan shall be ~~1,500,000~~**2,800,000** shares of Common Stock; *provided, however*, that no more than ~~375,000~~**1,675,000** of the Authorized Shares may be issued to Participants pursuant to Restricted Stock Awards, Restricted Stock Units or Awards issued pursuant to Section 7 hereof. If any Award expires, or is terminated, surrendered or forfeited, in whole or in part, the unissued Common Stock covered by such Award shall again be available for the grant of Awards under the Plan; **provided, however, that (i) shares of Common Stock tendered in payment of an Option shall not be added to the aggregate plan limit described above; (ii) shares of Common Stock withheld by the Company to satisfy any tax withholding obligation shall not be added to the aggregate plan limit described above; and (iii) shares of Common Stock that are repurchased by the Company with Option proceeds shall not be added to the aggregate plan limit described above.** Shares issued under the Plan may consist in whole or in part of authorized but unissued shares or treasury shares.

b. Per-Participant Limit. Subject to adjustment under Section 3(c), no Participant may be granted Awards during any one fiscal year to purchase more than 120,000 shares of Common Stock, other than Awards granted in connection with a Person assuming status as a Participant.

c. Adjustment to Common Stock. In the event of any stock split, stock dividend, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, combination, exchange of shares, liquidation, spin-off, split-up, or other similar change in capitalization or event, (i) the number and class of securities available for Awards under the Plan and the per-Participant share limit, (ii) the number and class of securities, vesting schedule and exercise price per share subject to each outstanding Option (as defined below), (iii) the repurchase price per security subject to repurchase, and (iv) the terms of each other outstanding stock-based Award shall be adjusted by the Company (or substituted Awards may be made) to the extent the Committee shall determine, in good faith, that such an adjustment (or substitution) is appropriate. If Section 8(e)(i) applies for any event, this Section 3(c) shall not be applicable.

d. Fractional Shares. No fractional shares shall be issued under the Plan and the Participant shall receive from the Company cash in lieu of such fractional shares.

### 4. Stock Options.

a. General. The Committee may grant options to purchase Common Stock (each, an “Option”) and determine the number of shares of Common Stock to be covered by each Option, the exercise price of each Option and the conditions and limitations applicable to the exercise of each Option and the Common Stock issued upon the exercise of each Option, including vesting provisions, repurchase provisions and restrictions relating to applicable federal or state securities laws, as it considers advisable.

b. Incentive Stock Options. An Option that the Committee intends to be an “incentive stock option” as defined in Section 422 of the Code (an “Incentive Stock Option”) shall be granted only to employees of the Company and shall be subject to and shall be construed consistently with the requirements of Section 422 of the Code. The Committee and the Company shall have no liability if an Option or any part thereof that is intended to be an Incentive Stock Option does not qualify as such. An Option or any part thereof that does not qualify as an Incentive Stock Option is referred to herein as a “Nonstatutory Stock Option.”

c. Dollar Limitation. For so long as the Code shall so provide, Options granted to any employee under the Plan (and any other plans of the Company) which are intended to constitute Incentive Stock Options shall not constitute Incentive Stock Options to the extent that such Options, in the aggregate, become exercisable for the first time in any one calendar year for shares of Common Stock with an aggregate Fair Market Value (as defined below) of more than \$100,000 (determined as of the respective date or dates of grant). To the extent that any such Incentive Stock Options exceed the \$100,000 limitation, such Options shall be Nonstatutory Stock Options.

d. Exercise Price. The Committee shall establish the exercise price (or determine the method by which the exercise price shall be determined) at the time each Option is granted and specify the exercise price in the applicable option agreement, *provided*, that the exercise price per share specified in the agreement relating to each Option granted under the Plan shall not be less than the Fair Market Value per share of Common Stock on the date of such grant. In the case of an Incentive Stock Option to be granted to an employee owning stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company, the price per share specified in the agreement relating to such Incentive Stock Option shall not be less than one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the date of grant. For purposes of determining stock ownership under this subsection, the rules of Section 424(d) of the Code shall apply. Subject to Section 3(c), an Option may not be amended subsequent to its issuance to reduce the price at which it is exercisable unless such amendment is approved by the Company’s stockholders.

e. Duration of Options. Each Option shall be exercisable at such times and subject to such terms and conditions as the Committee may specify in the applicable option agreement; *provided*, that no Option shall be exercisable for a period of time greater than seven (7) years from the date of grant of such Option; *provided, further*, that Incentive Stock Options granted to an employee owning stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company shall be exercisable for a maximum of five (5) years from the date of grant of such option. For purposes of determining stock ownership under this subsection, the rules of Section 424(d) of the Code shall apply.

f. Vesting of Options. Subject to Section 8(e) and Section 8(i), no more than one-third of the shares of Common Stock covered by an Option may vest in any twelve (12) month period; *provided, however*, that the vesting of an Option granted in connection with a person assuming status as a Participant and the vesting of an Option upon a Participant’s disability, death, cessation of status as a Participant and other similar circumstances may be other than as specified in this Section 4(f) and will be provided in the agreement evidencing the Option.

g. Exercise of Option. Options may be exercised only by delivery to the Company at its principal office address or to such transfer agent as the Company shall designate of a written notice of exercise specifying the number of shares as to which such Option is being exercised, signed by the proper person, or by notification of the Company-designated third party commercial provider (the “Third Party Commercial Provider”), in accordance with the procedures approved by the Company and to which the holder of the Option shall have ongoing access by means of accessing such person’s account maintained with the Third Party Commercial Provider, together with payment in full as specified in Section 4(h) for the number of shares for which the Option is exercised.

h. Payment Upon Exercise. Common Stock purchased upon the exercise of an Option shall be paid for by one or any combination of the following forms of payment:

- (i) in United States dollars in cash or by check or by fund transfer from the Option holder’s account maintained with the Third Party Commercial Provider;
- (ii) at the discretion of the Committee, through delivery of shares of Common Stock having a fair market value equal as of the date of the exercise to the cash exercise price of the Option, *provided* that such shares were not acquired by the Participant in the prior six months;
- (iii) at the discretion of the Committee and consistent with applicable law, through the delivery of an assignment to the Company of a sufficient amount of the proceeds from the sale of the Common Stock acquired upon exercise of the Option and an authorization to the broker or selling agent to pay that amount to the Company, which sale shall be at the participant’s direction at the time of exercise;
- (iv) at the discretion of the Committee, by any combination of (i), (ii), or (iii) above.

If the Committee exercises its discretion to permit payment of the exercise price of an Incentive Stock Option by means of the methods set forth in clauses (ii), (iii) or (iv) of the preceding sentence, such discretion shall be exercised in writing at the time of the grant of the Incentive Stock Option in question.

i. Notice to Company of Disqualifying Disposition. By accepting an Incentive Stock Option granted under the Plan, each optionee agrees to notify the Company in writing immediately after such optionee makes a disqualifying disposition of any stock acquired pursuant to the exercise of Incentive Stock Options granted under the Plan. A “disqualifying disposition” is generally any disposition occurring on or before the later of (a) the date two years following the date the Incentive Stock Option was granted or (b) the date one year following the date the Incentive Stock Option was exercised.

j. Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, each Option will terminate immediately prior to the consummation of such proposed action or at such other time and subject to such other conditions as shall be determined by the Committee.

k. Issuances of Securities. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares subject to Options. No adjustments shall be made for dividends paid in cash or in property other than securities of the Company.

## 5. Restricted Stock.

a. Grants. The Committee may grant Awards entitling recipients to acquire shares of Common Stock, subject to (i) delivery to the Company by the Participant of a check in an amount at least equal to the par value of the shares purchased, and (ii) the right of the Company to repurchase all or part of such shares at their issue price or other stated or formula price from the Participant in the event that conditions specified by the Committee in the applicable Award are not satisfied prior to the end of the applicable restriction period or periods established by the Committee for such Award (each, a “Restricted Stock Award”).

b. Terms and Conditions. A Participant that is the holder of a Restricted Stock Award, whether vested or unvested, shall be entitled to enjoy all stockholder rights with respect to the shares of Common Stock underlying such Restricted Stock Award, including the right to receive dividends and vote such shares. Subject to Section 5(c) hereof, the Committee shall determine all other terms and conditions of any such Restricted Stock Award. Any stock certificates issued in respect of a Restricted Stock Award shall be registered in the name of the Participant and, unless otherwise determined by the Committee, deposited by the Participant, together with a stock power endorsed in blank, with the Company (or its designee). After the expiration of the applicable restriction periods, the Company (or such designee) shall deliver the certificates no longer subject to such restrictions to the Participant or, if the Participant has died, to the beneficiary designated by the Participant, in a manner determined by the Committee, to receive amounts due or exercise rights of the Participant in the event of the Participant’s death (the “Designated Beneficiary”). In the absence of an effective designation by a Participant, Designated Beneficiary shall mean the Participant’s estate.

c. Vesting of Restricted Stock. Subject to Section 8(e) and Section 8(i), no more than one-third of the shares covered by a Restricted Stock Award may vest in any twelve (12) month period; *provided, however*, that the vesting of a Restricted Stock Award granted in connection with a person assuming status as a Participant and the vesting of a Restricted Stock Award upon a Participant’s disability, death, cessation of status as a Participant and other similar circumstances may be other than as specified in this Section 5(c) and will be provided in the agreement evidencing the Restricted Stock Award.

6. Restricted Stock Unit.

a. Grants. The Committee may grant Awards entitling recipients to acquire shares of Common Stock in the future, with the future delivery of the Common Stock subject to a risk of forfeiture or other restrictions that will lapse upon the satisfaction of one or more specified conditions (each, a “Restricted Stock Unit”).

b. Terms and Conditions. Subject to Section 6(c) hereof, the Committee shall determine the terms and conditions of any such Restricted Stock Unit. A Participant may not vote the shares represented by a Restricted Stock Unit, but a Restricted Stock Unit may provide a Participant with the right to receive dividend payments or dividend equivalent payments with respect to Common Stock subject to the Award (both before and after such Common Stock is earned or vested), which payments may be either made currently or credited to an account for the Participant, and may be settled in cash or Common Stock, as determined by the Committee. Any such settlements, any such crediting of dividends or dividend equivalents or reinvestment in shares of Common Stock, may be subject to such conditions, restrictions and contingencies as the Committee shall establish, including the reinvestment of such credited amounts in Common Stock equivalents.

c. Vesting of Restricted Stock Unit. Subject to Section 8(e) and Section 8(i), no more than one-third of the shares covered by a Restricted Stock Unit may vest in any twelve (12) month period; *provided, however*, that the vesting of a Restricted Stock Unit granted in connection with a person assuming status as a Participant and the vesting of a Restricted Stock Unit upon a Participant’s disability, death, cessation of status as a Participant and other similar circumstances may be other than as specified in this Section 6(c) and will be provided in the agreement evidencing the Restricted Stock Unit.

7. Other Stock-Based Awards.

The Committee shall have the right to grant other Awards based upon the Common Stock having such terms and conditions as the Committee may determine, including, without limitation, the grant of shares based upon certain conditions, the grant of securities convertible into Common Stock and the grant of stock appreciation rights, phantom stock awards or stock units. No more than one-third of the shares covered by an Award pursuant to this Section 7 may vest in any twelve (12) month period; *provided, however*, that the vesting of an Award pursuant to this Section 7 granted in connection with a person assuming status as a Participant and the vesting of an Award pursuant to this Section 7 upon a Participant’s disability, death, cessation of status as a Participant and other similar circumstances may be other than as specified in this Section 7 and will be provided in the agreement evidencing such Award.

8. General Provisions Applicable to Awards.

a. Transferability of Awards. Except as the Committee may otherwise determine or provide in an Award, Awards shall not be sold, assigned, transferred, pledged or otherwise encumbered by the person to whom they are granted, either voluntarily or by operation of law, except by will or the laws of descent and distribution, and, during the life of the Participant, shall



be exercisable only by the Participant, *provided, however*, that Nonstatutory Stock Options may be transferred pursuant to a qualified domestic relations order (as defined in the Code) or to a grantor-retained annuity trust or a similar estate-planning vehicle in which the trust is bound by all provisions of the Option which are applicable to the Participant. References to a Participant, to the extent relevant in the context, shall include references to authorized transferees.

b. Documentation. Each Award granted under the Plan shall be evidenced by a written Award agreement in such form as the Committee shall from time to time approve. Award agreements shall comply with the terms and conditions of the Plan and may contain such other provisions not inconsistent with the terms and conditions of the Plan as the Committee shall deem advisable. In the case of an Incentive Stock Option, the Award agreement shall contain, or refer to, such provisions relating to exercise and other matters as are required of “incentive stock options” under the Code. Award agreements may be evidenced by an electronic transmission (including an e-mail or reference to a website or other URL) sent to the Participant through the Company’s normal process for communicating electronically with its employees. As a condition to receiving an Award, the Committee may require the proposed Participant to affirmatively accept the Award and agree to the terms and conditions set forth in the Award agreement by physically and/or electronically executing the Award agreement or by otherwise physically and/or electronically acknowledging such acceptance and agreement. With or without such affirmative acceptance, however, the Committee may prescribe conditions (including the exercise or attempted exercise of any benefit conferred by the Award) under which the proposed Participant may be deemed to have accepted the Award and agreed to the terms and conditions set forth in the Award agreement.

c. Committee Discretion. The terms of each type of Award need not be identical, and the Committee need not treat Participants uniformly.

d. Termination of Status. The Committee shall determine the effect on an Award of the disability, death, retirement, authorized leave of absence or other change in the employment or other status of a Participant and the extent to which, and the period during which, the Participant, or the Participant’s legal representative, conservator, guardian or Designated Beneficiary, may exercise rights under the Award, subject to applicable law and the provisions of the Code related to Incentive Stock Options.

e. Acquisition of the Company.

(i) Consequences of an Acquisition. If the Company is to be consolidated with or acquired by another entity in a merger or other reorganization in which the holders of the outstanding voting stock of the Company immediately preceding the consummation of such event, shall, immediately following such event, hold, as a group, less than a majority of the voting securities of the surviving or successor entity, or in the event of a sale of all or substantially all of the Company’s assets or otherwise (each, an “Acquisition”), the Committee or the board of directors of any entity assuming the obligations of the Company hereunder (the “Successor Committee”), shall, as to outstanding Awards, either (i) make appropriate provision for the continuation of such Awards by substituting on an equitable basis for the shares then subject to such Awards either (a) the consideration payable with respect to the outstanding shares

of Common Stock in connection with the Acquisition, (b) shares of stock of the surviving or successor corporation or (c) such other securities as the Successor Committee deems appropriate, the fair market value of which shall not materially exceed the fair market value of the shares of Common Stock subject to such Awards immediately preceding the Acquisition; or (ii) upon written notice to the Participants, provide that all Awards must be exercised, to the extent then exercisable or to be exercisable as a result of the Acquisition, within a specified number of days of the date of such notice, at the end of which period the Awards shall terminate; or (iii) terminate all Awards in exchange for a cash payment equal to the excess of the fair market value of the shares subject to such Awards (to the extent then exercisable or to be exercisable as a result of the Acquisition) over the exercise price thereof.

(ii) Assumption of Awards Upon Certain Events. In connection with a merger or consolidation of an entity with the Company or the acquisition by the Company of property or stock of an entity, the Committee may grant Awards under the Plan in substitution for stock and stock-based awards issued by such entity or an affiliate thereof. The substitute Awards shall be granted on such terms and conditions as the Committee considers appropriate in the circumstances.

f. Withholding. Each Participant shall pay to the Company, or make provisions satisfactory to the Company for payment of, any taxes required by law to be withheld in connection with Awards to such Participant no later than the date of the event creating the tax liability. The Committee may allow Participants to satisfy such tax obligations in whole or in part by transferring shares of Common Stock, including shares retained from the Award creating the tax obligation, valued at their Fair Market Value. The Company may, to the extent permitted by law, deduct any such tax obligations from any payment of any kind otherwise due to a Participant.

g. Amendment of Awards. The Committee may amend, modify or terminate any outstanding Award including, but not limited to, substituting therefor another Award of the same or a different type, changing the date of exercise or realization, modifying the exercise price, and converting an Incentive Stock Option to a Nonstatutory Stock Option; *provided that*, except as otherwise provided in Section 8(e)(i), the Participant's consent to such action shall be required unless the Committee determines that the action, taking into account any related action, would not materially and adversely affect the Participant; *provided, further*, that subject to Section 3(c), an Option may not be amended subsequent to its issuance either to reduce the price at which such previously issued Option is exercisable or to extend the period of time for which such previously-issued Option shall be exercisable unless such amendment is approved by the Company's stockholders.

h. Conditions on Delivery of Stock. The Company will not be obligated to deliver any shares of Common Stock pursuant to the Plan or to remove restrictions from shares previously delivered under the Plan until (i) all conditions of the Award have been met or removed to the satisfaction of the Company, (ii) in the opinion of the Company's counsel, all other legal matters in connection with the issuance and delivery of such shares have been satisfied, including any applicable securities laws and any applicable stock exchange or stock market rules and regulations, (iii) the Participant has executed and delivered to the Company

such representations or agreements as the Company may consider appropriate to satisfy the requirements of any applicable laws, rules or regulations, and (iv) the Participant has paid to the Company, or made provisions satisfactory to the Company for payment of, any taxes required by law to be withheld in connection with the Award.

(i) Acceleration. The Committee may at any time provide that any Options shall become immediately exercisable in full or in part, that any Restricted Stock Awards shall be free of some or all restrictions, or that any other stock-based Awards may become exercisable in full or in part or free of some or all restrictions or conditions, or otherwise realizable in full or in part, as the case may be, despite the fact that the foregoing actions may (i) cause the application of Sections 280G and 4999 of the Code if a change of control of the Company occurs, or (ii) disqualify all or part of the Option as an Incentive Stock Option. In the event of the acceleration of the exercisability of one or more outstanding Options, including pursuant to Section 8(e)(i), the Committee may provide, as a condition of full exercisability of any or all such Options, that the Common Stock or other substituted consideration, including cash, as to which exercisability has been accelerated shall be restricted and subject to forfeiture back to the Company at the option of the Company at the cost thereof upon termination of employment or other relationship, with the timing and other terms of the vesting of such restricted stock or other consideration being equivalent to the timing and other terms of the superseded exercise schedule of the related Option.

#### 9. Foreign Jurisdictions.

To the extent that the Committee determines that the material terms set by the Committee or imposed by the Plan preclude the achievement of the material purposes of the Plan in jurisdictions outside the United States, the Committee will have the authority and discretion to modify those terms and provide for such additional terms and conditions as the Committee determines to be necessary, appropriate or desirable to accommodate differences in local law, policy or custom or to facilitate administration of the Plan. The Committee may adopt or approve sub-plans, appendices or supplements to, or amendments, restatements or alternative versions of, the Plan as it may consider necessary, appropriate or desirable, without thereby affecting the terms of the Plan as in effect for any other purpose. The special terms and any appendices, supplements, amendments, restatements or alternative versions, however, shall not include any provisions that are inconsistent with the terms of the Plan as then in effect, unless the Plan could have been amended to eliminate such inconsistency without further approval by the stockholders. The Committee shall also have the authority and discretion to delegate the foregoing powers to appropriate officers of the Company.

#### 10. Miscellaneous.

##### a. Definitions.

(i) “Company” for purposes of eligibility under the Plan, shall include any present or future subsidiary corporations of SeaChange International, Inc., as defined in Section 424(f) of the Code (a “Subsidiary”), and any present or future parent corporation of SeaChange International, Inc., as defined in Section 424(e) of the Code. For purposes of Awards other than

Incentive Stock Options, the term “Company” shall include any other business venture in which the Company has a direct or indirect significant interest, as determined by the Committee in its sole discretion.

(ii) “Code” means the Internal Revenue Code of 1986, as amended, and any regulations promulgated thereunder.

(iii) “employee” for purposes of eligibility under the Plan (but not for purposes of Section 4(b)) shall include a person to whom an offer of employment has been extended by the Company and who has actually commenced employment with the Company, whether full or part-time status.

(iv) “Fair Market Value” of the Company’s Common Stock on any date means (i) the average (on that date) of the high and low prices of the Common Stock on the principal national securities exchange on which the Common Stock is traded, if the Common Stock is then traded on a national securities exchange; or (ii) the last reported sale price (on that date) of the Common Stock on the NASDAQ National Market, if the Common Stock is not then traded on a national securities exchange; or (iii) the average of the closing bid and asked prices last quoted (on that date) by an established quotation service for over-the-counter securities, if the Common Stock is not reported on the NASDAQ National Market; or (iv) if the Common Stock is not publicly traded, the fair market value of the Common Stock as determined by the Committee after taking into consideration all factors which it deems appropriate, including, without limitation, recent sale and offer prices of the Common Stock in private transactions negotiated at arm’s length); *provided*, that, in all events the Fair Market Value shall represent the Committee’s good faith determination of the fair market value of the Common Stock. The Committee’s determination shall be conclusive as to the Fair Market Value of the Common Stock.

b. No Right To Employment or Other Status. No person shall have any claim or right to be granted an Award, and the grant of an Award shall not be construed as giving a Participant the right to continued employment or any other relationship with the Company. The Company expressly reserves the right at any time to dismiss or otherwise terminate its relationship with a Participant free from any liability or claim under the Plan.

c. No Rights As Stockholder. Subject to the provisions of the applicable Award, no Participant or Designated Beneficiary shall have any rights as a stockholder with respect to any shares of Common Stock to be distributed with respect to an Award until becoming the record holder thereof.

d. Effective Date and Term of Plan. The Plan shall become effective on the date on which it is approved by the stockholders of the Company (the “Effective Date”). No Awards shall be granted under the Plan after the completion of ten years from the Effective Date, but Awards previously granted may extend beyond that date.

e. Amendment of Plan. The Committee may amend this Plan at any time, provided that any material amendment to the Plan will not be effective unless approved by the Company’s stockholders. For this purpose, a material amendment is any amendment that would (i) other than

pursuant to Section 3(c), materially increase either the number of shares of Common Stock available under the Plan; the maximum number of shares of Common Stock that may be granted as Restricted Stock, Restricted Stock Units or pursuant to Section 7; or the maximum number of shares of Common Stock issuable in one fiscal year to a Participant; (ii) expand the class of persons eligible to receive awards or otherwise participate in the Plan; (iii) subject to Section 3(c), reduce the price at which a previously-issued Option is exercisable or to extend the period of time for which a previously-issued Option shall be exercisable; (iv) subject to Section 8(e) and Section 8(i), amend the minimum vesting provisions of Awards contained in Sections 4(f), 5(c), 6(c) or 7 of the Plan; or (v) require stockholder approval pursuant to the requirements of Nasdaq or any exchange on which the Company is then listed or applicable law.

f. Governing Law. The provisions of the Plan and all Awards made hereunder shall be governed by and interpreted in accordance with the laws of the Commonwealth of Massachusetts, exclusive of reference to rules and principles of conflicts of law.

Adopted by the Board of Directors on  
May ~~25, 2005~~ 22, 2007

Approved by the stockholders on July  
~~13, 2005~~ 18, 2007

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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-K

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

For the fiscal year ended January 31, 2007

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

Commission File Number: 0-21393

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## SEACHANGE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

**Common Stock, \$.01 par value**

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

**None**

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act);

Large accelerated filer ☐ Accelerated Filer ☒ Non Accelerated Filer ☐

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

As of July 31, 2006, the aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the closing price for the registrant's Common Stock on the Nasdaq National Market on such date was \$168,180,378.42. The number of shares of the registrant's Common Stock outstanding as of the close of business on April 12, 2007 was 29,391,613.

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the definitive Proxy Statement (which is expected to be filed within 120 days after the Company's fiscal year end) relating to the registrant's Annual Meeting of Stockholders to be held on or about July 18, 2007 to be filed pursuant to Regulation 14A are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## PART I

This Annual Report on Form 10-K includes certain statements of a forward-looking nature which reflect the Company's current views relating to future events, estimates or the future financial performance of the Company. These forward-looking statements are only predictions and are subject to risks and uncertainties, particularly the matters set forth in ITEM 1A "Risk Factors" below, which could cause actual events or results to differ materially from historical results or those indicated by such forward-looking statements.

### ITEM 1. Business

SeaChange International, Inc. ("SeaChange", "we" or "us"), a Delaware corporation founded on July 9, 1993, is a leading developer, manufacturer and marketer of digital video systems and services. These products and services facilitate the management, aggregation, licensing, storage, and distribution of video, television programming, gaming and advertising content. We sell our products and services worldwide to cable system operators, including Cablevision, Comcast, Cox Communications, Virgin Media, Time Warner Cable and India Online Broadband; telecommunications companies, including Nippon Telephone & Telegraph (NTT), Manitoba Telecom and Verizon Communications; and broadcast television companies, including ABC Disney, CNBC UK, Ascent Media, Clear Channel, and China Central Television.

Our digital video systems are designed to enable our customers to reduce subscriber turnover and access new revenue-generating opportunities from subscribers, advertisers and electronic commerce initiatives. Using our products and services, we believe our customers can increase their revenues by offering additional services such as on demand television, which allows, for example, the operator to offer a variety of programming for viewing whenever a subscriber chooses and incorporates the ability for subscribers to pause and rewind live television shows. Our systems also allow our customers to insert advertising, known as spot advertising, into their local and on-demand programming. As on-demand continues to grow, our advertising systems will allow our customers to target advertising segments to specific subscribers in a particular geographic and/or demographic market. In addition, our systems enable broadband system operators to offer other interactive television services that allow subscribers to customize and/or dynamically interact with their television, enhancing their viewing experience.

The primary thrust of our business has been supplying systems to deliver video assets in the evolving "On Demand" television environment. Through acquisitions and partnerships we have expanded our products and services to address the needs of video content owners, broadcasters, and aggregators. We refer to this flow of video assets from the content owner to the subscriber as the "Content Pipeline". Our products and services include middleware that drives set top box applications such as Games on Demand, hardware and software for content management and delivery systems, advertising systems to pay for content, and services that involve the acquisition and distribution of video content. We believe that the expansion of our product line will position SeaChange to support and maintain our existing customer base, take advantage of new customers entering the on-demand marketplace and to be able to enter adjacent markets.

Our core technologies provide a foundation for products and services that can be deployed in next generation systems capable of increased levels of subscriber interactivity. We have received several awards for technological excellence, including an Emmy Award in 2001 for our patented MediaCluster<sup>®</sup> technology and an Emmy Award in 2004 for our video-on-demand system.

Since 2004, we have made a number of strategic acquisitions and investments to expand our portfolio of products and services. These acquisitions and investments position SeaChange to offer customers of our video-on-demand systems a broader set of products and services. We have expanded our product line to cover the complete Content Pipeline including middleware and applications, networking technology and media services.

### Industry Background

#### Cable System Operators and Telecommunications Companies

The number of cable households has been estimated at 74 million in the United States and approximately 350 million worldwide. Over the last several years, cable system operators have spent billions of dollars to upgrade their networks from analog to digital, yielding a significant increase in available bandwidth, channel capacity and two-way capability. We believe this investment by the cable system operators reflects their intent to provide video-on-demand, advertising insertion, Internet access and other value-added services to their customers, that will differentiate cable system operators from competing service providers, including telecommunications companies and satellite delivery systems.



In 2001, cable system operators and telecommunications companies began the deployment of residential video-on-demand capability allowing subscribers to watch video programming at any time with pause, rewind, fast forward and a number of additional interactive capabilities. All of the top ten North American cable system operators have deployed video-on-demand services in one or more major residential markets. The various on-demand applications offered by cable system operators and, increasingly, telecommunications operators include movies-on-demand, subscription video-on-demand, such as Home Box Office (HBO), as well as news, sports, music videos, games on-demand, and time-shifted television.

Cable companies have also begun to market telephony services. In response, telecommunications operators, notably AT&T and Verizon in the U.S., have initiated efforts to provide competitive digital television services. We believe their public statements regarding further network investments and other initiatives signal their strategic intentions to become significant players in video-on-demand and other interactive television services. Elsewhere, international telecommunications companies with high-speed network capacity are actively exploring and launching similar television services.

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

Increased demand for video and audio content over the Internet will also require a substantial increase in storage capacity and bandwidth over time. We believe that cable system operators and telecommunications companies will play an integral role in providing these broadband Internet applications. We also believe that in order to offer high quality video applications over the Internet, cable system operators and telecommunications companies will need more storage and delivery systems capable of complex management and scheduling of video data streams.

### **Broadcast Television Companies**

Both domestically and internationally, broadcast television companies face a number of new challenges to their business. In digital broadcasting, changing ownership trends, new consumer alternatives (e.g., cable television, satellite television, or Internet) and evolving viewership models (e.g., Personal Video Recorders (PVR), cell phones, Personal Digital Assistants (PDA), etc.) are creating a more complex competitive environment for our customers that calls for greater efficiencies and business innovation. We believe broadcast television companies are therefore turning away from their outdated tape-based systems with robotic libraries, which are cumbersome and require high levels of maintenance and manual intervention.

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

### **SeaChange Business Segments**

#### **Broadband**

Our high-bandwidth network, or Broadband, business is the foundation of our company and includes our video-on-demand (VOD) System which digitally manages, stores and distributes digital video. Our video-on-demand system allows cable system operators and telecommunications companies to offer video-on-demand and other interactive television services, including interactive electronic advertising and retrieval of Internet content through the television. Our video-on-demand system can be deployed in either a residential environment or a commercial environment (e.g., hotels, schools, etc.) to deliver a wide variety of video services. Since 2000, we have been selected to supply our video-on-demand system in over 100 domestic and international commercial deployments of video-on-demand systems, including deployments by eight of the top 10 cable system operators in the United States, as well as large cable operators in Asia, Europe and Latin America. As of the end of the third quarter of 2006, there were approximately 30.0 million US homes that received digital cable. Approximately 25.0 million of these homes have access to video-on-demand and some research analysts are forecasting that access to video-on-demand will grow to over 40.0 million digital cable homes by the end of 2008.

Our video-on-demand platform is comprised of hardware in the form of servers that store and deliver video content, and software that manages the video assets, the network and the back-office functions of the service.

In 2006, we began selling Axiom, our video-on-demand software, independent of our VOD hardware and offering subscription services for the software in an effort to increase market share and reduce revenue volatility through more recurring revenues. By porting our software to other third party hardware platforms, we expect to increase our market share

through opportunities at competitive vendors' installations. In July of 2006, we announced our first software subscription service sale to Comcast. Since that time, five additional customers have purchased software subscription services.

Our Broadband business segment also includes our SPOT System<sup>™</sup> for the insertion of advertisements and other short-form video into television network streams. Our advertising insertion products are available for both the traditional analog environment (the way that video signals have been transmitted for the past 60 years), and for the digital environment which provides the cable operator with a significant increase in available bandwidth, channel capacity and two-way capability. Based on currently available industry sources and our internal data, we believe our SPOT System is the leading analog video insertion system in the United States in the multichannel television market for advertisements and other short-form video. Over the last several years, our customers have begun to migrate to digital video ad insertion, and we believe our digital video ad insertion system is establishing a strong market position as well. The SPOT System automates the management and distribution process, which we believe reduces operating costs, provides high accuracy, high video image quality, and permits geographic and demographic specificity of advertisements. While the majority of our customers consist of major cable system operators and telecommunications companies in the United States, we have sold SPOT Systems to support over 55,000 channels throughout the world. Migration from the analog environment to the digital environment (particularly in the U.S.) has slowed demand for analog advertisement systems while accelerating demand for digital advertisement systems. In the future, we believe that our expertise in both the analog and digital advertising insertion market positions us well as the opportunities continue to develop for delivering interactive and targeted advertisements into television streams and into new media formats such as video-on-demand streams, games, and other applications.

Our middleware and application business is focused on producing set-top client middleware software products and end-to-end interactive television applications, and performing system integration and software customization services. Our middleware and applications team is comprised of engineers located in Fort Washington, PA and San Mateo, CA. Our client middleware solutions include the VODlink Platform Suite<sup>™</sup> built for and deployed on common North American cable set top boxes and the TV Navigator platform deployed in Europe. We have also acquired the source code rights to technology developed by Minerva Networks which will allow us to deploy its Multiverse<sup>®</sup> IPTV solutions in the telecom space.

Our middleware products consist of standards-based set top applications, head-end server components, software developer tools and a set of user applications. We have an open middleware architecture that can span both telecom and cable service provider deployments and is able to produce and facilitate a broad offering of applications that realize an end-to-end solution with other technologies. These include advanced asset management systems, DVD-on-Demand, switched broadcast, electronic program guides that include support for video-on-demand, subscription video-on-demand like HBO (SVOD), Personal Video Recording (PVR) and Network Personal Video Recording (nPVR), advertising insertion in video-on-demand, and the GameNow game management system and streaming game technology. SeaChange middleware is currently deployed in over 2 million homes in North America and over 3 million homes in Europe.

In June of 2005, SeaChange made an \$8.2 million investment in preferred stock of Casa Systems, Inc. representing a 19.8% ownership interest. Founded in 2003, Casa is a privately held technology company that has developed next generation broadband networking devices targeted at the growing market opportunity in interactive digital video and IP services over broadband networks. Based on innovative technologies, we believe that Casa's products may increase the efficiency while reducing the capital and operating expense of large scale deployments of video-on-demand, Interactive TV, Digital Video Recording (DVR), Switch Digital Video Broadcast (SDV), Video over Internet (video over IP) and broadband services.

## **Broadcast**

Our Broadcast network business segment includes our Broadcast MediaCluster System<sup>™</sup>, which allows broadcast television companies to directly transmit content, such as commercials and other programming, for broadcast television companies, to their viewers through either single, multichannel or satellite based delivery systems. We believe that our Broadcast MediaCluster System will effectively eliminate the need for analog tape libraries and provide broadcasters with the automated storage and playback features that they require and are seeking. Since 1998, we have installed our Broadcast MediaCluster System at more than 250 customer locations including network affiliates and multichannel operations in Asia, Europe and the Americas. In addition, we provide media companies, including studios, television networks, stations and cable and telecom operators, with the ability to interoperate with other devices (e.g., video editing and production equipment) within their customers' enterprise as part of a client-server architecture with our SeaChange MediaClient system to support the streaming and storage requirements of digital video applications. As media companies take advantage of new video services, including video-on-demand, Internet video streaming, and High-Definition television, we believe that they will derive greater benefit from storing media in a digital format. Our MediaLibrary and MediaClient systems are designed to support the storage, streaming and conversion of digital media files for a variety of video services.

## **Services**

SeaChange has expanded into media content services, consisting of content aggregation and distribution, through the acquisition of On Demand Group Limited (ODG), completed in September of 2005. ODG is a leader in Europe in the development and deployment of interactive media services. ODG specializes in aggregating content for video-on-demand and

network video-on-demand (NVOD) platforms, and has provided services to cable operators in several countries in Europe. ODG owns 33.3 percent of Filmflex Movies Limited (Filmflex), a movie video-on-demand service that supplies movies to the UK cable industry and whose other investors are the Walt Disney Company Limited and Columbia Pictures Corporation Limited. Filmflex supplies content from Warner Brothers, Paramount, Universal, MGM, and Dreamworks, as well as the studio partners that are investors in Filmflex, and the majority of the independent film distributors in the UK. ODG also sources, acquires, packages, markets and accounts for Virgin Media's (the largest cable operator in the U.K.) video-on-demand services in the areas of music, children's, comedy and dramatic content. ODG has developed its own content rights management system and a content preparation center for incorporating video content from all of the major content suppliers around the world.

In Germany, the largest European market, ODG launched its own Pay-per-View service for Kabel Deutschland Germany (KDG) in fiscal 2007. KDG has approximately 9 million subscribers and has just begun to deploy digital services. We expect to transition the Pay-per-View service to a full fledged VOD service as the digital roll-out occurs. In addition, to augment the amount and variety of video content to be made available for KDG's Pay-per-View services and other prospective German service providers, ODG entered into a joint venture in fiscal 2008 with TeleMunchen Gruppe, a German media company whose activities include the production and acquisition of German-speaking feature films, television productions and classical music programs.

In addition to media content services, SeaChange installs, maintains, and supports its hardware and software products in North America, Asia, South America and Europe. We currently provide installation, maintenance and technical support services to all our Broadband and Broadcast segment customers. With the addition of our middleware software products, we are also performing system integration, software customization and other professional services. We offer maintenance and technical support to customers, agents and distributors of our products on a 24-hour, seven-day a week basis, and our systems include at least one year of warranty support. We also offer basic and advanced on-site training for our customers.

Information about our business segments is included in Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 3 of the Consolidated Financial Statements.

### **The SeaChange Solution**

We are a leading developer, manufacturer and marketer of digital video systems and services. Our digital video systems, which include hardware, such as servers, as well as operations and applications software, automate the storage, management and distribution of video content such as movies, broadcast programming, games, advertising and other video content types. We market our products and services to cable system operators, telecommunications companies and broadcast television companies, and are actively exploring the marketing of our products to new customers that are entering the video-on-demand market. Our solutions are based on the following five core areas of functionality:

- Content aggregation, management and distribution;
- Storage and retrieval of video content to and from digital libraries;
- Automated distribution of video streams between digital libraries by means of local and wide-area data networks;
- Delivery of video streams over single and multiple channels; and
- Management of video sales, scheduling, billing and execution of related business transactions and services.

We use these core areas of functionality to provide solutions to a number of commercial markets and are focused on providing solutions to meet the opportunities presented by next-generation systems with increased levels of subscriber interactivity. Our systems are designed to provide a consistent set of features and benefits, including:

- *Viewer Targeting.* Our digital video products enable broadband system operators (telecom and cable television companies) to efficiently target viewers in specific demographic or geographic groups. We believe this allows operators to capitalize on new revenue-generating opportunities from subscribers and advertisers. Using our video-on-demand system, broadband operators are able to offer interactive television services to individual residences or hotel rooms and, with our advertising system, can better target advertising campaigns to consumers.

- *Scalability.* Our products are scalable in both video storage and video stream capacity. Our proprietary technology, including our patented single-copy storage system, the MediaCluster™ system, allows a single copy of content to be streamed through all available outputs without the need for duplication of content or re-routing between servers on the system. Our storage technology and distributed architecture results in a highly scalable system that reduces operational complexity and yields storage and bandwidth efficiencies as the amount of available content and the number of subscribers increase. Our products are scalable to the needs of our customers whether operating in a single channel system concentrated in one specific zone or a system with hundreds of channels serving multiple markets and a large number of users within each market.
- *Interoperability.* Our products have been designed to be compatible with a wide range of hardware systems and software applications used by broadband system operators to deliver their digital video offerings. These include set top boxes from Motorola, Scientific Atlanta, Sony, Pioneer and Pace, a variety of programming guides including TV Guide, Passport and SARA, billing systems, service delivery systems and interactive application control software. Likewise, our broadcast systems interoperate with a range of systems and applications from such companies as Adobe Systems, Apple Computer, Avid Technology, Harris, Sony, Thomson and others.
- *Automation.* Our automated system allows broadband system operators to distribute and manage content without significant human intervention. We believe this automation also allows our customers to minimize operating personnel and equipment requirements resulting in lower ongoing operating costs and opportunities for new services.
- *Reliability.* Through the use of our proprietary MediaCluster technology and application software and low-cost standard computer industry components, our products are designed to be fault resilient, with no single point of failure, providing the high reliability required for television and video-on-demand operations.

## Strategy

Our strategy is to be the leading provider of video solutions to meet the growing demand for on-demand solutions in the television industry. We develop, manufacture and market digital video systems and services that include the management, aggregation, licensing, storage, and distribution of video, television, gaming and advertising content. The key elements of our strategy are to:

- *Develop, Maintain and Extend Long-term Customer Relationships.* We focus our product development, marketing and direct sales efforts on maintaining and extending long-term customer relationships with cable system operators, telecommunications companies and television broadcasters across the world. We have formed important relationships with customers that have grown from advertisement and other short-form video insertion to video-on-demand systems and other interactive television services, storage systems and streaming systems. We believe that the fundamental shift from broadcast to on-demand applications and the growing emphasis on interactive technologies will continue to present opportunities for us to develop, market and support solutions to our existing customers as well as to new additional markets.
- *Offer Integrated Solutions.* Our customers operate complex networks that require the delivery and management of video programming across multiple channels and target zones. We believe that our integrated solutions can provide advantages in cost and implementation for digital video applications while interoperating with existing and emerging third-party equipment and software. To continue to address these needs, we intend to provide and further develop, internally and with our partners, integrated applications and support services for our customers. We believe that providing complete integrated solutions has been a significant factor in our success in the advertising and video-on-demand markets to date.
- *Establish and Maintain Technological Leadership.* We believe our competitive position is dependent in large part on the features and performance of our systems. As a result, we focus our research and development efforts on introducing systems with improved hardware and software capabilities. We have been granted patents for our single-copy storage technology and have other patents pending. We have received several awards for technological excellence, including an Emmy Award in 2001 for our patented MediaCluster storage technology and a second Emmy Award in 2004 for our video-on-demand system. As of January 31, 2007, 44% of our employees were focused on research and product development efforts.

- *Provide Superior Customer Service and Support.* Our products operate in customer environments where continuous operation is critical. As a result, we believe that providing a high level of service and support gives us a competitive advantage and is a differentiating factor in developing and maintaining key customer relationships. Our in-depth industry and application knowledge allows us to better understand the service needs of our customers. As of January 31, 2007, 27% of our employees were dedicated to customer service and support, including project design and implementation, maintenance, installation and training. Customers have access to service personnel via 24-hour, seven-day a week telephone support. In addition, we believe that the acquisitions and investments that have been made by us in media services and in system integration and customization services have positioned us as an integral partner with our customers to ensure optimal performance of their systems.

## **Key Products and Services**

### **SeaChange Video-On-Demand System**

We have developed and are deploying a video-on-demand system to cable television companies and telecommunications companies within the Broadband segment. Our video-on-demand system consists of:

- MediaCluster video storage servers that reside at various points in a broadband network system and are used to play or stream videos as requested;
- Axiom video operations services software to manage and control the system and to support integration with third-party systems and applications;
- Interactive middleware software that enables cable operators outside North America to run multiple services, including high-definition television, video-on-demand, and personal video recorders on multiple platforms;
- SPOT advertising systems hardware and software;
- Real-Time Record System<sup>™</sup>, a time-shifting television application that enables broadcasted programming to be automatically encoded by broadband operators, with complete trick-mode functionality or video cassette recorder-like functionality; and
- Interfaces to digital headend modulators, control systems and subscriber management systems.

Our video-on-demand system allows our customers to offer the following interactive services to their subscribers:

- *Video-on-Demand.* This interactive service allows residential users and commercial users (e.g., hotel guests, academic institutions) to review lists of available movies and/or programming content, order individual movies and/or programs and view them in real-time. Using this service, subscribers gain full control over the video stream.
- *Subscription Video-on-Demand.* This service provides premium channel offerings, such as those offered by HBO, Showtime or Starz, in an on-demand manner, as well as on a scheduled basis. Similar to our video-on-demand service, our subscription video-on-demand service allows subscribers to review lists of available premium channel content, order individual programs and watch them at home with full video recorder control.

In addition, our video-on-demand system is designed to support interactive services that are being developed by broadband system operators including:

- *Networked Digital Video Recording.* This service provides users with interactive control over broadcasted television programming, enabling viewers to watch sports, news, and other program types with full video cassette recorder and personal video recorder-like (e.g., Tivo) control over the video stream. We enable the provision of this service through our servers and software located in broadband local transmission sites known as headends. We believe this service also has the potential to accommodate new advertising techniques, such as ad replacement or limited fast-forward functionality.
- *Targeted and Interactive Advertising.* This service will support interactive advertising, or advertising where the subscriber controls the path and delivery of an advertisement, in a video-on-demand service and in other forms of programming that result in a dedicated communications link between the subscriber's set top box and the video-on-demand system itself. This service will be competitive with those provided by direct marketing and direct mail firms and may allow purchases over the television, such as one might do with a web browser over the Internet.

- *DVD-on-demand.* This interactive service brings DVD functionality to video-on-demand applications and provides a common standard for distributing and presenting video content. Our software tools and applications provide the capability to transform DVDs, including their menus and content chapter and options, to video-on-demand applications, which potentially offers movie studios and a variety of other video content producers the opportunity to leverage the significant DVD market.

### **SeaChange SPOT System**

Our family of SPOT Systems automates the complex process of advertisement and other video insertion across multiple channels and geographic zones for cable system operators and telecommunications companies primarily in the Broadband segment. Through our embedded proprietary software, our SPOT System allows cable system and telecom operators to insert local and regional advertisements and other video streams into a specific time allocated by cable television networks such as CNN, MTV, ESPN, Black Entertainment Television, Discovery Channel and Nickelodeon. The SPOT System is also capable of inserting advertising into digital cable channels and delivering targeted advertising, as well as advertising with interactive links to content on video-on-demand system, as well as to other interactive advertising systems.

The SPOT System is an integrated solution composed of hardware platforms, software applications, data networks and easy to use graphical interfaces. Our SPOT System is designed to be installed at local transmission sites, known as headends, and advertising sales business offices. Our video insertion process consists of six steps:

- *Encoding.* The process begins with our encoding software, which in real time transforms and compresses analog to digital short-and long-form video.
- *Storage.* Our SPOT System organizes, manages and stores these video streams in a disk-based video library capable of storing thousands of advertisements.
- *Scheduling.* Our advertising management software coordinates with the traffic and billing application to determine the designated time slot, channel and geographic zone for each video stream.
- *Distribution.* Our strategic digital video software then copies the video files from the master video library and distributes them over the operator's data network to appropriate headends, where they are stored in video servers for future play.
- *Insertion.* Following a network cue, our video switch module automatically inserts the video stream into the network feed (initiating the analog conversion, if necessary), where they are then seen by television viewers.
- *Verification.* After the video streams run, our proprietary software and hardware verifies the content, accuracy, timing and placement of these video streams to facilitate proper customer billing.

### **SeaChange MediaLibrary System**

The SeaChange MediaLibrary™ is a mass storage system designed for media companies, including studios, television networks, stations and cable and telecommunications (telco) operators. The system utilizes our patented MediaCluster technology and stores any media file, independent of format and compression. This approach separates operators' application decisions from their storage requirements, enabling all the client systems within a television facility, such as SeaChange's MediaClient on-air servers, non-linear editors, archives, and other media tools to share a centralized, fault-resilient online storage resource. The MediaLibrary has been deployed by a number of television operators to date and is sold in both the Broadband and Broadcast segments.

### **SeaChange MediaClient System**

The SeaChange MediaClient is a media device equipped with product-specific video hardware and applications software. The device is designed for use by media companies, including studios, television networks, stations and cable and telecom operators, to interoperate with other devices within their customers' enterprise as part of a client/server architecture. Introduced in 2004, the SeaChange MediaClient typically operates as an adjunct to the SeaChange MediaLibrary to support the streaming and storage requirements of digital video applications and is sold in both the Broadband and Broadcast segments.

We believe that as media companies take advantage of new and various video services, including video-on-demand, Internet video streaming, and High-Definition television, among others, they will derive greater benefit from the storage of media in a digital format. The MediaLibrary and the MediaClient are designed to support the storage, streaming and conversion of digital media files for a variety of video services.

## **SeaChange Broadcast MediaCluster System**

Our Broadcast MediaCluster System is composed of multiple individual video servers arranged in a cluster acting as one system. This system is designed to provide high-quality digital based video storage and playback for use with automation systems in broadcast television stations. Its product is intended to replace on-air tape decks used to store and play back advertising, movies and other programming from video tape cart systems and, in some cases, to replace the cart systems themselves. Our Broadcast MediaCluster System is designed for customers both in larger broadcast television markets, which use station automation systems, and in smaller markets, which use control software included in the system. This product is sold within the Broadcast segment.

As with the video-on-demand system in the Broadband segment, our Broadcast MediaCluster System is designed to simultaneously record, encode, store to a disk and play video content using compression and decompression hardware. This product is designed to seamlessly integrate into television broadcasters' current tape-based operations and meet the high performance requirements of television broadcasters. Our Broadcast MediaCluster System has features that enable the television broadcaster to have end-to-end functionality and reliability, including one feature that enables broadcasters to schedule its programming for a week of television content.

## **Service and Support**

We install, maintain and support our hardware and software products in North America, Europe, Asia and South America. We offer basic and advanced on-site training for customer employees. We currently provide installation, maintenance and technical support to all our customers. We offer maintenance and technical support to customers, agents and distributors of our hardware, software and systems on a 24-hour, seven-day a week basis. Generally, our product sales include at least one year of free maintenance.

SeaChange has expanded into media content services, consisting of content aggregation and distribution, through the acquisition of On Demand Group Limited (ODG), completed in the third quarter of fiscal 2006. ODG is a leader in Europe in the development and deployment of interactive media services. ODG specializes in aggregating content for video-on-demand and network video-on-demand (NVOD) platforms, and has provided services to cable operators in more than 20 countries in Europe. ODG owns 33.3 percent of Filmflex Movies Limited (Filmflex), a movie video-on-demand service that supplies movies to the UK cable industry and whose other investors are the Walt Disney Company Limited and Columbia Pictures Corporation Limited.

## **Customers**

We currently sell our products primarily to cable system operators, broadcast and telecommunications companies.

Our customer base is highly concentrated among a limited number of large customers, primarily due to the fact that the cable, movie, broadcast, and telecommunications industries in the United States are dominated by a limited number of large companies. A significant portion of our revenues in any given fiscal period have been derived from substantial orders placed by these large organizations. In the years ended January 31, 2007, 2006 and 2005 total revenues from our five largest customers represented approximately 64%, 54% and 63%, respectively, of our total revenues. Customers accounting for more than 10% of total revenues consisted of Comcast (37%) and Virgin Media Inc. (formerly NTL Incorporated and Telewest Global, Inc. who merged during fiscal 2007) (16%) in the year ended January 31, 2007; Comcast (25%) in the year ended January 31, 2006; and Comcast (48%) in the year ended January 31, 2005. We expect that we will continue to be dependent upon a limited number of customers for a significant portion of our revenues in future periods. As a result of this customer concentration, our business, financial condition and results of operations could be materially adversely affected by the failure of anticipated orders to materialize and by deferrals or cancellations of orders as a result of changes in customer requirements or new product announcements or introductions. In addition, the concentration of customers may cause variations in revenue, expenses and operating results on a quarterly basis due to seasonality of orders or the timing and relative size of orders received and shipped during a fiscal quarter.

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

## **Selling and Marketing**

We sell and market our products in the United States primarily through a direct sales organization and internationally through direct sales and independent agents and distributors, complemented by a coordinated marketing effort of our product

marketing personnel. Direct sales activities in the United States are conducted from our Massachusetts headquarters and through sales representatives deployed across the country. We also market certain of our products to systems integrators and value-added resellers.

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

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

## **Research and Product Development**

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

Our research and development expenditures totaled approximately \$40.9 million, \$34.4 million and \$29.4 million for the years ended January 31, 2007, 2006, and 2005 respectively. At January 31, 2007, 360 employees were engaged in research and product development. We believe that the experience of our product development personnel is an important factor in our success. We perform our research and product development activities at our headquarters and in offices in Greenville, New Hampshire, Fort Washington, Pennsylvania, San Mateo, California and Shanghai, China.

## **Manufacturing**

Our manufacturing operations are located at facilities in Acton, Massachusetts and in Greenville, New Hampshire. The manufacturing operations in Massachusetts consist primarily of component and subassembly procurement, system integration and final assembly, testing and quality control of the complete systems. Our operations in New Hampshire consist primarily of component and subassembly procurement, video server integration and final assembly, testing and quality control of the video servers. We rely on independent contractors to manufacture components and subassemblies to our specifications. Each of our products undergoes testing and quality inspection at the final assembly stage.

## **Competition**

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

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



## **Proprietary Rights**

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

## **Employees**

As of January 31, 2007, we employed 811 persons, including 360 in research and development, 218 in customer service and support, 82 in selling and marketing, 58 in manufacturing and 93 in finance and administration. We believe that our relations with our employees are good.

## **Geographic Information**

Geographic information is included in Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 3 of the Consolidated Financial Statements.

## **Available Information**

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

Financial and other information about SeaChange, including SeaChange's Code of Ethics and Business Conduct and charters for SeaChange's Audit Committee, Compensation and Option Committee and Corporate Governance and Nominating Committee, is available on our website ([www.schange.com](http://www.schange.com)). We make available free of charge on our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information contained on our web site is not incorporated by reference into this document and should not be considered a part of this Annual Report. Our web site address is included in this document as an inactive textual reference only.

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

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

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

An increasing portion of our revenue in the last year has come from sales and services related to our video-on-demand products. However, the video-on-demand market continues to develop as a commercial market and may not gain broad market acceptance. The potential size of the video-on-demand market and the timing of its development are uncertain. The success of this market requires that broadband system operators, particularly the seven largest domestic cable system

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

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

Our customer base is highly concentrated among a limited number of large customers, and, therefore, a limited number of customers account for a significant percentage of our revenues in any year. In fiscal 2007 our five largest customers accounted for 64% of our revenues. Our five largest customers have accounted for approximately half to three quarters of our revenues in each of the past five years. Our largest customer has represented approximately 37% and 25% of our revenues in fiscal 2007 and fiscal 2006, respectively. We generally do not have written agreements that require customers to purchase fixed minimum quantities of our products. Our sales to specific customers tend to vary significantly from year to year depending upon these customers' budgets for capital expenditures and our new product introductions. We believe that a significant amount of our revenues will continue to be derived from a limited number of large customers in the future. The loss of, or reduced demand for products or related services from, any of our major customers could have a material adverse effect on our business, financial condition and results of operations.

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

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

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

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

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

Digital video-on-demand, advertising, movie and broadcast products are relatively complex and their purchase generally involve a significant commitment of capital, with attendant delays frequently associated with large capital expenditures and implementation procedures within an organization. Moreover, the purchase of these products typically requires coordination and agreement among a potential customer's corporate headquarters and its regional and local operations. For these and other reasons, the sales cycle associated with the purchase of our digital video-on-demand, advertising, movie and broadcast products is typically lengthy and subject to a number of significant risks, including customers' budgetary constraints and internal acceptance reviews, over which we have little or no control. Based upon all of the foregoing, we believe that our quarterly revenues and operating results are likely to vary significantly in the future, that

period-to-period comparisons of our results of operations are not necessarily meaningful and that these comparisons should not be relied upon as indications of future performance.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We currently compete against both computer companies offering video server platforms and more traditional analog video playback systems. In the digital advertisement insertion market, we compete against suppliers of both analog tape-based and digital systems.

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

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

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

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

**Because our business is susceptible to risks associated with international operations, we may not be able to maintain or increase international sales of our products.**

International product and service revenues ranged from 12% to 40% of our total revenues in each of the past five years. Our international operations are expected to continue to account for a significant portion of our business in the future. However, in the future we may be unable to maintain or increase international sales of our products and services. International sales are subject to a variety of risks, including:

- difficulties in establishing and managing international distribution channels;
- difficulties in selling, servicing and supporting overseas products and in translating products into foreign languages;
- the uncertainty of laws and enforcement in certain countries relating to the protection of intellectual property;
- multiple and possibly overlapping tax structures;
- currency and exchange rate fluctuations; and
- economic or political changes in international markets.

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

As discussed in “Management’s Discussion and Analysis” we have made equity investments in other companies, including Filmflex Movies Limited, Casa Systems, Inc., Minerva Networks, Inc. and InSite One, Inc., and we may in the future make additional investments in these and/or other companies. These investments may require additional capital and may not generate the expected rate of return that we believed possible at the time of making the investment. This may adversely affect our financial condition or results of operations. Also, investments in development-stage companies may generate other than temporary declines in fair value of our investment that would result in impairment charges.

**Future acquisitions may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention.**

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

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

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

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

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

**We may not be able to hire and retain highly skilled employees, particularly managerial, engineering, customer service, selling and marketing, finance and manufacturing personnel, which could affect our ability to compete effectively because our business is technology-based and there is a shortage of these employees within the New England area.**

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

#### **ITEM 1B. Unresolved Staff Comments**

None.

## **ITEM 2. Properties**

In February 2006, we moved our corporate headquarters, which is also our principal administrative, selling, marketing, customer service and support and product development facility, to a 120,000 square foot facility in Acton, Massachusetts that was purchased in June 2005. The Acton facility replaces our previously-rented Maynard facility of approximately 105,000 square feet. We had rented the Maynard facility under a lease which expired on February 28, 2006. In addition to our Acton corporate headquarters, we own approximately 24,000 square feet of office and manufacturing space in Greenville, New Hampshire. We also lease two facilities totaling approximately 13,000 square feet in Greenville, New Hampshire that are used for the development and final assembly of our video servers. Additionally, we lease approximately 14,000 square feet of office space in Fort Washington, Pennsylvania, that is primarily used for the development of software products for companies specializing in digital video and interactive television. We also lease small research and development and/or sales and support offices in Shanghai, China, Belleville, Illinois, Reno, Nevada, San Jose, California, San Mateo, California, London, England, Valbonne, France, Singapore, Tokyo, Japan and Mumbai, India.

## **ITEM 3. Legal Proceedings**

### **Litigation**

None.

### **Other Matters**

We enter into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require us to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to our products. From time to time, we also indemnify customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of our products and services or resulting from the acts or omissions of our employees, authorized agents or subcontractors. For example, in a letter dated May 16, 2005 from Cablevision Systems Corp., in a letter dated May 19, 2005 from Time Warner Cable, Inc., and in a letter dated July 22, 2005 from Insight Communications Company, Inc., all SeaChange customers, SeaChange and other suppliers were notified that each party was served on May 3, 2005, April 25, 2005 and April 26, 2005 respectively with a complaint by Acacia Media Technologies, Corp. for allegedly infringing U.S. Patent Nos.: 5,132,992; 5,253,275; 5,550,863; and 6,144,702 by providing broadcast video and video-on-demand services to end user customers. In addition, in a letter dated August 4, 2006 from Cox Communications, Inc., in a letter dated June 29, 2006 from Time Warner Inc. and in a letter dated October 6, 2006 from Comcast Cable Communications, LLC, SeaChange and other suppliers were notified that each party was served on June 13, 2006 with a complaint by USA Video Technology Corporation for allegedly infringing U.S. Patent No. 5,130,792 by providing video-on-demand services to end use customers. These customers have requested our support under our indemnification obligations. We continue to review our potential obligations under indemnification agreements with these customers, in view of the claims made by Acacia and complaint made by USA Video Technology Corporation and the indemnity obligations to these customers from other vendors that also provided equipment and services to these customers.

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

## **ITEM 4. Submission of Matters to a Vote of Securities Holders**

No matters were submitted during the fourth quarter of the fiscal year ended January 31, 2007 to a vote of security holders of the Company through the solicitation of proxies or otherwise.

## PART II

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

Our common stock is traded on the Nasdaq National Market under the symbol "SEAC". The following table sets forth the high and low closing sale prices for the Common Stock for the periods indicated, as reported on the Nasdaq National Market.

	High	Low
Three Month Period Ended:		
April 30, 2005 .....	\$ 17.00	\$ 10.04
July 31, 2005 .....	10.52	6.84
October 31, 2005 .....	7.75	5.07
January 31, 2006 .....	9.22	5.81
April 30, 2006 .....	9.83	6.73
July 31, 2006 .....	7.16	6.03
October 31, 2006 .....	9.15	6.45
January 31, 2007 .....	10.63	8.17

On April 12, 2007, the last reported sale price of our common stock on the Nasdaq national market was \$8.55.

We have not paid any cash dividends on our capital stock since its inception, and do not expect to pay cash dividends on our common stock in the foreseeable future. We currently intend to retain all of our future earnings for use in operations and expansion of the business.

As of April 12, 2007, we had 151 stockholders of record. We believe that the number of beneficial holders of our common stock exceeds 5,000.

### Equity Compensation Plan Information

The following table provides information about the common stock that may be issued upon the exercise of options, warrants and rights under all of SeaChange's existing equity compensation plans as of January 31, 2007, including the 2005 Equity Compensation and Incentive Plan, the Amended and Restated 1995 Stock Option Plan, the 1996 Non-Employee Director Stock Option Plan and the Third Amended and Restated 1996 Employee Stock Purchase Plan.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted- average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders(1) ...	5,936,735(2)	\$ 14.85	778,819(3)
Equity compensation not approved by security holders(4).....	160,134	\$ 14.71	0
Total.....	6,096,869	\$ 14.85(5)	778,819

- (1) Consists of the 2005 Equity Compensation and Incentive Plan, the Amended and Restated 1995 Stock Option Plan, the 1996 Non-Employee Director Stock Option Plan and the Third Amended and Restated 1996 Employee Stock Purchase Plan.
- (2) Excludes the shares to be issued for the period ended May 31, 2007 under the Third Amended and Restated 1996 Employee Stock Purchase Plan, because the number of shares to be issued upon exercise of currently outstanding options thereunder cannot be determined, as it will be determined on May 31, 2007, the last day of the payment period, and will be for a maximum of 1,125 shares per eligible participant.
- (3) As of January 31, 2007, 416,000 shares remained available for issuance under the 2005 Equity Compensation and Incentive Plan and 362,819 shares remained available for grant under the Third Amended and Restated 1996 Employee Stock Purchase Plan. As of January 31, 2007, no shares remained available for issuance under the 1996 Non-Employee Director Stock Option Plan as this plan was terminated by the Board of Directors in May 2002 and no shares remained available for issuance under the Amended and Restated 1995 Stock Option Plan as the plan was terminated following the adoption of the 2005 Equity Compensation and Incentive Plan on July 13, 2005.
- (4) Pursuant to the Video-on-Demand Purchase Agreement, dated as of December 1, 2000, by and between SeaChange and Comcast Cable Communications of Pennsylvania, Inc., Comcast has been issued warrants exercisable for 450,000



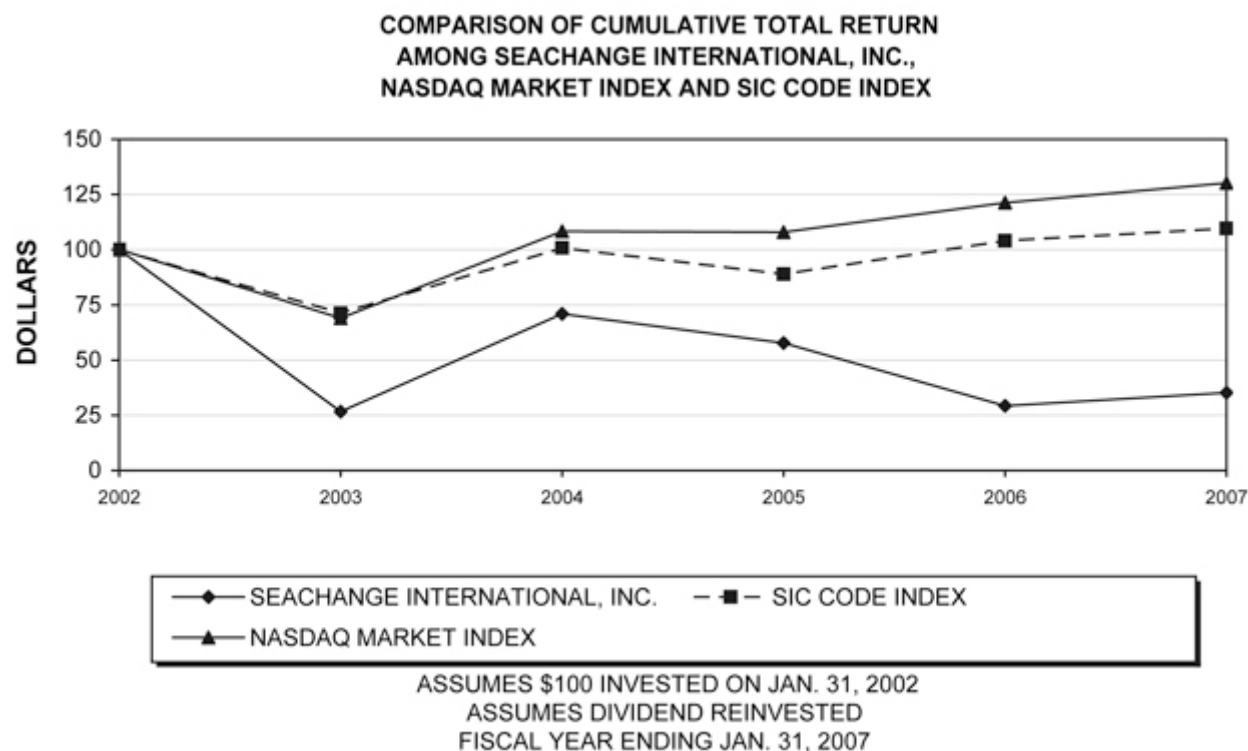
shares of common stock. As disclosed in SeaChange's Current Report on Form 8-K filed October 6, 2004, Comcast exercised certain of these warrants and there remains outstanding today one warrant exercisable for 160,134 shares of common stock with a per share exercise price of \$14.71 and which is nonforfeitable and freely exercisable.

- (5) Excludes the weighted average exercise price for shares to be issued under the Third Amended and Restated 1996 Employee Stock Purchase Plan, as amended, because the weighted average exercise price of currently outstanding options thereunder cannot be determined, as it will be equal to 85% of the lower of the average market price of the common stock on December 1, 2006 and May 31, 2007, the first and last business day of the applicable payment period.

## STOCK PERFORMANCE GRAPH

The following graph compares the change in the cumulative total stockholder return on SeaChange's common stock during the period from the close of trading on January 31, 2002 through January 31, 2007, with the cumulative total return on the Center for Research in Securities Prices ("CRSP") Index for the Nasdaq Stock Market (U.S. Companies) and a SIC Code Index based on the SeaChange's SIC Code. The comparison assumes \$100 was invested on January 31, 2002 in SeaChange's common stock at the \$28.45 closing price on that date and in each of the foregoing indices and assumes reinvestment of dividends, if any.

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



Notes:

- A. The lines represent monthly index levels derived from compounded daily returns that include all dividends.
- B. If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.
- C. The Index level for all series was set to 100.0 on January 31, 2002.

## ITEM 6. Selected Financial Data

The following consolidated selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this annual report. The consolidated statement of operations data for each of the years ended January 31, 2007, 2006, 2005, 2004 and 2003 and the consolidated balance sheet data at January 31, 2007, 2006, 2005, 2004 and 2003 are detailed below. The results of operations for the fiscal year ended January 31, 2003 includes an \$11.1 million

charge related to the unfavorable jury verdict in connection with a patent infringement claim and income tax expense of \$7.9 million primarily related to a valuation allowance against net deferred tax assets. An explanation of the determination of the number of shares used in computing net income (loss) per share for the most recent three years is given in the notes to the consolidated financial statements.

	Year ended January 31,				
	2007	2006	2005	2004	2003
	(in thousands except per share data)				
Consolidated Statement of Operations Data:					
Revenues: .....					
Product (hardware, software and systems) .....	\$ 95,000	\$ 73,516	\$ 113,764	\$ 112,227	\$ 103,282
Services .....	66,334	52,748	43,539	35,939	32,344
	161,334	126,264	157,303	148,166	135,626
Costs of revenues: .....					
Product (hardware, software and systems) .....	48,316	45,858	60,141	64,927	61,599
Services .....	37,169	28,275	25,705	22,647	23,100
	85,485	74,133	85,846	87,574	84,699
Gross profit.....	75,849	52,131	71,457	60,592	50,927
Operating expenses: .....					
Research and development .....	40,914	34,378	29,424	26,030	26,097
Selling and marketing.....	22,413	18,646	18,053	16,653	15,704
General and administrative .....	19,141	14,241	10,323	9,138	21,559
Amortization of intangibles .....	5,664	2,201	1,333	1,599	1,513
	88,132	69,466	59,133	53,420	64,873
(Loss) income from operations .....	(12,283)	(17,335)	12,324	7,172	(13,946)
Interest income, net.....	1,355	2,038	962	1,734	1,447
Impairment on investment in affiliate.....	(150)	—	—	(313)	—
(Loss) income before income taxes and equity income					
(loss) in earnings of affiliates.....	(11,078)	(15,297)	13,286	8,593	(12,499)
Income tax benefit (expense).....	1,632	2,941	(3,200)	(3,169)	(7,925)
Equity income (loss) in earnings of affiliate, net of tax.....	1,272	39	(148)	137	(6)
Net (loss) income.....	\$ (8,174)	\$ (12,317)	\$ 9,938	\$ 5,561	\$ (20,430)
Earnings (loss) per share:					
Basic.....	\$ (0.28)	\$ (0.44)	\$ 0.36	\$ 0.21	\$ (0.77)
Diluted.....	\$ (0.28)	\$ (0.44)	\$ 0.34	\$ 0.20	\$ (0.77)
Consolidated Balance Sheet Data (as of January 31):					
Working capital.....	\$ 58,559	\$ 45,812	\$ 126,568	\$ 99,164	\$ 85,411
Total assets.....	199,296	210,021	212,305	182,256	171,039
Deferred revenue.....	21,806	20,045	21,342	16,437	11,624
Long-term liabilities.....	1,121	1,353	—	209	744
Total liabilities .....	42,137	56,224	47,300	36,369	34,359
Total stockholders' equity.....	157,160	153,797	165,005	145,887	136,680

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

You should read the following discussion and analysis together with our consolidated financial statements, related notes and other financial information appearing elsewhere in this Annual Report. In addition to historical information, the following discussion and other parts of this Annual Report contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to competitive factors and other factors discussed at ITEM 1A. "Risk Factors" and elsewhere in this Annual Report.

### **Overview**

We are a leading developer, manufacturer and marketer of digital video systems and services including the management, aggregation, licensing, storage, and distribution of video, television, gaming and advertisement content to cable system operators, telecommunications companies and broadcast television companies.

We have three reportable segments: Broadband, Broadcast and Services. The Broadband segment includes hardware, software and systems, such as our digital advertising and video-on-demand products that digitally manage, store and distribute digital video for cable system operators and telecommunications companies. The Broadcast segment includes products for the storage, archival, on-air playback of advertising and other video programming for the broadcast television industry. Our hardware, software and systems ("product") revenues are comprised of sales originating from our Broadband and Broadcast segments. The Services segment is comprised of revenue related to professional services, media content services, installation, training, project management, product maintenance and technical support for the above products.

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

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

Factors that may impact the shipment of customer orders include:

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

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

Our operating results are significantly influenced by a number of factors, including the mix of products sold and services provided, pricing, costs of materials used in our products and the expansion of our operations during the fiscal year. We price our products and services based upon our costs and consideration of the prices of competitive products and services in the marketplace. The costs of our products primarily consist of the costs of components and subassemblies that have generally declined from product introduction to product maturity. As a result of the growth of our business, our operating expenses have historically increased in the areas of research and development, selling and marketing, customer service and support and administration. In the current state of the economy, we currently expect that our Broadband and Broadcast customers may still have limited capital spending budgets as we believe they are dependent on advertising revenues to fund their capital equipment purchases. Accordingly, we expect our financial results to vary from quarter to quarter, and our historical financial results are not necessarily indicative of future performance. In light of the higher proportion of our international business due, in part, to our acquisitions of the European-based businesses from Liberate Technologies and ODG in fiscal 2006, we expect movements in foreign currency exchange rates to have a greater impact on our operating results and the equity section of our balance sheet in the future.

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

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

Effective February 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") using the modified prospective transition method. In accordance with that transition method, we have not restated prior periods for the effect of compensation expense calculated under SFAS 123R. We have continued to use the Black-Scholes pricing model as the most appropriate method for determining the estimated fair value of all applicable awards. Compensation expense for all share-based equity awards is being recognized on a straight-line basis over the vesting period of the award. During fiscal 2007, total share-based compensation was \$3.5 million, compared to \$43,000 in fiscal 2006 which only included share-based compensation for restricted stock awards.

On January 26, 2006, the Company accelerated the vesting of certain unvested stock options with exercise prices equal to or greater than \$9.00 per share that were previously awarded to its employees, including its executive officers and non-employee directors, under the Company's equity compensation plans. This decision was the principal reason for the lower stock-based compensation expense recorded in fiscal 2007 compared to the pro forma expense of \$12.7 million and \$9.1 million for the years ended January 31, 2006 and 2005, respectively.

As of January 31, 2007, the unrecognized stock-based compensation related to the unvested stock options was \$1.5 million net of estimated forfeitures. Total unrecognized compensation cost will be adjusted for any future changes in estimated changes in forfeitures. This cost will be recognized over an estimated weighted average amortization period of 1.0 years.

In fiscal 2007, our total revenues increased 28% to \$161.3 million compared to a 20% decrease in fiscal 2006 over fiscal 2005. The increase in revenues is attributable to a 29% increase in product revenues to \$95.0 million in fiscal 2007 as compared to a 35% decrease in fiscal 2006 over fiscal 2005 and a 26% increase in service revenues to \$66.3 million in fiscal 2007 as compared to a 21% increase in fiscal 2006 over fiscal 2005. The product revenue increase in fiscal 2007 was primarily attributable to higher revenues from video-on-demand, with total sales of \$74.4 million recorded in fiscal 2007 as compared to \$49.1 million in fiscal 2006. The product revenue increase in fiscal 2007 was primarily attributable to a \$17.5 million increase in our video-on-demand software development revenues in the Broadband segment associated with the Comcast agreement executed in July 2006 and a full year of revenues from the middleware software contracts acquired from Liberate Technologies in July 2005. In addition, video-on-demand systems revenues increased by \$7.8 million reflecting an increase in demand by North American cable system operators. Our advertising product revenues within the Broadband segment decreased by 31% to \$10.5 million in fiscal 2007 compared to an increase of 16% in fiscal 2006 over fiscal 2005. The decrease in advertising product revenues is due to decreased order activity for customer replacement of analog advertising insertion systems with digital systems. We expect video-on-demand product revenues will increase in fiscal 2008 as compared to fiscal 2007 based upon our customers' continued expansion of these systems and software in key regional domestic markets, the success of certain telephony companies in entering the video-on-demand market, and the continued deployment of video-on-demand systems and software to new customers in Asia, Europe and South America during fiscal 2008.

Our Broadcast product revenues increased by 10% to \$10.1 million in fiscal 2007 compared to a decrease of 33% in fiscal 2006 over fiscal 2005. We expect sales of Broadcast products to increase in fiscal 2008 as compared to fiscal 2007 based on the expected introduction of enhancements to our existing Broadcast products.

Services revenues increased \$13.6 million or 26% in fiscal 2007 compared with a 21% increase in fiscal 2006 over fiscal 2005 primarily due to a full year of ODG's media content services, or \$12.9 million, recognized in fiscal 2007 in comparison to only four months, or \$4.2 million, recognized in fiscal 2006 from the date of SeaChange's acquisition of ODG in September 2005. In addition, \$4.0 million of the increase is attributable to the increase in video-on-demand product maintenance contracts and other technical support services from a growing installed base of VOD systems. We expect Services revenues will increase in fiscal 2008 as compared to fiscal 2007, due to an anticipated increase in the installed base of our video-on-demand systems and increased revenue at ODG tied to the expansion of its business beyond the UK.

Gross profit increased 6 percentage points to 47% in fiscal 2007 from 41% in fiscal 2006 in comparison to a four percentage point increase in fiscal 2006 over fiscal 2005. Increased total revenues and increased revenues from higher margin software development contracts each contributed to the increase in gross profit. Our services gross profit was 44% in fiscal 2007 compared to 46% in fiscal 2006. We believe that competitive pressures will continue and our ability to maintain or improve gross margin will be dependent upon maintaining or increasing current levels of revenues and achieving technological advances that will further reduce material costs of sales. We expect service margins to decrease over the next several quarters due to increased headcount-related costs to service increased installed base of systems, our new products expected to be introduced in fiscal 2008 and additional costs at ODG as it expands its operations beyond the U.K.

Our operating expenses increased \$18.7 million or 27% in fiscal 2007 over fiscal 2006 in comparison to a \$10.3 million or 17% increase in fiscal 2006 over fiscal 2005. This increase is principally attributable to a full year of ODG operating expenses in fiscal year 2007 as compared with four months in fiscal year 2006, the hiring of additional employees to support new middleware product initiatives, a full year of amortization of intangibles for the Liberate and ODG acquisitions from the second and third quarters of fiscal 2006, respectively, and stock compensation expense of \$3.1 million relating to adoption of FAS 123R. We expect operating expenses to continue to increase in fiscal 2008 in support of increased business activity.

Equity income in earnings of affiliates was \$1.3 million in fiscal 2007 in comparison to \$39,000 in fiscal 2006 reflecting \$1.3 million from our investment in Filmflex in fiscal 2007 compared to a loss of approximately \$300,000 in fiscal 2006.

The results of our operations in fiscal 2007 were a net loss of \$8.2 million or \$0.28 per share as compared to net loss of \$12.3 million or \$0.44 per share in fiscal 2006. The primary contributors to our \$9.6 million increase in cash in fiscal year 2007 were net sales and maturities of marketable securities, proceeds from the issuance of common stock relating to stock options and employee stock purchases, partially offset by our net loss adjusted for non-cash depreciation, amortization and stock compensation expense, the cash payment made to C-Cor Incorporated (as successor to nCube Corp.) in settlement of the now resolved patent infringement litigation, capital expenditures, contingent consideration cash payment for fiscal 2006 made to the sellers of ODG and changes in operating assets and liabilities. We believe there are significant uncertainties about our ability to be profitable in fiscal 2008. These uncertainties include the timing and magnitude of orders from new customers located primarily outside the United States and the timing and magnitude of orders from our largest U.S. customer who has represented 37% and 25% of our total revenues in fiscal 2007 and fiscal 2006, respectively. In addition, it is uncertain as to the extent to which our Broadcast product enhancements will be accepted in its targeted markets. There also continues to be pricing pressures from our competitors across all our product lines. Revenues for fiscal year 2008 are also dependent upon the timely introduction and customer acceptance of new products within each of our product families.

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

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

We believe that the accounting policies described below are critical to understanding our business, results of operations and financial condition because they involve significant judgments and estimates used in the preparation of our consolidated financial statements. An accounting policy is deemed to be critical if it requires a judgment or accounting estimate to be made based on assumptions about matters that are highly uncertain, and if different estimates that could have been used, or if changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact our consolidated financial statements. We have discussed the development, selection and application of our critical accounting policies with

the audit committee of our board of directors, and our audit committee has reviewed our disclosure relating to our critical accounting policies in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Other significant accounting policies, primarily those with lower levels of uncertainty than those discussed below, are also critical to understanding our consolidated financial statements. The notes to our consolidated financial statements contain additional information related to our accounting policies and should be read in conjunction with this discussion.

*Principles of Consolidation.* The Company consolidates the financial statements of its wholly owned subsidiaries and all inter-company accounts are properly eliminated in consolidation. SeaChange also holds minority investments in the capital stock of certain private companies having product offerings or customer relationships that have strategic importance. The Company evaluates its equity and debt investments and other contractual relationships with affiliate companies in order to determine whether the guidelines of FASB Interpretation (“FIN”) No. 46, “Consolidation of Variable Interest Entities,” as revised under FIN 46R should be applied in the financial statements. FIN 46R addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. The Company has concluded that it is not the primary beneficiary for any variable interest entities as of January 31, 2007. The Company’s investments in affiliates include investments accounted for under the cost method and the equity method of accounting. The investments that represent less than a 20% ownership interest of the common shares of the affiliate are carried at cost. Under the equity method of accounting, which generally applies to investments that represent 20% to 50% ownership of the common shares of the affiliate, SeaChange’s proportionate ownership share of the earnings or losses of the affiliate are included in equity income (loss) in earnings of affiliates in the consolidated statement of operations.

*Revenue Recognition and Allowance for Doubtful Accounts.* The accounting related to revenue recognition is complex and affected by interpretations of the rules and an understanding of industry practices. As a result, revenue recognition accounting rules require us to make significant judgments. Our judgment is required in assessing the probability of collection, which is generally based on evaluation of customer-specific information, historical collection experience and economic market conditions. Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when title and risk of loss has passed to the customer, there is evidence of an arrangement, fees are fixed or determinable and collection of the related receivable is considered probable. Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities are deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support agreements are recognized ratably over the period of the related agreements. Revenue from software development contracts that include significant modification or customization, including software product enhancements, is recognized based on the percentage of completion contract accounting method using labor efforts expended in relation to estimates of total labor efforts to complete the contract. For contracts, where some level of profit is assured but the Company is only able to estimate ranges of amounts of total contract revenue and total contract cost, the Company uses the lowest probable level of profits in accounting for the contract revenues and costs. Accounting for contract amendments and customer change orders are included in contract accounting when executed. Revenue from shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues. Our share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

Our transactions frequently involve the sales of hardware, software, systems and services in multiple element arrangements. Revenues under multiple element arrangements are recorded based on the residual method of accounting. Under this method, the total arrangement value is allocated first to undelivered elements, based on their fair values, with the remainder being allocated to the delivered elements. The amounts allocated to undelivered elements, which may include project management, training, installation, maintenance and technical support and hardware and software components, are based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation, training and project management revenue is based upon standard hourly billing rates and the estimated time required to complete the service. These services are not essential to the functionality of systems as these services do not alter the equipment’s capabilities, are available from other vendors and the systems are standard products. For multiple element arrangements that include software development with significant modification or customization and systems sales where vendor-specific objective evidence of the fair value does not exist for the undelivered elements of the arrangement (other than maintenance and technical support), percentage of completion accounting is applied for revenue recognition purposes to the entire arrangement with the exception of maintenance and technical support. Where fair value of undelivered service elements has not been established, the total arrangement value is recognized over the period during which the services are performed. For transactions in which consideration, including equity instruments, is given to a customer, SeaChange accounts for the value of this consideration as an adjustment to revenue. We must apply judgment in determining all elements of the arrangement and in determining the fair value for each element.

We recognize revenue for product and services only in those situations where collection from the customer is probable. The Company performs ongoing credit evaluations of customers’ financial condition but generally does not require collateral.

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

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

*Inventories and Reserves for Obsolescence.* Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out (FIFO) method. Inventories consist primarily of components, subassemblies and finished products held for sale. All of our hardware components are purchased from outside vendors. We depend upon certain vendors for the manufacture of significant components for all of our products. If these vendors were to become unwilling or unable to manufacture these products in required volumes, we would have to identify and qualify acceptable alternative vendors. The inability to develop alternative sources, if required in the future, could result in delays or reductions in product shipments and thereby adversely affect our financial condition and results of operations.

Our manufacturing, finance and operations personnel monitor quarterly the inventories to determine that the carrying value is stated at the lower of cost or net realizable value. We record charges to reduce inventory to its net realizable value when an impairment is identified through the quarterly management review process. Obsolete inventory, consisting of on-hand components, subassemblies and finished products, is written down to its estimated net realizable value, if less than cost. The obsolescence evaluation is based upon assumptions and estimates about future demand and possible alternative uses and involves significant judgments. In fiscal 2007 and 2006, we recorded inventory write-downs of \$1,057,000 and \$988,000.

*Investments in Affiliates.* Investments in affiliates include equity investments accounted for under the cost method or the equity method of accounting. For investments that represent less than a 20% ownership interest of the affiliate, the investments are carried at cost. Under the equity method of accounting, which generally applies to investments that represent 20% to 50% ownership of the common stock of the affiliate, our proportionate ownership share of the earnings or losses of the affiliate is recorded as equity income (loss) in earnings of affiliates in our consolidated statement of operations. We are required to exercise judgment in determining whether an investment is more accurately reflected using the cost or equity method.

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

*Accounting for Acquisitions.* We have completed business acquisitions that resulted in goodwill and other intangible asset balances. Our accounting for acquisitions involves judgments and estimates primarily, but not limited to: the estimates of fair values of certain acquired intangible assets which may involve projections of future revenues and cash flows, of acquired tangible acquired assets, of assumed liabilities and contingencies; and the estimated useful lives of acquired long-lived assets; and the accounting for income taxes in purchase accounting. The values we record for goodwill and other intangible assets represent fair values primarily calculated by using a discounted cash flow valuation method. Such valuations depend upon significant estimates and assumptions that are derived from information obtained from the management of the acquired businesses and our business plans for the acquired businesses or intellectual property. These estimates and assumptions used in the initial valuation of goodwill and intangible assets include, but are not limited to:

- future expected cash flows from product sales, customer contracts and acquired developed technologies and patents,

- expected costs to complete any in-process research and development projects and commercialize viable products and estimated cash flows from sales of such products,
- the acquired companies' brand awareness and market position,
- assumptions about the period of time over which we will continue to use the acquired products or services, and
- discount rates.

These estimates and assumptions may be incomplete or inaccurate because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be inaccurate, ongoing reviews of the carrying values of such goodwill and intangible assets, as discussed below, may indicate impairment which will require us to record an impairment charge in the period in which we identify the impairment. Changes in assumptions and estimates related to acquisitions could have a material impact on our financial position or results of operations.

*Valuation of Goodwill and Other Long-Lived Assets.* Other long-lived assets include \$30.7 million of property and equipment, \$13.1 million of intangible assets and \$5.0 million of purchased software for resale as of January 31, 2007. Goodwill, of \$23.7 million as of January 31, 2007, was acquired primarily through the purchases of ODG and Liberate. Whereas, the intangible assets have been subject to amortization since acquisition, the software, which was acquired in fiscal 2005 and fiscal 2006, began amortization in the first half of fiscal 2007. We review goodwill for impairment annually and periodically review both goodwill and intangibles for the existence of facts or circumstances, both internal and external, which may suggest an asset is not recoverable—that is, the carrying amount of the asset exceeds the sum of the undiscounted cash flows expected to result from the asset's use and eventual disposition. Factors we consider important that could trigger the impairment review include:

- significant underperformance relative to historical or projected future operating results;
- significant negative industry or economic trends;
- significant decrease in the market value of the long-lived asset;
- significant adverse change to the extent or manner in which a long-lived asset is being used or in its physical condition;
- significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset;
- significant decline in our stock price for a sustained period;
- significant decline in our technological value as compared to the market; and
- a reduction in our market capitalization relative to net book value.

If such circumstances exist, we evaluate the carrying value of long-lived assets to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and comparing that value to the carrying value of the assets. If the carrying value of the asset is greater than the estimated future undiscounted cash flows, the asset is written down to its estimated fair value. We determine the estimated fair value of the assets on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the current business model. In determining expected future cash flows, assets are grouped at the lowest level for which cash flows are identifiable and independent of cash flows from other asset groups. Our cash flow projections contain management's best estimates, using appropriate and customary assumptions and projections at the time. We believe there is no impairment of goodwill and other long-lived assets as of January 31, 2007.

*Accounting for Income Taxes.* We record income taxes using the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards. We evaluate the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. We will record a valuation allowance if the likelihood of realization of the deferred tax assets in the future is reduced based on an evaluation of objective verifiable evidence. Significant management judgment is required in determining our income tax expense (benefit), our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. We have established a valuation allowance against our deferred tax assets due to indications that they may not be fully realized. The amount of the deferred tax asset considered realizable is subject to change based on future events, including generating sufficient pre-tax income in future periods.

We maintained a full valuation allowance against our U.S. deferred tax assets primarily due to the significant historical pre-tax losses and the significant ongoing uncertainties surrounding the ability of the U.S. entity, SeaChange International, Inc., to generate pre-tax income for fiscal 2008 and thereafter. In addition, SeaChange maintains a valuation allowance for the full amount of certain foreign tax assets. At January 31, 2007, the valuation allowance was \$18.7 million.



In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes*, and SFAS No. 5, *Accounting for Contingencies*, we established reserves for uncertain tax positions that reflect our best estimate of the transactions and deductions that we may be unable to sustain or that we may be willing to concede as part of a broader tax settlement. We are subject to undergoing routine tax examinations by federal, state, and foreign jurisdictions. Tax authorities may challenge certain transactions and deductions we reported on our income tax returns. We do not expect the outcome of these examinations, either individually or in the aggregate, to have a material adverse effect on our financial position, results of operations, or cash flows.

*Accounting for Contingencies.* We are subject to certain claims and litigation, including proceedings under government laws and regulations and commercial disputes relating to our operations, including ordinary routine litigation incidental to our business. We review and determine which liabilities, if any arising from these claims and litigations could have a material adverse effect on our consolidated financial position, liquidity or results of operations. We assess the likelihood of any adverse judgments or outcomes as well as potential ranges of probable losses. Loss contingency liabilities are recorded for these contingencies based on careful analysis of each matter with the assistance of outside counsel when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. In fiscal 2003, we recorded charges of \$11.1 million associated with an unfavorable jury verdict in connection with the litigation with nCube, \$7.5 million of this amount was for accrued settlement costs. Our reserve at January 31, 2006, fully covered the settlement costs including interest accrued through that date. On April 6, 2006 the U.S. District Court granted nCube’s motions for damages, attorneys’ fees, costs and interest of \$8.0 million which was fully paid to C-COR Incorporated on April 20, 2006 as the successor in interest to nCube.

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

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

*Off-Balance Sheet Arrangements.* We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital or incurring debt. Other than our equity investment in Casa Systems and Filmflex (see Note 5 included in the Consolidated Financial Statements and Liquidity and Capital Resources), we do not have any arrangements or relationships with entities that are not consolidated into our financial statements that are reasonably likely to materially affect our liquidity or the availability of our capital resources.

## Fiscal Year Ended January 31, 2007 Compared to the Fiscal Year Ended January 31, 2006

*Product Revenues.* Our product revenues consist of sales of hardware, software and systems from our Broadband and Broadcast segments.

	Year ended January 31,	
	2007	2006
Broadband revenues:		
Video-on-demand revenues.....	74,447,000	49,117,000
Advertising revenues.....	10,458,000	15,248,000
Total Broadband revenues .....	84,905,000	64,365,000
Broadcast revenues: .....	10,095,000	9,151,000
Total Product revenues .....	\$ 95,000,000	\$ 73,516,000

Our total product revenues increased 29% to \$95.0 million in the fiscal year ended January 31, 2007 from \$73.5 million in the fiscal year ended January 31, 2006.

Revenues from the Broadband segment, which accounted for 89% of product revenues in fiscal 2007 and 88% of product revenues in fiscal 2006, increased to \$84.9 million in fiscal 2007 from \$64.4 million in fiscal 2006. Advertising product revenues were \$10.5 million for the fiscal year ended January 31, 2007 as compared to \$15.2 million for the fiscal year ended January 31, 2006. Video-on-demand product revenues increased to \$74.4 million for the fiscal year ended January 31, 2007 as compared to \$49.1 million for the fiscal year ended January 31, 2006. The significant increase in video-on-demand product revenues between years related to a \$17.5 million increase in software development revenue in connection with the VOD Purchase Agreement with Comcast signed during the quarter ended July 31, 2006, and software development revenue derived from the middleware contracts acquired from Liberate Technologies in July 2005. The remaining \$7.8 million increase in video-on-demand product revenues stemmed from increased video-on-demand systems revenue tied to higher demand for our products from North American cable systems operators. The increase in video-on-demand product revenue was partially offset by a decrease in revenues from our Advertising products due to lower order activity related to customer conversion from analog to digital advertising insertion systems.

Broadcast product revenues were \$10.1 million in the fiscal year ended January 31, 2007 compared to \$9.2 million in the fiscal year ended January 31, 2006, representing a 10% increase. The increase in Broadcast revenues is due primarily to a \$3.6 million order from the U.S. government recorded in the second quarter of fiscal 2007 partially offset by lower year over year order activity for the remainder of this operating segment.

We expect future revenue growth, if any, to come principally from our video-on-demand products as telecommunications companies, both in North America and internationally, begin to deploy video-on-demand systems, North American cable companies continue to expand their existing deployments of video-on-demand systems, and we expand our existing product line of video-on-demand products with new hardware and software products and services.

*Services Revenues.* Our services revenues consist of fees for installation, training, project management, product maintenance and technical support, software development, and movie content services. Our services revenues increased 26% to \$66.3 million in the year ended January 31, 2007 from \$52.7 million in the year ended January 31, 2006. The growth in Services revenue is primarily attributable to a full year of ODG's media content services, or \$12.9 million, recognized in fiscal 2007 in comparison to only four months, or \$4.2 million, recognized in fiscal 2006 from the date of SeaChange's acquisition of ODG in September 2005. In addition, \$4.0 million of the increase in Services revenues between years is attributable to the increase in video-on-demand product maintenance contracts and other technical support services from a growing installed base of VOD systems. Revenues from services are expected to continue to grow from our expanding installed base of products and additional service offerings.

For the fiscal year ended January 31, 2007, two customers each accounted for more than 10% and collectively, accounted for 53% of our total revenues, and one customer accounted for more than 25% of our total revenues for the year ended January 31, 2006. Revenues from these customers were primarily in the Broadband segment. We believe that a significant amount of our revenues will continue to be derived from a limited number of customers.

International products and services revenues accounted for approximately 33% and 40% of total revenues in the fiscal years ended January 31, 2007 and 2006, respectively. Customers in the U.S. and United Kingdom each accounted for more than 10% and collectively accounted for 87% and 81% of total revenue in fiscal 2007 and fiscal 2006, respectively. Revenues from European customers increased to \$39.7 million from \$32.9 million in the fiscal years ended January 31, 2007 and January 31, 2006, respectively. The increase in European revenues was primarily attributable to U.K. customers that generated \$32.9 million in revenues in the fiscal year ended January 31, 2007. The increase in revenues from the United Kingdom is primarily due to the service revenues from the video content services provided by ODG for the full fiscal year 2007 in comparison to four months from the acquisition date in fiscal 2006. In addition, the middleware software development revenues included a full year in fiscal 2007 from the contracts acquired from Liberate Technologies in comparison to six months from the acquisition date in fiscal 2006. We expect that international products and services revenues will remain a significant portion of our business in the future. Since substantially all of our product sales are made in United States dollars (USD), we have not experienced, nor do we expect to experience in the near term, any material impact from fluctuations in foreign currency exchange rates on our results of operations. With the acquisition of ODG, which has designated the Great Britain Pound (GBP) as its functional currency, their service sales, primarily payable in GBP, provide a natural hedge for payments in local currency. Thus, we do not expect to experience, nor have we experienced any material impact on our results from fluctuations in foreign currency transactions from ODG operations. However, since the ODG operation is translated to USD for reporting purposes, translation gains and losses, as a result of foreign currency rate fluctuations, are recorded in the equity section of our balance sheet. We continue to expect exposure in fluctuations in the USD/GBP exchange rate in the equity section of our balance sheet in the future.

*Product Gross Profit.* Costs of product revenues consist primarily of the cost of purchased material components and subassemblies, labor and overhead costs relating to the final assembly and testing of complete systems, and related expenses and labor and overhead costs related to software development contracts. Costs of product revenues increased to \$48.3 million, or 51% of the related product revenues in the fiscal year ended January 31, 2007 as compared to \$45.9 million or 62% of related product revenues, in the fiscal year ended January 31, 2006. In fiscal 2007, the increase in the costs of product revenues primarily reflects the increased revenues. Costs of product revenues as a percentage of revenues decreased due to the increased revenues from higher margin software development contracts. Product gross profit for the Broadband segment increased to 54% of related revenues in fiscal 2007 from 43% of related revenues in fiscal 2006. The increase in Broadband gross profit percentages is primarily due to increased revenues from higher margin software development contracts. Product gross profit for the Broadcast segment was up from 1% of related product revenues in fiscal 2006 to 8% of related product revenues in fiscal 2007.

*Services Gross Profit.* Cost of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support, software development, project management and costs associated with providing video content services. Costs of services revenues increased 31% from \$28.3 million or 54% of services revenues in the year ended January 31, 2006 to \$37.2 million or 56% of services revenues in the year ended January 31, 2007, primarily due to a full year of ODG costs of services in fiscal year 2007 as compared with four months in fiscal year 2006. We expect that service gross profit percentage will decrease over the next several quarters due to increased headcount-related costs to service our increased installed base of systems, our new products expected to be introduced in fiscal 2008 and additional costs at ODG as it expands its operations beyond the U.K.

*Research and Development.* Research and development expenses consist primarily of the compensation of development personnel, depreciation of development and test equipment and an allocation of related facilities expenses. Research and development expenses increased from \$34.4 million, or 27% of total revenues, in the fiscal year ended January 31, 2006 to \$40.9 million, or 25% of total revenues, in the fiscal year ended January 31, 2007 primarily due to \$3.4 million in increased salaries and benefits attributable to the hiring of additional development engineers primarily to support middleware products and stock compensation expense of \$1.5 million due to adoption of FAS 123R. We expect that research and development expenses will continue to increase in fiscal year 2008 as we continue our development of our new products and enhancements.

*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 20% from \$18.6 million or 15% of total revenues in the fiscal year ended January 31, 2006 to \$22.4 million, or 14% of total revenues, in the fiscal year ended January 31, 2007. This increase is primarily due to \$1.7 million in increased salaries and benefits attributable to the hiring of additional sales and marketing employees, increased commissions of approximately \$500,000 due to higher revenues, and stock compensation expense of approximately \$500,000 due to adoption of FAS 123R. We expect selling and marketing expenses to increase in fiscal 2008 as we continue to expand our product offerings and increase our selling presence in overseas markets.

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

expenses. In the fiscal year ended January 31, 2007, general and administrative expenses of \$19.1 million, or 12% of total revenues, increased from \$14.2 million, or 11% of total revenues, in the fiscal year ended January 31, 2006 due to \$3.1 million attributable to a full year of ODG general and administrative expense in fiscal year 2007 as compared with four months in fiscal year 2006, \$1.0 million due to the hiring of additional general and administrative employees, \$1.2 million due to stock compensation expense, an increase in the bad debt provision of approximately \$400,000 in fiscal 2007 in comparison with net bad debt recoveries of approximately \$100,000 in fiscal 2006, all partially offset by a reduction in professional fees of approximately \$700,000 some of which related to fiscal 2006 acquisitions.

*Amortization of Intangibles.* Amortization expense consists of the amortization of acquired intangible assets which are operating expenses and not considered costs of revenues. Amortization of intangible assets was \$5.7 million in the fiscal year ended January 31, 2007 and \$2.2 million in the fiscal year ended in January 31, 2006. The increase in amortization expense is attributable to the acquisitions of Liberate and ODG in the second and third quarters of fiscal 2006, respectively. The table below classifies the amortization expense by its source category, sales and marketing or general and administrative expense.

(Amounts in thousands)	For the year ended January 31, 2007	For the year ended January 31, 2006
Sales and marketing expense .....	\$ 5,446	\$ 1,948
General and administrative expense .....	218	253
Amortization expense .....	<u>\$ 5,664</u>	<u>\$ 2,201</u>

An additional \$643,000 and \$297,000 of amortization expense related to acquired technology was charged to cost of sales for the years ended January 31, 2007 and 2006, respectively.

*Interest Income and Interest Expense.* Interest income was \$1.5 million in the fiscal year ended January 31, 2007 and \$2.1 million in the fiscal year ended January 31, 2006. Interest expense was \$96,000 for the fiscal year ended January 31, 2007 as compared to \$30,000 for the fiscal year ended January 31, 2006. The decrease in interest income is primarily due to the decrease in marketable securities during the fiscal year ended January 31, 2007 in comparison to the fiscal year ended January 31, 2006.

*Impairment on Investment in Affiliate.* Impairment on investment in affiliate was a loss of \$150,000 in the fiscal year ended January 31, 2007 due to the impairment of a small investment in an affiliate company and none in the fiscal year ended January 31, 2006.

*Equity Income in Earnings of Affiliates.* Equity income in earnings of affiliates was \$1.3 million in the fiscal year ended January 31, 2007 compared with \$39,000 in the fiscal year-ended January 31, 2006. The equity income in earnings of affiliates consists of our proportionate ownership share of the net income (loss) under the equity method of accounting. For fiscal 2007, the equity income in earnings of affiliates consisted of our proportionate ownership share of the earnings of Filmflex. For fiscal 2006, the equity income in earnings of affiliates consisted of our proportionate ownership share of the earnings of ODG until we purchased 100% of the company in September 2005. As part of the ODG acquisition, we increased our ownership interest to 33.3% in Filmflex for which we recorded our proportionate ownership share of its net income or loss from the acquisition date. The year over year increase in earnings from our investment in Filmflex was \$1.5 million offset by the loss of approximately \$200,000 from ODG in fiscal 2006 prior to our acquisition of the remaining interest in ODG.

*Income Tax Benefit.* Our effective tax rate and income tax benefit was 15% or \$1.6 million and 19% or \$2.9 million for fiscal years ended January 31, 2007 and 2006, respectively. For the fiscal year 2007, the income tax benefit was primarily attributable to \$315,000 of net operating losses generated during the current fiscal year that are expected to be carried back to recover taxes paid in prior years and the change in estimate of the prior year's tax provision relating to the tax benefit booked for the fiscal 2006 federal loss carryback versus the actual cash refund received of \$422,000. At January 31, 2007 and January 31, 2006, we provided a valuation allowance for the full amount of net deferred tax assets recorded in the United States due to the uncertainty of realization of those assets as a result of the current fiscal year's pre-tax losses and uncertainties related to our ability to generate pre-tax income for fiscal 2007 and thereafter. In addition, SeaChange maintains a valuation allowance for the full amount of certain foreign tax assets. We will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If we determine that we can generate sufficient future pre-tax income, some portion or all of the valuation allowance would be reversed and a corresponding increase in net income would be recognized.

#### **Fiscal Year Ended January 31, 2006 Compared to the Fiscal Year Ended January 31, 2005**

*Product Revenues.* Our product revenue consists of sales of hardware, software and systems from our Broadband and Broadcast segments.

	Year ended January 31,	
	2006	2005
Broadband revenues:		
Video-on-demand revenues.....	\$ 49,117,000	\$ 86,879,000
Advertising revenues.....	15,248,000	13,170,000
Total Broadband revenues .....	64,365,000	100,049,000
Broadcast revenues: .....	9,151,000	13,715,000
Total Product revenues .....	<u>\$ 73,516,000</u>	<u>\$ 113,764,000</u>

Our total product revenues decreased 35% to \$73.5 million in the fiscal year ended January 31, 2006 from \$113.8 million in the fiscal year ended January 31, 2005.

Revenues from the Broadband segment, which accounted for 51% of total revenues in fiscal 2006 and 64% of total revenues in fiscal 2005, decreased from \$100.0 million in fiscal 2005 to \$64.4 million in fiscal 2006. Advertising product revenues were \$15.2 million for the fiscal year ended January 31, 2006 as compared to \$13.2 million for the fiscal year ended January 31, 2005. Video-on-demand product revenues, excluding software development revenues, decreased to \$42.6 million for the fiscal year ended January 31, 2006 as compared to \$86.9 million for the fiscal year ended January 31, 2005. Revenues from video-on-demand product for the fiscal year ended January 31, 2005 were increased by \$1.1 million for the adjustment recorded in connection with the final agreement with Comcast (See Note 11 to Financial Statements) concerning incentive common stock purchase warrants. The decrease in Broadband revenues reflects a decline in demand by U.S. cable operators, including a significant decline in revenues from our largest U.S. customer and price decreases partially offset by increased revenues from the initial deployment of video-on-demand systems in Europe and the new middleware software revenues of \$6.5 million from customer contracts acquired from Liberate Technologies. This decrease was also partially offset by an increase in revenues from our Advertising products due to an increase in demand for digital advertising systems, reflecting cable operators' replacement of the analog technology with digital technology.

Broadcast product revenues were \$9.2 million in the fiscal year ended January 31, 2006 compared to \$13.7 million in the fiscal year ended January 31, 2005. The 33% decrease in Broadcast revenues during the fiscal year ended January 31, 2006 was primarily attributable to the delay in the introduction and initial customer acceptance of the new products.

*Services Revenues.* Our services revenues consist of fees for installation, training, project management, product maintenance and technical support, software development, and movie content services. Our services revenues increased 21% to \$52.7 million in the year ended January 31, 2006 from \$43.5 million in the year ended January 31, 2005. This increase in service revenues primarily resulted from the annual renewals of product maintenance and technical support service contracts from our expanding installed base of products and \$4.2 million of revenues from ODG's video content services recorded since the acquisition of ODG in September 2005. Software development and professional services revenues from our wholly-owned subsidiary, Digital Video Arts, increased to \$3.4 million in the fiscal year ended January 31, 2006 from \$3.0 million in the fiscal year ended January 31, 2005.

For the fiscal years ended January 31, 2006 and 2005, one customer accounted for more than 10% of our total revenues. This customer accounted for 25% and 48% of revenues in the fiscal years ended January 31, 2006 and 2005, respectively. Revenue from this customer was primarily in the Broadband segment.

International products and services revenues accounted for approximately 40% and 22% of total revenues in the fiscal years ended January 31, 2006 and 2005, respectively. Both U.S. and United Kingdom customers accounted for more than 10% of total revenue in fiscal 2006. The U.S. was the only country to account for more than 10% of total revenues in fiscal 2005. Revenues from European customers increased from \$16.7 million to \$32.9 million in the fiscal years ended January 31, 2005 and January 31, 2006, respectively. The increase in European revenues was primarily attributable to U.K. customers. The increase in revenues from the United Kingdom is primarily due to the expansion of the video-on-demand system deployments by United Kingdom cable operators, software revenues generated from our U.K. customer contracts recently acquired from Liberate Technologies, and the service revenues from the video content services provided by On Demand Group since its acquisition.

*Product Gross Profit.* Costs of product revenues consist primarily of the cost of purchased material components and subassemblies, labor and overhead relating to the final assembly and testing of complete systems and related expenses. Costs of product revenues decreased to \$45.9 million, or 38% of related product revenues, in the fiscal year ended January 31, 2006 as compared to \$60.1 million, or 47% of related product revenues, in the fiscal year ended January 31, 2005. In the fiscal 2006, the decrease in the costs of product revenues primarily reflects the decrease of the video-on-demand systems revenue. Product gross profit for the Broadband segment decreased from 49% of related revenues in fiscal 2005 to 43% of related revenues in fiscal 2006. The decrease in Broadband gross profit percentages is primarily due to lower video-on-demand product revenues offset in part by an increase in software revenues from customer contracts recently acquired from Liberate Technologies. Product gross profit for the Broadcast segment was down from 34% of related product revenues in fiscal year 2005 to 1% of related product revenues in fiscal 2006. The decrease in gross profit percentage is primarily due to lower revenues, higher discounts on certain Broadcast orders as a result of competitive pressures and the additional cost of sales necessary to enhance the performance of certain systems.

*Services Gross Profit.* Cost of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support, software development, project management provided by us and costs associated with providing video content services. Costs of services revenues increased 10% from \$25.7 million or 46% of services revenues in the year ended January 31, 2005 to \$28.3 million or 41% of services revenues in the year ended January 31, 2006, primarily due to additional costs of services generated as a result of the acquisition of ODG in September 2005. The increase in services gross profit was primarily due higher revenue levels and a relatively fixed cost base and the added margin generated from the On Demand Group revenues recognized since the acquisition in September 2005.

*Research and Development.* Research and development expenses consist primarily of the compensation of development personnel, depreciation of development and test equipment and an allocation of related facilities expenses. Research and development expenses increased from \$29.4 million, or 19% of total revenues, in the fiscal year ended January 31, 2005 to \$34.4 million, or 27% of total revenues, in the fiscal year ended January 31, 2006 primarily due to the hiring of additional development engineers to support new product initiatives (\$3.8 million) and additional development costs incurred by ODG (\$500,000) after its acquisition date.

*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 3% from \$18.1 million or 11% of total revenues, in the fiscal year ended January 31, 2005 to \$18.6 million, or 15% of total revenues, in the fiscal year ended January 31, 2006. This increase is primarily due to increased tradeshow and travel expenses related to increased direct sales efforts partially offset by reduced sales commissions on lower revenues.

*General and Administrative.* General and administrative expenses consist primarily of the compensation of executive, finance, human resource and administrative personnel, legal and accounting services and an allocation of related facilities expenses. In the fiscal year ended January 31, 2006, general and administrative expenses of \$14.2 million, or 11% of total revenues, increased from \$10.3 million, or 7% of total revenues, in the fiscal year ended January 31, 2005 due to \$1.1 million of higher accounting and consulting fees associated with the Company's acquisitions and investments in affiliates and compliance with Sarbanes-Oxley legislation, \$1.0 million to further develop operations on a world-wide basis and particularly in China, and \$900,000 additional general and administrative expenses incurred by ODG after the acquisition date. During the fourth quarter of fiscal 2006, we reversed charges related to the retirement agreement for our Chief Financial Officer due to the execution of a Management Transition Agreement which continues his employment through January 31, 2008 with no retirement benefits. The fiscal year 2006 general and administrative expenses differ from the amount reported in our earnings release, issued March 14, 2006, by an additional \$209,000 of interest expense recorded in connection with our patent infringement litigation accrual.

*Amortization of Intangibles.* Amortization of intangible assets was \$2.2 million in the fiscal year ended January 31, 2006 and \$1.3 million in the fiscal year ended in January 31, 2005. This increase in amortization of intangibles is primarily due to the acquisitions of intangible assets acquired from Liberate Technologies' Non-North American business in July 2005 and from the step acquisition of ODG in September 2005.

*Interest Income and Interest Expense.* Interest income was \$2.1 million in the fiscal year ended January 31, 2006 and \$1.0 million in the fiscal year ended January 31, 2005. In fiscal 2005, we recorded an \$800,000 adjustment (\$519,000 net of taxes) to reduce interest income to properly account for the amortization of market premiums and discounts on acquired marketable securities.

*Equity income (loss) in earnings of affiliates.* Equity income in earning of affiliates was \$39,000 in the fiscal year ended January 31, 2006 and equity loss in earnings of affiliates was \$148,000 in the fiscal year-ended January 31, 2005. For fiscal 2006, the equity income in earnings of affiliates consisted of our proportionate ownership share of the earnings of ODG until we purchased 100% of the company in September 2005. As part of the ODG acquisition, we also increased our ownership interest to 33.3% in Filmflex for which we recorded our proportionate ownership share of its net loss since the acquisition date. For fiscal 2005, the equity loss in earnings of affiliates consisted of our proportionate ownership share of the net loss of ODG under the equity method of accounting.

*Income Tax Expense (Benefit).* Our effective tax rate was (19)% and 24% for fiscal years ended January 31, 2006 and 2005, respectively. For the fiscal year ended January 31, 2006, we recorded a \$2.9 million income tax benefit that is primarily attributable to operating losses generated during the current fiscal year that are expected to be carried back to recover prior year taxes paid. At January 31, 2006, we provided a valuation allowance for the full amount of net deferred tax assets recorded in the United States due to the uncertainty of realization of those assets as a result of the current fiscal year's pre-tax losses and uncertainties related to our ability to generate pre-tax income for fiscal 2007 and thereafter. In addition, SeaChange maintains a valuation allowance for the full amount of certain foreign tax assets. We have experienced a significant decline in product revenues since the fourth quarter of fiscal 2005, which was primarily attributable to a decline in video-on-demand systems revenues that subsequently resulted in lower gross margins and net losses. We will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If we determine that we can generate sufficient future pre-tax income, some portion or all of the valuation allowance would be reversed and a corresponding increase in net income would be recognized. Income tax expense for fiscal year 2005 included a \$2.1 million benefit primarily related to the implementation of a tax law change relating to the tax treatment of deferred revenues which resulted in the realization of an associated deferred tax asset and a corresponding valuation allowance release as SeaChange began to follow the same method for both book and tax purposes for recognizing revenue for maintenance service contracts. SeaChange had an effective income tax rate of 40% for the year ended January 31, 2005 before recording the adjustment discussed above.

## Quarterly Results of Operations

The following table presents unaudited financial information for the quarterly periods in the fiscal years ended January 31, 2006 and January 31, 2007. The results for any quarter are not necessarily indicative of future quarterly results, and we believe that period-to-period comparisons should not be relied upon as an indication of future performance.

	Three months ended							
	April 30, 2005	July 31, 2005	October 31, 2005	January 31, 2006	April 30, 2006	July 31, 2006	October 31, 2006	January 31, 2007
	(in thousands, except per share amounts)							
Revenue.....	\$ 31,512	\$ 26,195	\$ 35,321	\$ 33,236	\$ 33,241	\$ 45,766	\$ 42,254	\$ 40,073
Gross profit.....	13,508	9,181	14,610	14,832	15,381	23,816	19,574	17,078
Operating expenses.....	15,558	16,851	18,234	18,823	21,458	22,783	21,750	22,141
Net income (loss).....	(578)	(6,556)	(2,108)	(3,075)	(4,355)	959	(1,033)	(3,745)
Earnings (loss) per share -								
Basic .....	(0.02)	(0.23)	(0.07)	(0.11)	(0.15)	0.03	(0.04)	(0.13)
Earnings (loss) per share -								
Diluted .....	(0.02)	(0.23)	(0.07)	(0.11)	(0.15)	0.03	(0.04)	(0.13)

We have experienced significant variations in revenues, expenses and operating results from quarter to quarter and such variations are likely to continue. A significant portion of our revenues have been generated from a limited number of customers, and it is difficult to predict the timing of future orders and shipments to these and other customers. Customers can cancel or reschedule shipments, and development or production difficulties could delay shipments. During the fiscal 2007 quarterly periods outlined above, we experienced increases in our revenues compared to the quarterly periods in fiscal 2006 primarily related to the increase in software development revenues in fiscal 2007 in connection with the VOD purchase agreement signed with Comcast in July of 2006, the increase in video-on-demand systems revenue related to increased demand for our products from North American cable system operators and the full year impact of the ODG acquisition and Liberate middleware contracts in fiscal 2006.

We have also experienced significant variations in our quarterly product gross profit. Changes in pricing policies, the product mix, the timing and significance of new product introductions and product enhancements, and fluctuations in the number of systems affects manufacturing efficiencies and, accordingly, gross profits. Quarterly services gross profits have historically fluctuated significantly because installation and training service revenue varies by quarter while the related costs are relatively consistent by quarter. Gross profits for fiscal 2007 were higher than quarterly gross profits for fiscal 2006 principally due to higher revenues for the reasons cited above and a greater mix of higher margin software development revenue. In addition, our gross profit for the quarter ended January 31, 2007 reflected the impact of approximately \$1.0 million of fiscal year 2007 sales discounts in connection with the 18 month extension of a middleware development contract.

During the quarterly periods outlined above, we generally experienced sequential increases in our operating expenses with the exception of the third quarter of fiscal 2007 when operating expenses decreased due to the start of the reclassification to cost of goods sold of software development expenses related to the Comcast agreement. Operating expenses, also vary somewhat with the number, timing and significance of new product and product enhancement introductions by us and our competitors, increased competition, the gain or loss of significant customers, the hiring of new personnel, the acquisition of businesses, and general economic conditions. Our selling and marketing costs fluctuate from quarter to quarter as a result of commissions related to our revenues, large tradeshow that take place in the first and third quarter of the year and significant promotional costs that are incurred for new product introductions. All of the above factors are difficult for us to forecast, and these or other factors may have a materially adverse effect on our business, financial condition and results of operations for one quarter or a series of quarters. Only a small portion of our expenses vary with revenues in the short-term and there would likely be a material adverse effect on our operating results if future revenues are lower than expectations.

Based upon all of the forgoing, we believe that quarterly revenues and operating results are likely to vary significantly in the future and that period-to-period comparisons of our results of operations should not be relied upon as indications of future performance.

### **Liquidity and Capital Resources**

Historically, we have financed our operations and capital expenditures primarily with the proceeds from sales of our common stock and cash flows generated from operations. During fiscal 2007, cash and cash equivalents increased \$9.6 million from \$21.6 million at January 31, 2006 to \$31.2 million at January 31, 2007 largely due to cash provided by certain operating, investing, and financing activities partially offset by our net loss. Working capital increased to \$58.6 million at January 31, 2007 from \$45.8 million at January 31, 2006.

Net cash provided by operating activities was \$488,000 for the fiscal year ended January 31, 2007 compared to net cash used in operating activities of \$20.0 million for the fiscal year ended January 31, 2006. The net cash used for operating activities in the fiscal year ended January 31, 2007 was the result of a net loss of \$8.2 million and the \$8.0 million cash payment made to C-Cor Incorporated (as successor to nCube Corp.) in settlement of the now resolved patent infringement litigation, which was offset by the non-cash depreciation and amortization of intangible assets of \$14.5 million, stock compensation expense of \$3.5 million and the changes in certain operating assets and liabilities. Significant changes in operating assets and liabilities that provided cash included an income tax refund that reduced income taxes receivable by \$2.4 million, and an increase in deferred revenues of \$1.6 million. The significant changes in assets and liabilities that used cash from operations included an increase in inventories of \$4.7 million, primarily due to inventory acquired and subsequently reclassified to fixed assets for use as research and development equipment, and a reduction in income taxes payable. The share-based compensation of \$3.5 million in fiscal 2007 increased from \$43,000 in fiscal 2006 and \$0.0 million in fiscal 2005 due to the adoption of SFAS 123R beginning February 1, 2006.

It is typical for us to experience fluctuations in our 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, we may experience significant increases or decreases in our inventories as a result of the timing of the procurement of components for anticipated orders for both our product segments and increases or decreases in our accounts receivable balances and customer deposits as a result of the timing of receiving customer orders during the period and of customer payments. We expect that the video-on-demand products within the Broadband segment will continue to require a significant amount of cash to fund future product development and additional capital expenditures for engineering equipment, quality systems and customer services test systems to meet higher forecasted revenue levels.

Net cash provided by investing activities was \$5.8 million for the fiscal year ended January 31, 2007 and net cash used in investing activities was \$53.5 million for the fiscal year ended January 31, 2006. Investment activity for fiscal 2007 consisted primarily of \$15.4 million net maturities and sales of marketable securities partially offset by capital expenditures of \$7.0 million and the \$3.0 million contingent consideration cash payment made to the former shareholders of ODG.



Net cash provided by financing activities was \$2.9 million for the fiscal year ended January 31, 2007 compared to \$1.5 million for the fiscal year ended January 31, 2006. In fiscal 2007 and fiscal 2006, the cash provided by financing activities was comprised of proceeds from the issuance of common stock in connection with stock option exercises and the employee stock purchase plan.

In the second quarter of fiscal 2007, we renewed our revolving line of credit with Citizens Bank (a subsidiary of the Royal Bank of Scotland Group plc) through June, 2007, for the committed amount of \$15.0 million. Loans made under this revolving line of credit bear interest at a rate per annum equal to the bank's prime rate which was 8.25% on January 31, 2007. Borrowings under this line of credit are collateralized by substantially all of our assets. The loan agreement requires that we provide Citizens 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, when amounts are outstanding under the loan agreement. As of January 31, 2007, we were not in compliance with the financial covenants but obtained a waiver from the bank for the quarter ended January 31, 2007. There are currently no amounts outstanding under the revolving line of credit.

In the third quarter of fiscal 2006, we purchased 72.4% of the outstanding capital stock of the On Demand Group Limited ("ODG"), a company incorporated under the laws of the United Kingdom. As a result of this purchase, we owned 100% of ODG at January 31, 2006. Under the terms of the purchase agreement, we acquired the outstanding shares in ODG we did not previously own in exchange for approximately \$14.0 million in cash consideration, including transaction costs of \$500,000. The purchase agreement also provides for additional contingent consideration if ODG meets certain annual performance goals related to net income over three measurement periods ending January 31, 2008. We may pay up to a maximum aggregate contingent consideration of \$11.9 million (based on the exchange rate in effect at January 31, 2007), including up to 50% payable in shares of our common stock, par value \$0.01 per share, with the remainder payable in cash provided that the performance goals are met. The contingent consideration is comprised of three installments, each to be made annually, beginning with the year ending January 31, 2006, for an annual baseline amount of \$2.2 million, \$2.3 million and \$4.9 million, respectively (based on the exchange rate in effect at January 31, 2006, June 30, 2007 and January 31, 2007, respectively). These amounts are subject to upward and downward adjustment based on the actual net income related performance of ODG, as clarified in the agreement, during these periods, provided that the aggregate maximum contingent consideration payable is the sum of these baseline amounts plus a maximum of \$2.6 million (based on the exchange rate in effect at January 31, 2007). The contingent consideration will be recorded as an additional cost of the purchase and recognized as goodwill if the performance measures are met by ODG and it becomes payable. On January 31, 2006, the first earnout measurement period ended, and we recorded \$2.8 million (USD equivalent) of additional purchase price as goodwill based upon ODG's net income for the initial annual performance period ended January 31, 2006. In May 2006, the Company paid \$3.0 million (USD equivalent at the current exchange rate) to satisfy this obligation. On June 30, 2006, SeaChange and the former stockholders of ODG amended the original purchase agreement to provide for the acceleration of the second installment of contingent consideration (for the year ended January 31, 2007) in exchange for the issuance to the sellers of 341,360 shares of SeaChange's common stock having a fair market value of \$2.3 million as of the date of the amendment. Consequently, the Company recorded an additional \$2.3 million of goodwill to reflect the accelerated second installment of contingent consideration.

In the second quarter of fiscal 2006, we acquired substantially all of the assets of Liberate Technologies' business outside of North America. At the time of the transaction, Liberate Technologies was a leading provider of software for digital cable systems. Under the terms of the purchase agreement, we acquired certain customer contracts, patents and other intellectual property, and assumed certain limited liabilities related to Liberate's business outside of North America in exchange for approximately \$23.7 million in cash consideration.

In the second quarter of fiscal 2006, we purchased for \$8.9 million real property located at 50 Nagog Park Drive in Acton, Massachusetts. The building on the property is approximately 120,000 square feet, and this site is our new corporate headquarters. All operations and personnel currently that were located at the facility in Maynard, Massachusetts were relocated to the new property in Acton, Massachusetts in February 2006.

In the first quarter of fiscal 2006, we entered into a Stock Purchase Agreement with InSite One, Inc. ("InSite"), an off-site medical imaging and data services company. As part of the agreement, we invested \$2.0 million for 5.9 million shares of 8% cumulative convertible preferred stock of InSite representing approximately 11% of the total capital stock of the InSite. The preferred shares are convertible to common stock based upon defined conversion factors subject to adjustment as defined in the agreement. In fiscal 2007, we converted a note receivable of \$407,000 related to an InSite One system sale to equity.

In January 2005, we executed a Secured Loan Agreement with Casa Systems, Inc. (“Casa”), a Massachusetts development stage company that specializes in video-on-demand products within the telecommunications and television markets. The original total loan commitment was \$1.9 million and \$750,000 was drawn at the end of fiscal year 2005. During the first quarter of fiscal 2006, we increased the total loan commitment to \$2.4 million, and Casa drew down the remaining \$1.7 million.

In the second quarter of fiscal 2006, we invested \$8.2 million in convertible preferred stock, which may convert to a 19.8% ownership interest, in Casa Systems, Inc. (“Casa”), a Massachusetts development stage company that specializes in video-on-demand products within the telecommunications and television markets. A portion of the purchase price was satisfied by our surrender and cancellation of the \$2.5 million in principal plus accrued interest outstanding pursuant to the Secured Loan Agreement with Casa. The remainder of the purchase price was paid in cash. The investment was made for shares of Casa’s convertible preferred stock, convertible at our option into shares of Casa’s common stock on a one-to-one basis. At the time of the investment, we also entered into agreements with Casa, its stockholders and its optionholders which grant us the right of first refusal on the issuance of additional shares of Casa securities or transfers of stock or options by holders. In addition, we had a call option exercisable until January 31, 2007 to purchase all of the outstanding stock and options not owned by us for an aggregate price of \$92 million. The Company did not exercise this option.

In fiscal 2005, SeaChange acquired all of the outstanding stock of ZQ Interactive, Ltd., a company incorporated in the British Virgin Islands with its principal office in Shanghai, China. According to the terms of the purchase agreement, \$1.0 million was paid to the sellers at the signing of the purchase agreement and the remaining \$1.0 million was to be paid to the sellers in two equal annual installments of \$500,000 on the first and second anniversary dates of the signing of the purchase agreement. The final installment of \$500,000 was paid in July 2006.

The following table reflects our current and contingent contractual obligations to make potential future payments as of January 31, 2007 (in thousands):

(\$000's)	Payment due by period				
	Total	Less than one year	One to three years	Three to five years	More than Five years
Purchase obligations.....	\$ 6,486	\$ 6,486	—	—	—
Acquisition commitments .....	6,800	6,800	—	—	—
Studio content minimum guarantees .....	3,747	960	\$ 2,568	\$ 219	—
Non-cancelable lease obligations .....	2,218	1,407	779	32	—
Total .....	<u>\$ 19,251</u>	<u>\$ 15,653</u>	<u>\$ 3,347</u>	<u>\$ 251</u>	<u>—</u>

The purchase obligations and studio content minimum guarantees include open, non-cancelable purchase commitments from our suppliers. The acquisition commitments primarily include estimated maximum additional contingent consideration obligations in the event ODG achieves specified annual performance thresholds in the future.

We believe that existing funds combined with available borrowings under the revolving line of credit and cash provided by future operating activities are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 24 months.

### Effects of Inflation

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

### New Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140” (SFAS No. 155). SFAS No. 155 permits a fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation. This accounting standard is effective as of the beginning of fiscal years beginning after September 15, 2006. The effect of adopting SFAS No. 155 on our financial position and results of operations will be immaterial.

In March 2006, the FASB issued the Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statements No. 140" (SFAS No. 156). SFAS No. 156 requires that servicing assets and servicing liabilities be recognized at fair value, if practicable, when we enter into a servicing agreement and allows two alternatives, the amortization and fair value measurement methods, as subsequent measurement methods. This accounting standard is effective for all new transactions occurring as of the beginning of fiscal years beginning after September 15, 2006. The effect of adopting SFAS No. 156 on our financial position and results of operations will be immaterial.

In June 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of February 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to opening retained earnings and other accounts as applicable. We are currently evaluating the effect of FIN 48 on our results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of SFAS 157 to have a material impact on its financial statements.

In September 2006, the SEC staff released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" method and the "iron curtain" method. The roll-over method focuses primarily on the impact of a misstatement on the income statement, including the reversing effect of prior year misstatements, but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The Company previously used the roll-over method for quantifying identified financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effect of the misstatements on each of the Company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification of errors under both the iron curtain and the roll-over methods.

SAB 108 permits public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of the beginning of the year of adoption, February 1, 2006 for the Company, with an offsetting adjustment recorded to the opening balance of retained earnings. The Company elected to record the effects of applying SAB 108 using the cumulative effect transition method.

The Company identified two errors, quantified them under the roll-over method and concluded they were immaterial, individually and in the aggregate. Inventory was increased by \$623,000 to reflect labor and overhead costs that had, in the past, been treated as period costs and had not been capitalized as a component of inventory. Accumulated other comprehensive income (loss) was decreased by \$130,000 to reflect a realized gain which should have been recognized in fiscal 2005. To record the initial application of SAB 108, SeaChange recorded a \$753,000 adjustment to decrease accumulated deficit at February 1, 2006.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 159 on our financial statements.

#### **ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk**

We face exposure to financial market risks, including adverse movements in foreign currency exchange rates and changes in interest rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results. Our primary exposure has historically been associated with product sales

arrangements denominated in the local currency where the functional currency of the foreign subsidiary is the U.S. dollar (as most of our revenues are in U.S. dollars) and operating expenses in Europe and Asia. In light of the higher proportion of our international businesses due, in part, to the recent acquisitions of European-based business from Liberate Technologies and ODG, we expect the risk of any adverse movements in foreign currency exchange rates to have a greater impact on our operating results in the future. Historically, we have not hedged specific currency exposures as gains and losses on foreign currency transactions have not been material to date. At January 31, 2006 and January 31, 2007, we had \$0 outstanding related to variable rate U.S. dollar denominated debt. As there were no amounts outstanding at January 31, 2006 and 2007 related to variable rate debt, there was no interest rate exposure.

The carrying amounts reflected in the consolidated balance sheet of cash and cash equivalents, short-term marketable securities, trade receivables and trade payables approximate fair value at January 31, 2007 due to the short maturities of these instruments. We maintain investment portfolio holdings of various issuers, types, and maturities. Our cash and marketable securities include cash equivalents, which we consider to be investments purchased with original maturities of three months or less. Given the short maturities and investment grade quality of the portfolio holdings at January 31, 2007, a sharp rise in interest rates should not have a material adverse impact on the fair value of our investment portfolio. Additionally, our long term marketable investments, which are carried at the lower of cost or market, have fixed interest rates, and therefore are not subject to any interest rate exposure. As a result, we do not currently hedge these market risk exposures. At January 31, 2007, we had \$11.2 million in short-term marketable securities and \$12.9 million in long-term marketable securities.

#### **ITEM 8. Financial Statements and Supplementary Data**

The Company's Financial Statements and Schedules, together with the independent registered public accounting firm reports thereon, appear at pages 50 through 85 of this Form 10-K. The supplementary financial information required by Item 302 of Regulation S-K is included in this Annual Report under Item 7.

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

On October 12, 2006, PricewaterhouseCoopers LLP was dismissed as the independent registered public accounting firm of the Company. The dismissal of PricewaterhouseCoopers LLP was approved by the Company's Audit Committee.

The reports of PricewaterhouseCoopers LLP on the Company's financial statements as of and for the fiscal years ended January 31, 2005 and 2006 did not contain an adverse opinion or a disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope or accounting principle.

During the Company's fiscal years ended January 31, 2005 and 2006 and through October 12, 2006 there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the satisfaction of PricewaterhouseCoopers LLP, would have caused them to make reference to the subject matter of the disagreement in connection with their reports on the financial statements for such years. During the Company's fiscal years ended January 31, 2005 and 2006 and through October 12, 2006 there were no reportable events as defined in Item 304(a)(1)(v) of Regulation S-K.

Effective as of October 17, 2006, the Company's Audit Committee engaged Grant Thornton LLP as its new independent registered public accounting firm to audit the Company's financial statements for the Company's fiscal year ending January 31, 2007. The decision to engage Grant Thornton LLP as the Company's independent registered public accounting firm was the result of a competitive selection process.

Prior to the engagement of Grant Thornton LLP, neither the Company nor anyone on behalf of the Company consulted with Grant Thornton LLP during the Company's fiscal years ended January 31, 2005 and 2006 and through October 17, 2006, in any manner regarding: (A) either the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's financial statements, and neither was a written report provided to the Company nor was oral advice provided that Grant Thornton LLP concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing, or financial reporting issue, or (B) the subject of either a disagreement or a reportable event, as defined in Item 304(a)(1)(iv) and (v), respectively, of Regulation S-K.

#### **ITEM 9A. Controls and Procedures**

##### **(A) Evaluation of Disclosure Controls and Procedures**

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

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

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

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

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

Our management assessed the effectiveness of our internal control over financial reporting as of January 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment, management concluded that, as of January 31, 2007, our internal control over financial reporting was effective based on those criteria.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of January 31, 2007 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report which appears herein.

**(C) Changes in Internal Control over Financial Reporting**

As a result of the evaluation completed by management, and in which Messrs. Styslinger and Bisson participated, we have concluded that there were no changes during the fiscal quarter ended January 31, 2007 in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**(D) Attestation Report of the Registered Public Accounting Firm**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and  
Stockholders of SeaChange International, Inc.

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that SeaChange International, Inc. and subsidiaries (a Delaware Corporation) (collectively the "Company") maintained effective internal control over financial reporting as of January 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that SeaChange International, Inc. maintained effective internal control over financial reporting as of January 31, 2007, is fairly stated, in all material respects, based on *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, SeaChange International, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of SeaChange International, Inc. as of January 31, 2007 and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for the year ended January 31, 2007 and our report dated April 13, 2007 expressed an unqualified opinion on those financial statements and includes explanatory paragraphs relating to the adoption of Statement of Financial Accounting Standards No. 123(R) and Staff Accounting Bulletin No. 108 in fiscal 2007.

/s/ GRANT THORNTON LLP

Boston Massachusetts  
April 13, 2007

## **ITEM 9B. Other Information**

None.

## **PART III**

### **ITEM 10. Directors, Executive Officers and Corporate Governance of the Registrant**

Information concerning the directors of SeaChange is hereby incorporated by reference from the information contained under the heading “Election of Directors” in SeaChange’s definitive proxy statement related to SeaChange’s Annual Meeting of Stockholders to be held on or about July 18, 2007 which will be filed with the Commission within 120 days after the close of the fiscal year (the “Definitive Proxy Statement”).

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

### **ITEM 11. Executive Compensation**

Information concerning executive compensation is hereby incorporated by reference to the information contained under the headings “Compensation and Other Information Concerning Directors and Officers”, “Compensation of Directors”, “Compensation and Option Committee Report”, “Compensation Committee Interlocks and Insider Participation” and “Options and Stock Plans” in the Definitive Proxy Statement.

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

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

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

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

### **ITEM 14. Principal Accountant Fees and Services**

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

## PART IV

### ITEM 15. Exhibits and Financial Statement Schedules.

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

The following Consolidated Financial Statements of the Registrant are filed as part of this report:

	<u>Page</u>
Reports of Independent Registered Public Accounting Firms .....	48-49
Consolidated Balance Sheet as of January 31, 2007 and 2006 .....	F-1
Consolidated Statement of Operations for the years ended January 31, 2007, 2006 and 2005 .....	F-2
Consolidated Statement of Stockholders' Equity and Comprehensive Income (Loss) for the years ended January 31, 2007, 2006 and 2005.....	F-3
Consolidated Statement of Cash Flows for the years ended January 31, 2007, 2006 and 2005 .....	F-4
Notes to Consolidated Financial Statements.....	F-5

#### (a)(2) INDEX TO FINANCIAL STATEMENT SCHEDULE

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

	<u>Page</u>
Schedule II - Valuation and Qualifying Accounts and Reserves .....	S-1

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

#### (a)(3) INDEX TO EXHIBITS

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

#### (b) EXHIBITS

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

#### (c) FINANCIAL STATEMENT SCHEDULES

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



## SIGNATURES

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

Dated: April 13, 2007

### SEACHANGE INTERNATIONAL, INC.

By: /s/William C. Styslinger, III

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

## POWER OF ATTORNEY AND SIGNATURES

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

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

Signature	Title(s)	Date
<u>/s/ WILLIAM C. STYSLINGER, III</u> .....	President, Chief Executive Officer,	April 13, 2007
<b>William C. Styslinger, III</b> .....	Chairman of the Board and Director (Principal Executive Officer)	
<u>/s/ KEVIN M. BISSON</u> .....	Chief Financial Officer, Senior Vice	April 13, 2007
<b>Kevin M. Bisson</b> .....	President, Finance and Administration, Treasurer and Secretary (Principal Financial and Accounting Officer)	
<u>/s/ MARTIN R. HOFFMANN</u> .....	Director	April 13, 2007
<b>Martin R. Hoffmann</b> .....		
<u>/s/ CARMINE VONA</u> .....	Director	April 13, 2007
<b>Carmine Vona</b> .....		
<u>/s/ THOMAS F. OLSON</u> .....	Director	April 13, 2007
<b>Thomas F. Olson</b> .....		
<u>/s/ MARY PALERMO COTTON</u> .....	Director	April 13, 2007
<b>Mary Palermo Cotton</b> .....		

## EXHIBIT INDEX

Exhibit No.	Description
2.1	Agreement for the Purchase and Sale of Share Capital of The ON Demand Group Limited, dated as of September 23, 2005, by and among the Company, Anthony Kelly, Andrew Birchall and the other parties set forth on the signature pages thereto (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K previously filed September 29, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).
2.2	Variation Agreement, dated as of June 30, 2006, by and among the Company, Anthony Kelly, Andrew Birchall and the others set forth on the signature pages thereto, to that certain Agreement for the Sale and Purchase of Share Capital of On Demand Group Limited (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K previously filed July 6, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
3.1	Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).
3.2	Certificate of Amendment, filed May 25, 2000 with the Secretary of State in the State of Delaware, to the Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 4.1 to the Company's Quarterly Report on 10-Q previously filed on December 15, 2000 with the Commission (File No. 000-21393) and incorporated herein by reference).
3.3	Amended and Restated By-laws of the Company (filed as Exhibit 3.5 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).
4.1	Specimen certificate representing the Common Stock (filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).
4.2	Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).
4.3	Certificate of Amendment, filed May 25, 2000 with the Secretary of State in the State of Delaware, to the Amended and Restated Certificate of Incorporation of the Company (filed as Exhibit 4.2 to the Company's registration statement on Form S-3 previously filed on December 6, 2000 with the Commission (File No. 333-51386) and incorporated herein by reference).
10.1	2005 Equity Compensation and Incentive Plan (filed as Appendix A to the Company's Proxy Statement on Schedule 14A previously filed May 27, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.2	Form of Restricted Stock Unit Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed December 14, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.3	Form of Incentive Stock Option Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.4	Form of Non-Qualified Stock Option Agreement pursuant to the Company's 2005 Equity Compensation and Incentive Plan (filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.5	Amended and Restated 1995 Stock Option Plan (filed as Annex B to the Company's Proxy Statement on Form 14a previously filed on May 31, 2001 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.6	Form of Incentive Stock Option Agreement pursuant to SeaChange's Amended and Restated 1995 Stock Option Plan (filed as Exhibit 99.1 to the Company's Current Report on Form 8-K filed on October 6, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.7	Form of Non-Qualified Stock Option Agreement pursuant to SeaChange's Amended and Restated 1995 Stock Option Plan (filed as Exhibit 99.2 to the Company's Current Report on Form 8-K filed on October 6, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.8	Form of Lockup Agreement (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed February 1, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.9	1996 Non-Employee Director Stock Option Plan (filed as Exhibit 10.2 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).

<b>Exhibit No.</b>	<b>Description</b>
10.10	Third Amended and Restated 1996 Employee Stock Purchase Plan of the Company (filed as Appendix A to the Company's Definitive Proxy Statement filed on Schedule 14A previously filed on May 24, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.11	Loan and Security Agreement, dated as of October 22, 2001, by and between Citizens Bank of Massachusetts and the Company (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on December 13, 2001 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.12	Amendment No. 1, dated as of June 14, 2002, by and between the Company and Citizen's Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizen's Bank of Massachusetts (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q previously filed on September 13, 2002 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.13	Amendment No. 2, dated as of April 21, 2003, between the Company and Citizen's Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001 by and between the Company and Citizen's Bank of Massachusetts (filed as Exhibit 10.7 to the Company's Annual Report on Form 10-K previously filed on May 1, 2003 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.14	Amendment No. 3, dated as of December 1, 2003, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001 by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on December 15, 2003 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.15	Amendment No. 8, dated as of April 14, 2006, between the Company and Citizens Bank of Massachusetts, to that certain Loan and Security Agreement, dated as of October 22, 2001, by and between the Company and Citizens Bank of Massachusetts (filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K previously filed on April 17, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.16	License Agreement dated May 30, 1996 between Summit Software Systems, Inc. and the Company (filed as Exhibit 10.7 to the Company's Registration Statement on Form S-1 previously filed on November 4, 1996 with the Commission (File No. 333-12233) and incorporated herein by reference).
10.17	Lease Agreement dated May 28, 1998 between Robert Quirk, Trustee of Maynard Industrial Properties Associates Trust and the Company (filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K previously filed on March 24, 1999 with the Commission (File No. 000-21393) and incorporated herein by reference).

<b>Exhibit No.</b>	<b>Description</b>
10.18	Change-in-Control Severance Agreement, dated as of July 30, 2004, by and between the Company and William L. Fiedler (filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on September 9, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.19	Change-in-Control Severance Agreement, dated as of July 30, 2004, by and between the Company and Ira Goldfarb (filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on September 9, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.20	Change-in-Control Severance Agreement, dated as of July 30, 2004, by and between the Company and Bruce Mann (filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on September 9, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.21	Change-in-Control Severance Agreement, dated as of July 30, 2004, by and between the Company and William C. Styslinger, III (filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on September 9, 2004 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.22	Change-in-Control Severance Agreement, dated as of March 13, 2006, by and between the Company and Kevin Bisson (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed March 9, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.23	Change-In-Control Agreement, dated as of May 31, 2006, by and between the Company and Randy Banton (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed June 19, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.24	Change-in-Control Severance Agreement, dated as of December 11, 2006, by and between SeaChange and Yvette Kanouff (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed December 14, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.25	Change-in-Control Severance Agreement, dated as of December 11, 2006, by and between SeaChange and Steven M. Davi (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K previously filed December 14, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.26	Management Transition Agreement, dated as of January 30, 2006, by and between the Company and William L. Fiedler (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K previously filed February 1, 2006 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.27	Executive Services Agreement, dated as of September 23, 2005, by and between On Demand Management Limited and Andrew Birchall (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K previously filed September 29, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).
10.28	Executive Services Agreement, dated as of September 23, 2005, by and between On Demand Management Limited and Anthony Kelly (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K previously filed September 29, 2005 with the Commission (File No. 000-21393) and incorporated herein by reference).
21.1*	List of Significant Subsidiaries.
23.1*	Consent of Grant Thornton LLP.
23.2*	Consent of PricewaterhouseCoopers LLP.
24.1	Power of Attorney (included on signature page).
31.1*	Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\* Provided herewith.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and  
Stockholders of SeaChange International, Inc.

We have audited the accompanying consolidated balance sheet of SeaChange International, Inc. and subsidiaries (a Delaware corporation) (collectively the “Company”) as of January 31, 2007, and the related consolidated statements of operations, stockholders’ equity and comprehensive income (loss), and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SeaChange International, Inc. and subsidiaries as of January 31, 2007, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. Schedule II is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

As discussed in Note 5 to the consolidated financial statements, the Company changed its method of accounting for stock-based payments as of February 1, 2006.

As discussed in Note 11 to the consolidated financial statements, the Company recorded a cumulative effect adjustment as of February 1, 2006, in connection with the adoption of SEC Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements.”

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of January 31, 2007, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 13, 2007 expressed an unqualified opinion on management’s assessment and an unqualified opinion on internal control effectiveness.

/s/ GRANT THORNTON LLP

Boston, Massachusetts  
April 13, 2007

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of SeaChange International, Inc.:

In our opinion, the consolidated balance sheet as of January 31, 2006 and the related consolidated statements of operations, of stockholders' equity and of cash flows for each of two years in the period ended January 31, 2006 present fairly, in all material respects, the financial position of SeaChange International, Inc. and its subsidiaries at January 31, 2006, and the results of their operations and their cash flows for each of the two years in the period ended January 31, 2006, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for each of the two years in the period ended January 31, 2006 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP  
Boston, Massachusetts  
April 17, 2006

**SEACHANGE INTERNATIONAL, INC.**

**CONSOLIDATED BALANCE SHEET**  
(in thousands, except share and per share data)

	January 31, 2007	January 31, 2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents .....	\$ 31,179	\$ 21,594
Restricted cash .....	—	500
Marketable securities .....	11,231	14,596
Accounts receivable, net of allowance for doubtful accounts of \$466 at January 31, 2007 and \$405 at January 31, 2006 .....	28,854	30,109
Unbilled receivables.....	5,562	4,363
Inventories, net.....	19,350	19,299
Income taxes receivable .....	409	2,781
Prepaid expenses and other current assets .....	2,990	4,594
Total current assets .....	99,575	97,836
Property and equipment, net.....	30,720	27,191
Marketable securities.....	12,885	24,689
Investments in affiliates.....	14,312	12,812
Intangible assets, net.....	13,054	18,904
Goodwill.....	23,726	20,379
Other assets .....	5,024	5,363
Total assets.....	<u>\$ 199,296</u>	<u>\$ 207,174</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable .....	\$ 10,003	\$ 10,016
Income taxes payable.....	941	2,843
Accrued litigation reserve .....	—	7,986
Other accrued expenses.....	5,884	8,408
Customer deposits.....	2,016	2,170
Deferred revenues .....	21,806	20,045
Deferred tax liabilities.....	366	556
Total current liabilities .....	41,016	52,024
Deferred tax liabilities, long-term .....	1,121	1,353
Total liabilities .....	42,137	53,377
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Convertible preferred stock, \$0.01 par value 5,000,000 shares authorized, none issued or outstanding .....	—	—
Common stock, \$0.01 par value; 100,000,000 shares authorized; 29,345,103 and 28,451,930 shares issued and outstanding at January 31, 2007 and 2006, respectively.....	293	285
Additional paid-in capital .....	184,976	176,238
Accumulated deficit.....	(29,685)	(22,264)
Accumulated other comprehensive income (loss) .....	1,575	(462)
Total stockholders' equity .....	157,159	153,797
Total liabilities and stockholders' equity .....	<u>\$ 199,296</u>	<u>\$ 207,174</u>

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

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

	Fiscal Year ended January 31,		
	2007	2006	2005
Revenues:			
Products.....	\$ 95,000	\$ 73,516	\$ 113,764
Services .....	66,334	52,748	43,539
	<u>161,334</u>	<u>126,264</u>	<u>157,303</u>
Costs of revenues:			
Products.....	48,316	45,858	60,141
Services .....	37,169	28,275	25,705
	<u>85,485</u>	<u>74,133</u>	<u>85,846</u>
Gross profit .....	<u>75,849</u>	<u>52,131</u>	<u>71,457</u>
Operating expenses:			
Research and development.....	40,914	34,378	29,424
Selling and marketing .....	22,413	18,646	18,053
General and administrative .....	19,141	14,241	10,323
Amortization of intangible assets .....	5,664	2,201	1,333
	<u>88,132</u>	<u>69,466</u>	<u>59,133</u>
(Loss) income from operations .....	<u>(12,283)</u>	<u>(17,335)</u>	<u>12,324</u>
Interest income .....	1,451	2,068	1,004
Interest expense .....	(96)	(30)	(42)
Impairment on investment in affiliate.....	(150)	—	—
	<u>(11,078)</u>	<u>(15,297)</u>	<u>13,286</u>
(Loss) income before income taxes and equity income (loss) in earnings of affiliate .....	<u>(11,078)</u>	<u>(15,297)</u>	<u>13,286</u>
Income tax benefit (expense).....	1,632	2,941	(3,200)
Equity income (loss) in earnings of affiliate, net of tax.....	1,272	39	(148)
	<u>(8,174)</u>	<u>(12,317)</u>	<u>9,938</u>
Net (loss) income .....	<u>\$ (8,174)</u>	<u>\$ (12,317)</u>	<u>\$ 9,938</u>
Earnings (loss) per share:			
Basic.....	<u>\$ (0.28)</u>	<u>\$ (0.44)</u>	<u>\$ 0.36</u>
Diluted.....	<u>\$ (0.28)</u>	<u>\$ (0.44)</u>	<u>\$ 0.34</u>
Weighted average common shares outstanding:			
Basic.....	<u>28,857</u>	<u>28,303</u>	<u>27,640</u>
Diluted.....	<u>28,857</u>	<u>28,303</u>	<u>29,053</u>

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



**SEACHANGE INTERNATIONAL, INC.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)**  
(in thousands, except share data)

	<u>Common Stock</u>					<u>Accumulated other comprehensive income (loss)</u>	<u>Total Stockholders' Equity</u>	<u>Comprehensive income (loss)</u>
	<u>Number of shares</u>	<u>Par value</u>	<u>Additional paid-in capital</u>	<u>Accumulated deficit</u>	<u>Deferred stock-based compensation</u>			
Balance at January 31, 2004	27,279,365	\$273	\$165,410	\$(19,393)	\$—	\$(403)	\$145,887	
Issuance of common stock pursuant to exercise of stock options	562,528	6	4,529	—	—	—	4,535	
Issuance of common stock in connection with the employee stock purchase plan	107,579	1	1,344	—	—	—	1,345	
Issuance of common stock in connection with Comcast stock warrant exercise	225,474	2	3,143	—	—	—	3,145	
Tax benefit from stock options	—	—	29	—	—	—	29	
Change in unrealized gain on marketable securities, net of tax	—	—	—	—	—	208	208	\$208
Translation adjustment	—	—	—	—	—	(82)	(82)	(82)
Net income	—	—	—	9,938	—	—	9,938	9,938
Comprehensive income								<u>\$10,064</u>
Balance at January 31, 2005	28,174,946	282	174,455	(9,455)	—	(277)	165,005	
Issuance of common stock pursuant to exercise of stock options	73,012	1	364	—	—	—	365	
Issuance of common stock in connection with the employee stock purchase plan	203,972	2	1,376	—	—	—	1,378	
Issuance of restricted stock units	—	—	818	—	(818)	—	—	
Amortization of unearned compensation on restricted stock units	—	—	—	—	43	—	43	
Adjustment for equity method loss incurred during lag period	—	—	—	(492)	—	—	(492)	
Change in unrealized loss on marketable securities, net of tax	—	—	—	—	—	(101)	(101)	\$(101)
Translation adjustment	—	—	—	—	—	(84)	(84)	(84)
Net loss	—	—	—	(12,317)	—	—	(12,317)	(12,317)
Comprehensive loss								<u>\$(12,502)</u>
Balance at January 31, 2006	28,451,930	\$285	\$177,013	\$(22,264)	\$(775)	\$(462)	\$153,797	
Cumulative effect adjustment upon adoption of SAB 108 (Note 11)	—	—	—	753	—	(130)	623	
Balance at February 1, 2006, as adjusted	28,451,930	\$285	\$177,013	\$(21,511)	\$(775)	\$(592)	\$154,420	
Issuance of common stock pursuant to exercise of stock options	266,074	2	1,587	—	—	—	1,589	
Issuance of common stock in connection with the employee stock purchase plan	250,082	2	1,354	—	—	—	1,356	
Issuance of common stock pursuant to vesting of restricted stock units	35,657	—	—	—	—	—	—	
Issuance of common stock pursuant to second earnout for ODG acquisition (Note 7)	341,360	4	2,283	—	—	—	2,287	
Stock-based compensation expense	—	—	3,514	—	—	—	3,514	
Change in unrealized loss on marketable securities, net of tax	—	—	—	—	—	254	254	\$254
Translation adjustment	—	—	—	—	—	1,913	1,913	1,913
Net loss	—	—	—	(8,174)	—	—	(8,174)	(8,174)
Reversal of unearned compensation upon adoption of FASB 123R	—	—	(775)	—	775	—	—	
Comprehensive loss								<u>\$(6,007)</u>
Balance at January 31, 2007	<u>29,345,103</u>	<u>\$293</u>	<u>\$184,976</u>	<u>\$(29,685)</u>	<u>\$—</u>	<u>\$1,575</u>	<u>\$157,159</u>	

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

## SEACHANGE INTERNATIONAL, INC.

**CONSOLIDATED STATEMENT OF CASH FLOWS**  
(in thousands)

	Year ended January 31,		
	2007	2006	2005
<b>Cash flows from operating activities:</b>			
Net (loss) income .....	\$ (8,174)	\$ (12,317)	\$ 9,938
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:.....			
Depreciation .....	7,799	6,642	5,917
Amortization of intangibles and capitalized software .....	6,655	2,498	1,333
Inventory valuation charge .....	1,057	988	842
Allowance for doubtful accounts receivable .....	403	100	200
Amortization of premiums on marketable securities .....	(1)	260	947
Tax benefit from stock options .....	—	—	29
Equity (income) loss in earnings of affiliates .....	(1,273)	(39)	148
Elimination of intercompany earnings in investments in affiliates .....	148	—	—
Stock-based compensation .....	3,514	43	—
Loss on investment in affiliates .....	150	—	—
Deferred income taxes .....	(493)	(110)	—
Changes in operating assets and liabilities:.....			
Accounts receivable .....	1,056	(3,978)	(8,449)
Unbilled receivables .....	(1,199)	(3,951)	(210)
Inventories .....	(4,652)	(5,066)	(3,569)
Income taxes receivable .....	2,372	1,304	(4,079)
Prepaid expenses and other assets .....	1,293	(7,232)	(1,491)
Accounts payable .....	(67)	(1,769)	8,312
Income taxes payable .....	(1,950)	(952)	1,239
Accrued litigation reserve .....	(7,986)	305	77
Accrued expenses .....	180	2,923	(907)
Customer deposits .....	(154)	2,005	(236)
Deferred revenues .....	1,623	(1,680)	4,904
Other .....	187	—	—
Net cash (used in) provided by operating activities .....	488	(20,026)	14,945
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment .....	(7,079)	(13,424)	(3,944)
Purchases of marketable securities .....	(32,267)	(24,786)	(9,592)
Proceeds from sale and maturity of marketable securities .....	47,692	25,488	9,048
Acquisition of businesses and payment of contingent consideration, net of cash acquired .....	(3,045)	(31,260)	(1,124)
Release (deposit) of restricted cash .....	500	500	(1,000)
Investments in affiliates .....	—	(10,743)	(1,000)
Repayment of (loan to) affiliate .....	—	750	(750)
Net cash provided by (used in) investing activities .....	5,801	(53,475)	(8,362)
<b>Cash flows from financing activities:</b>			
Repayments of obligations under capital lease .....	—	(209)	(399)
Proceeds from issuance of common stock, net of issuance costs .....	2,947	1,743	5,880
Net cash provided by financing activities .....	2,947	1,534	5,481
Effect of exchange rate changes on cash .....	349	—	—
Net increase (decrease) in cash and cash equivalents .....	9,585	(71,967)	12,064
Cash and cash equivalents, beginning of period .....	21,594	93,561	81,497
Cash and cash equivalents, end of period .....	\$ 31,179	\$ 21,594	\$ 93,561
<b>Supplemental disclosure of cash flow information:</b>			
Income taxes paid .....	\$ 1,846	\$ 405	\$ 6,551
Interest paid .....	96	30	42
<b>Supplemental disclosure of non-cash activities:</b>			
Transfer of items originally classified as inventories to equipment .....	4,167	4,237	3,196
Transfer of items originally classified as equipment to inventories .....	—	11	188
Issuance of equity for ODG contingent consideration (Note 7) .....	2,287	—	—
Conversion of note receivable to equity related to investment in affiliate (Note 6) .....	407	—	—
Issuance of note payable for acquisition of business .....	—	—	1,000
Issuance of common stock in connection with warrant exercise .....	—	—	3,145

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

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Nature of Business

SeaChange International, Inc. ("SeaChange" or "the Company"), headquartered in Acton, Massachusetts, is a leading developer, manufacturer and marketer of digital video systems and services including the management, aggregation, licensing, storage and distribution of video, television, gaming and advertising content to cable system operators, telecommunications companies and broadcast television companies. Through January 31, 2007, substantially all of SeaChange's revenues were derived from the sale of hardware, software and systems and related services and movie content to cable system operators, broadcast and telecommunications companies located in the United States of America and internationally.

#### 2. Summary of Significant Accounting Policies

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

##### *Principles of Consolidation*

The Company consolidates the financial statements of its wholly owned subsidiaries and all inter-company accounts are eliminated in consolidation. SeaChange also holds minority investments in the capital stock of certain private companies having product offerings or customer relationships that have strategic importance. The Company evaluates its equity and debt investments and other contractual relationships with affiliate companies in order to determine whether the guidelines of FASB Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," as revised under FIN 46R should be applied in the financial statements. FIN No. 46R addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity ("VIE") is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary is required to consolidate the financial position and results of the VIE. Since the adoption of FIN 46R in the first quarter of fiscal 2005, the Company concluded that FIN 46R has not required the consolidation of any affiliate company. The Company has concluded that it is not the primary beneficiary for any variable interest entities during the fiscal year ended January 31, 2007.

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

##### *Revenue Recognition and Allowance for Doubtful Accounts*

Revenues from sales of hardware, software and systems that do not require significant modification or customization of the underlying software are recognized when title and risk of loss has passed to the customer, there is evidence of an arrangement, fees are fixed or determinable and collection of the related receivable is considered probable. Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities are deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support agreements are recognized ratably over the period of the related agreements. Revenue from software development contracts that include significant modification or customization, including software product enhancements, is recognized based on the percentage of completion contract accounting method using labor efforts expended in relation to estimates of total labor efforts to complete the contract. For contracts, where some level of profit is assured but the Company is only able to estimate ranges of amounts of total contract revenue and total contract cost, SeaChange uses the lowest probable level of profits in accounting for the contract revenues and costs. Accounting for contract amendments and customer change orders are included in contract accounting when executed. Revenue from shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues. SeaChange's share of intercompany profits associated with sales and services provided to affiliated companies are eliminated in consolidation in proportion to our equity ownership.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

SeaChange recognizes revenue for product and services only in those situations where collection from the customer is probable. The Company performs ongoing credit evaluations of customers' financial condition but generally does not require collateral. For some international customers, SeaChange requires an irrevocable letter of credit to be issued by the customer before the purchase order is accepted. The Company monitors payments from customers and assesses any collection issues. The Company maintains allowances for specific doubtful accounts and other risk categories of accounts based on estimates of losses resulting from the inability of the Company's customers to make required payments and records these allowances as a charge to general and administrative expenses. SeaChange bases its allowances for doubtful accounts on historical collections and write-off experience, current trends, credit assessments, and other analysis of specific customer situations.

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

### *Concentration of Credit Risk*

Financial instruments which potentially expose SeaChange to concentrations of credit risk include cash equivalents, investments in treasury bills, certificates of deposits and commercial paper, auction rate securities, trade accounts receivable, accounts payable and accrued liabilities. The Company restricts its cash equivalents and investments in marketable securities to repurchase agreements with major banks and U.S. government and corporate securities which are subject to minimal credit and market risk. For trade accounts receivable, SeaChange evaluates customers' financial condition, requires advance payments from certain of its customers and maintains reserves for potential credit losses. At January 31, 2007 and 2006, SeaChange had an allowance for doubtful accounts of \$466,000 and \$405,000, respectively, to provide for potential credit losses. Such losses have not exceeded management's expectations to date.

The following table summarizes revenues by significant customer where such revenue exceeded 10% of total revenues of the fiscal year. Revenues from significant customers were generated in the Broadband segment.

	Year ended January 31,		
	2007	2006	2005
Customer A.....	37%	25%	48%
Customer B.....	16%	—	—

At January 31, 2007, one customer accounted for 42% of SeaChange's gross accounts receivable balance. At January 31, 2006, one customer accounted for 20%, a second customer accounted for 17% and a third customer accounted for 11% of SeaChange's gross accounts receivable balance.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### Use of Estimates

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

### Cash Equivalents and Marketable Securities

SeaChange's investment portfolio consists of investments classified as cash equivalents, short-term marketable securities and long-term marketable securities. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. SeaChange's marketable securities are classified as available for sale and are reported at fair value. Any unrealized gains or losses are included in stockholders' equity as a component of accumulated other comprehensive loss. Any realized gains or losses would be shown in the accompanying consolidated statements of operations in other income or expense. The cost basis, aggregate fair value and unrealized gains and losses for SeaChange's cash equivalents, short- and long-term marketable securities portfolio is shown below (in thousands).

	Cost	Fair Market Value	Unrealized Gain (Loss)
<b>January 31, 2007:</b>			
Cash.....	\$ 30,491	\$ 30,491	\$ —
Cash equivalents.....	688	688	—
Cash and cash equivalents .....	31,179	31,179	—
US government agency issues.....	10,210	10,212	2
Corporate debt securities.....	18	18	—
State and municipal obligations .....	1,001	1,001	—
Marketable securities—short-term.....	11,229	11,231	2
US government agency issues.....	10,965	10,929	(36)
Corporate debt securities.....	1,936	1,956	20
Marketable securities—long-term .....	12,901	12,885	(16)
Total cash equivalents and marketable securities .....	\$ 55,309	\$ 55,295	\$ (14)
<b>January 31, 2006:</b>			
Cash.....	\$ 18,258	\$ 18,258	\$ —
Cash equivalents.....	3,336	3,336	—
Cash and cash equivalents .....	21,594	21,594	—
US government agency issues.....	8,308	8,293	(15)
Corporate debt securities.....	2,225	2,203	(22)
State and municipal obligations .....	4,100	4,100	—
Marketable securities—short-term.....	14,633	14,596	(37)
US government agency issues.....	22,984	22,749	(235)
Corporate debt securities.....	1,936	1,940	4
Marketable securities—long-term .....	24,920	24,689	(231)
Total cash equivalents and marketable securities .....	\$ 61,147	\$ 60,879	\$ (268)

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *Inventories and Reserves for Obsolescence*

Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in, first-out (FIFO) method. Inventories consist primarily of components and subassemblies and finished products held for sale. All of SeaChange's hardware components are purchased from outside vendors.

The costs and net realizable value of inventories are reviewed quarterly. SeaChange records charges to reduce inventory to its net realizable value when an impairment is identified through the quarterly review process. For inventory that has been written down to its net realizable value, the reserve is released upon sale or disposal of this inventory.

#### *Property and Equipment*

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

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

Costs associated with software developed or obtained for internal use are capitalized when the Company has completed the preliminary project stage and has determined that the project will be completed and used to perform the function intended. Capitalization of such costs ceases when the project is substantially complete and ready for its intended purpose. Post-implementation training, maintenance and other operating costs are expensed as incurred. At each of the years ended January 31, 2007 and 2006, \$1.9 million of internal use software costs were capitalized. Accumulated amortization related to these internal use software costs at January 31, 2007 and 2006 were \$1.7 million and \$1.1 million, respectively. The related amortization expense was \$633,000 and \$612,000 for fiscal years ended January 31, 2007 and 2006, respectively.

#### *Investments in Affiliates.*

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

The Company periodically review indicators of the fair value of the investments in affiliates in order to assess whether available facts or circumstances, both internally and externally, may suggest an other than temporary decline in the value of the investment. The carrying value of an investment in an affiliate may be affected by the affiliate's ability to obtain adequate funding and execute its business plans, general market conditions, industry considerations specific to the affiliate's business, and other factors. SeaChange records an impairment charge when management believes an investment has experienced a decline in value that is other-than-temporary.

#### *Business Combinations*

The Company accounts for business acquisitions in accordance with SFAS No. 141, "Business Combinations", which requires that the purchase method of accounting be used for all business "combinations". The Company determines and records the fair values of assets acquired and liabilities assumed as of the dates of acquisition.

#### *Goodwill and Intangible Assets*

SeaChange evaluates goodwill for impairment on, at least, an annual basis. SeaChange evaluates the recoverability of goodwill annually, in the second quarter for goodwill associated with the Broadband segment (primarily the goodwill associated with the acquisition of the non-North American assets of Liberate Technologies) and in the third quarter for goodwill associated with the Services segment (primarily the goodwill associated with the acquisition of the On Demand Group Ltd and for the related equity method goodwill associated with Filmflex). The Broadband and Services segments were determined to be the applicable reporting units for the goodwill impairment analyses. Goodwill is evaluated more frequently

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

if events or changes in circumstances, such as declines in sales, earnings or cash flows or material adverse changes in the business climate, indicate that the carrying value of goodwill might be impaired. Goodwill is considered to be impaired when the net book value of a reporting unit exceeds its estimated fair value. Fair values are primarily determined using a discounted cash flow methodology. The determination of discounted cash flows is based on SeaChange's strategic plans and future forecasts. SeaChange completed the annual impairment tests of goodwill associated with the Broadband and Services segments and determined that no adjustment was required to the carrying value of goodwill based on the analyses performed at those times or at January 31, 2007. However, there can be no assurance that goodwill will not become impaired in future periods.

Intangible assets consist of customer contracts, completed technology, patents and trademarks and are reported as part of the Broadband and Services segments. The intangible assets are amortized to cost of sales and operating expenses, as appropriate, on a straight-line or accelerated basis in order to reflect the expected pattern and period that the assets will be consumed.

#### *Software Development Costs*

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

SeaChange also purchases software for resale and capitalizes those costs associated with projects that meet technological feasibility. At the end of each of the fiscal years ended January 31, 2007 and 2006, \$5.2 million of purchased software costs were capitalized. Amortization expense is recorded over the period of economic consumption or the life of the agreement whichever results in the higher expense, starting with the first shipment of the product to a customer. The related amortization expense was \$346,000 and \$0 for fiscal years ended January 31, 2007 and 2006, respectively.

#### *Long-lived Assets*

SeaChange evaluates property and equipment, intangible assets and other long-lived assets on a regular basis for the existence of facts or circumstances, both internal and external that may suggest an asset is not recoverable. Factors SeaChange considers important that could trigger the impairment review include:

- significant underperformance relative to historical or projected future operating results;
- significant negative industry or economic trends;
- significant decrease in the market value of the long-lived asset;
- significant adverse change to the extent or manner in which a long-lived asset is being used or in its physical condition;
- significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset;
- significant decline in our stock price for a sustained period;
- significant decline in our technological value as compared to the market; and
- a decline in the Company's market capitalization relative to net book value.

If such circumstances exist, SeaChange evaluates the carrying value of long-lived assets to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and compares that value to the carrying value of the assets. If the carrying value of the assets is greater than the estimated future undiscounted cash flows, the assets are written down to their estimated fair value. SeaChange determines the estimated fair value of the assets on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the current business model. In determining expected future cash flows, assets are grouped at the lowest level for which cash flows are identifiable and independent of cash flows from other asset groups. SeaChange's cash flow estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time.

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted statutory tax rates in effect in the year in which the differences are expected to reverse. A deferred tax asset is established for the expected future benefit of net operating loss and credit carryforwards. A valuation reserve is required, if, based upon available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

SeaChange does not provide for U.S. federal and state income taxes on the undistributed earnings of its non-U.S. subsidiaries that are considered indefinitely reinvested in the operations outside the U.S.

Income taxes payable includes uncertain tax positions taken that could be challenged by taxing authorities. These probable exposures result from the varying application of statutes, rules, regulations and interpretations. The Company's estimate of the value of its tax contingencies contains assumptions based on past experiences and judgments about potential actions by taxing jurisdictions.

#### *Stock-based Compensation*

On February 1, 2006, SeaChange adopted SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS 123R"), which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors including stock options, employee stock purchases under a stock purchase plan, and non-vested share awards (restricted stock units) based on estimated fair values. SFAS 123R supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). The Company adopted the provisions of SFAS 123R using the modified prospective transition method beginning February 1, 2006, the first day of the first quarter of fiscal 2007. In accordance with that transition method, the Company has not restated prior periods for the effect of compensation expense calculated under SFAS 123R. The Company has continued to use the Black-Scholes option pricing model for determining the estimated fair values of all applicable awards. The determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by the historical price of the Company's stock as well as key assumptions including the expected life of the award, the expected stock price, volatility over the term of the award and actual and projected exercise behaviors. For all awards the Company has recognized stock compensation expense using a straight-line amortization method over the vesting period of the award. As SFAS 123R requires that stock-based compensation expense be based on awards that ultimately vest, estimated share-based compensation for fiscal 2007 has been reduced for estimated forfeitures.

#### *Foreign Currency Translation*

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

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

The aggregate foreign exchange transaction losses were \$314,000, \$339,000 and \$133,000 for the years ended January 31, 2007, 2006 and 2005, respectively.

#### *Comprehensive Income (Loss)*

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



# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### *Advertising Costs*

Advertising costs are charged to expense as incurred. Advertising costs were \$313,000, \$273,000 and \$224,000 for the years ended January 31, 2007, 2006 and 2005, respectively.

### *Earnings (Loss) Per Share*

Earnings (loss) per share are presented in accordance with SFAS No. 128, "Earnings Per Share", which requires the presentation of "basic" earnings (loss) per share and "diluted" earnings (loss) per share. Basic earnings (loss) per share is computed by dividing earnings (loss) available to common shareholders by the weighted-average shares of common stock outstanding during the period. For the purposes of calculating diluted earnings (loss) per share, the denominator includes both the weighted average number of shares of common stock outstanding during the period and the weighted average number of potential common stock, such as stock options and restricted stock, calculated using the treasury stock method.

For the fiscal years ended January 31, 2007 and 2006, 6,177,411 and, 6,551,857, respectively, of common shares issuable upon the exercise of stock options are anti-dilutive because SeaChange recorded a net loss for the periods and, therefore, have been excluded from the diluted loss per share computation. For the fiscal year ended January 31, 2005, 2,220,000 of common shares issuable upon the exercise of stock options are anti-dilutive and have been excluded from the diluted earnings per share computation as the exercise prices of these common shares were above the market price of the common stock for the periods indicated.

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

	Year Ended January 31,		
	2007	2006	2005
Weighted average shares used in calculating earnings (loss) per share—Basic	28,857,381	28,303,000	27,640,000
Dilutive common stock equivalents .....	—	—	1,413,000
Weighted average shares used in calculating earnings (loss) per share—			
Diluted .....	28,857,381	28,303,000	29,053,000

### *New Accounting Pronouncements*

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140" (SFAS No. 155). SFAS No. 155 permits a fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that would otherwise require bifurcation. This accounting standard is effective as of the beginning of fiscal years beginning after September 15, 2006. The effect of adopting SFAS No. 155 on the Company's financial position and results of operations will be immaterial.

In March 2006, the FASB issued the Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statements No. 140" (SFAS No. 156). SFAS No. 156 requires that servicing assets and servicing liabilities be recognized at fair value, if practicable, when we enter into a servicing agreement and allows two alternatives, the amortization and fair value measurement methods, as subsequent measurement methods. This accounting standard is effective for all new transactions occurring as of the beginning of fiscal years beginning after September 15, 2006. The effect of adopting SFAS No. 156 on the Company's financial position and results of operations will be immaterial.

In June 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of February 1, 2007, as required. The cumulative effect of adopting FIN 48 will be recorded as an adjustment to opening retained earnings and other accounts as applicable. The Company is currently evaluating the effect of FIN 48 on the Company's results of operations or financial position.

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement." SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not expect the adoption of SFAS 157 to have a material impact on its financial statements.

In September 2006, the SEC staff released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" method and the "iron curtain" method. The roll-over method focuses primarily on the impact of a misstatement on the income statement, including the reversing effect of prior year misstatements, but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The Company previously used the roll-over method for quantifying identified financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effect of the misstatements on each of the Company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification of errors under both the iron curtain and the roll-over methods.

SAB 108 permits public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of the beginning of the year of adoption, February 1, 2006, for the Company, with an offsetting adjustment recorded to the opening balance of retained earnings. The Company has applied the provisions of SAB 108 using the cumulative effect transition method as of February 1, 2006, as discussed in Note 11 to the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on its financial statements.

### 3. Consolidated Balance Sheet Detail

Inventories consist of the following:

	January 31,	
	2007	2006
Components and assemblies .....	\$ 11,825,000	\$ 13,455,000
Finished products .....	7,525,000	5,844,000
	<u>\$ 19,350,000</u>	<u>\$ 19,299,000</u>

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Property and equipment consist of the following:

	Estimated useful life (years)	January 31,	
		2007	2006
Land.....		\$ 3,063,000	\$ 283,000
Buildings.....	20	12,509,000	2,150,000
Office furniture and equipment.....	5	2,320,000	2,204,000
Computer equipment, software and demonstration equipment.....	3	43,833,000	38,467,000
Deployed assets .....	2-7	3,280,000	3,405,000
Service and spare components.....	5	6,796,000	5,516,000
Leasehold improvements .....	1-7	1,511,000	2,694,000
Automobiles/truck .....	5	649,000	635,000
Construction in progress .....		—	10,347,000
		<u>73,961,000</u>	<u>65,701,000</u>
Less - Accumulated depreciation and amortization.....		<u>(43,241,000)</u>	<u>(38,510,000)</u>
		<u>\$ 30,720,000</u>	<u>\$ 27,191,000</u>

Construction in progress at January 31, 2006 included \$8.9 million of real property located at 50 Nagog Park in Acton, Massachusetts which was purchased in the second quarter of fiscal 2006. The building has approximately 120,000 square feet, and as of mid-February 2006, became the Company's new corporate headquarters. All operations and personnel that were located at the facility in Maynard, Massachusetts were relocated to the new property in Acton, Massachusetts in February 2006. All related construction in progress balances were capitalized, primarily to the buildings category, during fiscal 2007.

Depreciation and amortization expense of fixed assets was \$7,799,000, \$6,642,000 and \$5,917,000 for the years ended January 31, 2007, 2006 and 2005, respectively. At both January 31, 2007 and 2006 SeaChange had no assets under capital lease.

Other accrued expenses consist of the following:

	January 31,	
	2007	2006
Accrued consideration payable to former shareholders in ODG .....	\$ —	\$ 2,804,000
Other accrued expenses .....	5,884,000	5,604,000
	<u>\$ 5,884,000</u>	<u>\$ 8,408,000</u>

This balance is net of a reclassification of the value-added tax (VAT) payable amount against the VAT receivable balance. The right of offset exists between these VAT amounts with the net balance being either a receivable or payable from the appropriate tax authorities. Reclassification of the VAT payable balance has been made to conform the January 31, 2006 balance to the current period presentation.

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**4. Segment Information and Significant Customer Information**

SeaChange has three reportable segments: Broadband, Broadcast and Services. The Broadband segment develops, markets and sells products to digitally manage, store and distribute digital video for cable system operators and telecommunications companies. The Broadcast segment develops, markets and sells products for the storage, archival, on-air playback of advertising and other video programming for the broadcast television industry. The Services segment provides installation, training, project management, product maintenance and technical support services, and software development, for all of the above products, and movie content services. SeaChange measures profitability of the segments based on their respective gross profit. There were no inter-segment sales or transfers. The following summarizes the revenues and cost of revenues by reportable segment:

	Year ended January 31,		
	2007	2006	2005
Revenues:			
Broadband hardware, software and systems.....	\$ 84,905,000	\$ 64,365,000	\$ 100,049,000
Broadcast hardware, software and systems .....	10,095,000	9,151,000	13,715,000
Services .....	66,334,000	52,748,000	43,539,000
	<u>\$ 161,334,000</u>	<u>\$ 126,264,000</u>	<u>\$ 157,303,000</u>
Costs of revenues:			
Broadband hardware, software and systems.....	\$ 39,022,000	\$ 36,805,000	\$ 51,023,000
Broadcast hardware, software and systems .....	9,294,000	9,053,000	9,118,000
Services .....	37,169,000	28,275,000	25,705,000
	<u>\$ 85,485,000</u>	<u>\$ 74,133,000</u>	<u>\$ 85,846,000</u>
Gross profit:			
Broadband hardware, software and systems.....	\$ 45,883,000	\$ 27,560,000	\$ 49,026,000
Broadcast hardware, software and systems .....	801,000	98,000	4,597,000
Services .....	29,165,000	24,473,000	17,834,000
	<u>\$ 75,849,000</u>	<u>\$ 52,131,000</u>	<u>\$ 71,457,000</u>

SeaChange does not measure the assets allocated to the segments, other than the goodwill and intangible assets in connection with its acquisitions. The following table summarizes intangible assets, net and goodwill by reportable segment:

	January 31, 2007	January 31, 2006
	(in thousands)	
Goodwill and Intangible Assets		
Broadband .....	\$ 19,282	\$ 23,711
Services .....	17,498	15,572
Total.....	<u>\$ 36,780</u>	<u>\$ 39,283</u>

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following summarizes revenues by customers' geographic locations:

	Fiscal Year ended January 31,		
	2007	2006	2005
Revenues:			
United States of America .....	\$ 107,950,000	\$ 75,817,000	\$ 122,245,000
United Kingdom.....	32,936,000	26,988,000	6,043,000
Canada and South America .....	7,446,000	9,733,000	9,238,000
Europe and Middle East (excluding the United Kingdom) .....	6,723,000	5,896,000	10,694,000
Asia/Pacific and other international locations.....	6,279,000	7,830,000	9,083,000
	<u>\$ 161,334,000</u>	<u>\$ 126,264,000</u>	<u>\$ 157,303,000</u>

The following summarizes fixed assets, net by geographic locations:

	January 31, 2007	January 31, 2006
	(in thousands)	
Fixed assets, net		
United States of America .....	\$ 27,619	\$ 25,444
United Kingdom .....	802	317
Europe and Middle East (excluding the United Kingdom).....	125	205
Asia/Pacific and other international locations.....	2,174	1,225
Total.....	<u>\$ 30,720</u>	<u>\$ 27,191</u>

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

Effective February 1, 2006, SeaChange adopted on a modified prospective basis the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123R, "Share-Based Payment (Revised 2004)," ("FAS No. 123R") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options, restricted stock units and employee stock purchases related to SeaChange's Employee Stock Purchase Plan ("ESPP") based on estimated fair values. Accordingly, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense on a straight-line basis over the employee's requisite service period. SeaChange has applied the provisions of Staff Accounting Bulletin No. 107, "Share-Based Payment," ("SAB 107") in its adoption of FAS No. 123R.

### *Impact of the Adoption of FAS No. 123R*

Under the modified prospective transition method, SeaChange recognized stock-based compensation expense during the year ended January 31, 2007 for: (a) ESPP awards from offering periods that began on December 1, 2005, June 1, 2006 and December 1, 2006 and ended on May 31, 2006, November 30, 2006 and May 31, 2007, respectively, (b) stock options and restricted stock units granted prior to, but not yet vested as of February 1, 2006, based on the grant date fair value estimated in accordance with the disclosure provisions of FAS No. 123, and (c) stock options and restricted stock units granted subsequent to February 1, 2006, based on the grant date fair value, estimated in accordance with the provisions of FAS No. 123R. Under the modified prospective transition method, results for prior periods are not restated. The adoption of FAS No. 123R did not affect the accounting for stock-based compensation expense related to restricted stock units. The fair value of a restricted stock unit is the market value of a share of the Company's common stock on the date of grant of the restricted stock unit. This fair value is amortized on a straight-line basis over the related vesting period of the restricted stock unit.

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The estimated fair value of SeaChange's stock-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis. The effect of recording stock-based compensation for the year ended January 31, 2007 was as follows:

	Year Ended January 31, 2007
	(Amounts in thousands, except per share amounts)
Stock-based compensation expense by type of award:	
Stock options.....	\$ 2,179
Restricted stock units .....	625
Performance-based restricted stock units .....	248
Employee Stock Purchase Plan .....	462
Total stock-based compensation .....	3,514
Less: Tax effect on stock-based compensation .....	—
Net effect on net loss .....	\$ 3,514
Effect on net loss per share	
Basic.....	\$ (0.12)
Diluted.....	\$ (0.12)

Since additional option grants are expected to be made each year and options vest over several years, the effects of applying SFAS No. 123R for recording stock-based compensation for the year ended January 31, 2007 are not indicative of future amounts.

The following table presents stock-based compensation expenses included in the Company's Consolidated Statement of Operations:

	Year Ended January 31, 2007
	(Amounts in thousands)
Cost of product revenue .....	\$ 109
Cost of service revenue .....	216
Research and development expense.....	1,551
Sales and marketing expense .....	470
General and administrative expense .....	1,168
Income tax benefit .....	—
Total stock-based compensation expense.....	\$ 3,514

SeaChange estimates the fair value of stock options, including rights granted under the ESPP, using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price, the expected option term, the risk-free interest rate over the option's expected term, the expected annual dividend yield and the expected stock price volatility. The expected option term was determined using the "simplified" method for "plain vanilla" options as allowed by SAB 107. The expected stock price volatility was established using a blended volatility, which is an average of the historical volatility of SeaChange's common stock over a period of time equal to the expected term of the stock option, and the average volatility of SeaChange's common stock over the most recent one-year and two-year periods. Estimates of fair values are not intended to predict actual future events or the value ultimately realized by the persons who receive equity awards.

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair value of each option grant was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions:

	Year ended January 31, 2007		
	Options		
	Range	Weighted Average	ESPP
Expected term (in years) .....	4 – 5	4.5	0.5
Expected volatility .....	51% – 58%	56%	45%
Risk-free interest rate .....	4.4% – 5.1%	4.7%	4.6%
Expected dividend yield .....	0%	0%	0%

***Pro Forma Information Under SFAS 123***

Prior to February 1, 2006, SeaChange accounted for its stock plans under the provisions of Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations (“APB 25”) and provided pro forma disclosures as though the fair value method was reported in accordance with SFAS No. 123, “Accounting for Stock-Based Compensation,” (“SFAS 123”), as amended by SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure, An Amendment of SFAS No. 123”. The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts.

The pro forma information for the years ended January 31, 2006 and 2005 was as follows:

(Amounts in thousands, except share amounts)	Year ended January 31, 2006	Year ended January 31, 2005
Net (loss) income, as reported .....	\$ (12,317)	\$ 9,938
Add: Stock-based compensation under APB No. 25, net of related tax effect .....	34	—
Less: Stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects .....	(12,688)	(9,100)
Pro forma net (loss) income .....	\$ (24,971)	\$ 838
Basic (loss) earnings per share		
As reported .....	\$ (0.44)	\$ 0.36
Pro forma .....	\$ (0.88)	\$ 0.03
Diluted (loss) earnings per share		
As reported .....	\$ (0.44)	\$ 0.34
Pro forma .....	\$ (0.88)	\$ 0.03

The fair value of SeaChange’s stock-based awards granted during the years ended January 31, 2006 and 2005 was estimated on the grant date using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Year Ended January 31, 2006 Options	Year Ended January 31, 2005 Options
Expected term (in years) .....	5.6	7.5
Expected volatility .....	68.0%	85% – 100%
Risk-free interest rate .....	3.9%	2.7%
Expected dividend yield .....	0%	0%

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The expected term for options granted during fiscal years 2006 and 2005 is higher than the expected term for options granted during fiscal year 2007 because of the shorter life of stock options granted under the 2005 Equity Compensation and Incentive Plan (the “2005 Plan”) which replaced the Company’s Amended and Restated 1995 Stock Option Plan (the “1995 Plan”) in July 2005. Under the 2005 Plan, stock options vest over three years and expire seven years from the date of grant, while stock options granted under the 1995 Plan generally vested over a four year period and expired ten years from the date of grant.

The expected volatility assumption is higher for options granted in fiscal years 2006 and 2005 than in fiscal 2007. The fiscal year 2006 and 2005 volatility was the historical volatility of SeaChange’s common stock over a period of time equal to the expected term of the stock option (rather than a blended rate). The fiscal 2007 volatility assumption was based upon a blended volatility rate.

On January 26, 2006, the Company accelerated the vesting of certain unvested stock options with exercise prices equal to or greater than \$9.00 per share that were previously awarded to its employees, including its executive officers and non-employee directors, under the Company’s equity compensation plans. This decision was the principal reason for the lower stock-based compensation expense recorded in fiscal 2007 compared to the disclosure of pro forma expense for the years ended January 31, 2006 and 2005.

#### ***Stock Option Plans***

##### *2005 Equity Compensation and Incentive Plan*

The 2005 Equity Compensation and Incentive Plan (the “2005 Plan”) provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units, and “other” non-stock option awards as determined by the plan administrator for the purchase of up to an aggregate of 1,500,000 shares of SeaChange’s common stock (but not greater than two percent of the aggregate shares outstanding per fiscal year) by officers, employees, consultants and directors of SeaChange. The Board of Directors is responsible for administration of the 2005 Plan and determining the term of each award, award exercise price, number of shares for which each award is granted and the rate at which each award is exercisable.

Option awards may be granted to employees at an exercise price per share of not less than 100% of the fair market value per common share on the date of the grant (not less than 110% for an incentive stock option granted to a 10% or more stockholder). Incentive stock options may be granted only to those employees of SeaChange to the extent that the fair value of the options granted that become exercisable during any one calendar year plus previously granted incentive stock options that become exercisable in that period is less than \$100,000. Restricted stock units and other equity-based non-stock option awards may be granted to any officer, employee, director or consultant at a purchase price per share as determined by SeaChange’s Board of Directors. Awards granted under the 2005 Plan generally vest over three years and expire seven years from the date of the grant (five years for incentive stock options granted to holders of more than 10% of SeaChange’s voting stock). As of January 31, 2007, there were 416,000 shares of SeaChange common stock available for future grant under the 2005 Plan.

##### *1995 Stock Option Plan*

The Amended and Restated 1995 Stock Option Plan (the “1995 Stock Option Plan”) provides for the grant of incentive stock options and nonqualified stock options for the purchase of up to an aggregate of 9,200,000 shares of SeaChange’s common stock by officers, employees, consultants and directors of SeaChange. The Board of Directors is responsible for administration of the 1995 Stock Option Plan and determining the term of each option, option exercise price, number of shares for which each option is granted and the rate at which each option is exercisable. Options generally vest ratably over four years. SeaChange may not grant an employee incentive stock options with a fair value in excess of \$100,000 that are initially exercisable during any one calendar year.

Incentive stock options may be granted to employees at an exercise price per share of not less than the fair value per common share on the date of the grant (not less than 110% of the fair value in the case of holders of more than 10% of SeaChange’s voting stock). Nonqualified stock options may be granted to any officer, employee, director or consultant at an exercise price per share as determined by SeaChange’s Board of Directors. Grants of stock options to the Board of Directors under SeaChange’s 1995 Stock Option Plan are made pursuant to a policy under which each non-employee director receives a grant of 2,500 stock options per quarter.



# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Options granted under the 1995 Stock Option Plan generally expire ten years from the date of the grant (five years for incentive stock options granted to holders of more than 10% of SeaChange's voting stock). In July 2005, SeaChange's Board of Directors terminated the 1995 Stock Option Plan and began granting stock options under the Company's 2005 Plan. As of January 31, 2007, no options were available for grant under the 1995 Stock Option Plan.

On January 26, 2006, the Company accelerated the vesting of certain unvested stock options with exercise prices equal to or greater than \$9.00 per share that were previously awarded to its employees, including its executive officers and non-employee directors, under the Company's 1995 Stock Option Plan. Stock options equivalent to 1,354,974 shares of the Company's common stock, including an aggregate of 243,821 options held by executive officers and directors are subject to this acceleration. Each director and executive officer has entered into a lock-up agreement that provides that the director or executive officers will refrain from selling the shares of common stock acquired upon the exercise of the accelerated options until the date on which the exercise would have been permitted under the option's pre-acceleration vesting terms or, if earlier, the person's last day of employment with or service to the Company or upon an acquisition of the Company, as defined in the 1995 Stock Option Plan. The acceleration of vesting became effective for stock options outstanding as of January 26, 2006.

The decision to accelerate the vesting of these options was made primarily to reduce non-cash compensation expense that would have been recorded in future periods following the Company's adoption of SFAS 123(R) on February 1, 2006. The Company's aggregate expense that will not be recorded as a result of the acceleration of the vesting of these options is approximately \$6.9 million, based on all outstanding options continuing to vest under their original, pre-acceleration vesting terms.

### Director Option Plan

In June 1996, SeaChange's Board of Directors adopted and the stockholders approved a director stock option plan (the "Director Option Plan") which provides for the grant of options to full time directors of SeaChange to purchase a maximum of 45,000 shares of common stock under the Director Option Plan. Under the Director Option Plan, participating directors receive an option to purchase 5,062 shares of common stock per annum. Options granted under the Director Option Plan vest as to 33 1/3% of the shares underlying the option immediately upon the date of the grant, and vest as to an additional 8 1/3% of the shares underlying the option at the end of each of the next 8 quarters, provided that the optionee remains a director. Directors will also receive, on each three-year anniversary of such director's option grant date, an additional option to purchase 5,062 shares of common stock, provided that such director continues to serve on the Board of Directors. All options granted under the Director Option Plan have an exercise price equal to the fair value of the common stock on the date of grant and a term of ten years from the date of grant. In May 2002, SeaChange's Board of Directors terminated the director option plan and began granting stock options to the board of directors under the Company's 1995 Stock Option Plan.

The following table summarizes the stock option activity (excluding restricted stock units) during the years ended January 31, 2007, 2006 and 2005:

	Fiscal Year ended January 31, 2007		Fiscal Year ended January 31, 2006		Fiscal Year ended January 31, 2005	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Outstanding at beginning of period .....	6,449,857	\$ 14.68	6,046,258	\$ 15.78	5,548,346	\$ 15.47
Granted .....	363,891	7.99	915,497	7.69	1,470,812	14.98
Exercised .....	(264,959)	6.11	(73,124)	5.00	(562,528)	8.06
Forfeited/Expired/Cancelled .....	(612,054)	15.27	(438,774)	15.30	(410,372)	19.23
Outstanding at end of period .....	<u>5,936,735</u>	\$ 14.85	<u>6,449,857</u>	\$ 14.68	<u>6,046,258</u>	\$ 15.78
Options exercisable at end of period .....	5,169,736	\$ 15.94	5,495,405		3,071,694	
Weighted average remaining contractual term (in years) .		5.79		7.28		7.16

The weighted-average grant date fair value of stock options granted during the years ended January 31, 2007, 2006 and 2005, was \$4.10, \$6.27 and \$11.32, respectively. As of January 31, 2007, the unrecognized stock-based compensation related to the unvested stock options was \$1.5 million net of estimated forfeitures. Total unrecognized compensation cost will be adjusted for any future changes in estimated changes in forfeitures. This cost will be recognized over an estimated weighted average amortization period of 1.0 years.

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The total intrinsic value of options exercised during the years ended January 31, 2007, January 31, 2006 and January 31, 2005 was \$730,757, \$185,972 and \$4,443,808, respectively, with intrinsic value defined as the difference between the market price on the date of exercise and the grant date price.

The following table summarizes information about employee and director stock options outstanding and exercisable as of January 31, 2007:

	Options outstanding			Options exercisable	
	Number outstanding	Weighted average remaining contractual term (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
Range of exercise prices					
\$ 4.00 to 6.20 .....	594,518	4.06	\$ 5.55	587,355	\$ 5.56
6.25 to 7.00 .....	752,262	5.90	6.88	344,760	6.94
7.17 to 10.33 .....	745,329	5.83	8.67	401,294	9.04
10.37 to 13.24 .....	699,332	6.19	12.02	691,032	12.04
13.31 to 14.47 .....	733,016	6.17	13.97	733,016	13.97
14.56 to 16.56 .....	610,868	6.19	15.62	610,868	15.62
17.26 to 22.00 .....	444,744	6.23	17.96	444,744	17.96
23.31 to 23.31 .....	611,662	5.86	23.31	611,662	23.31
24.10 to 34.00 .....	683,954	6.14	29.93	683,954	29.93
35.50 to 39.13 .....	61,050	6.43	37.57	61,050	37.57
	<u>5,936,735</u>	<u>5.86</u>	<u>\$ 14.85</u>	<u>5,169,735</u>	<u>\$ 15.94</u>
Aggregate intrinsic value 13.31 to 14.47 .....	\$ 6,048,778			\$ 4,124,324	

***Restricted Stock Units***

Pursuant to the 2005 Plan, SeaChange may grant restricted stock units that entitle recipients to acquire shares of SeaChange's common stock. Of the 1,500,000 shares of SeaChange's common stock authorized for grant under the 2005 Plan, no more than twenty-five percent (375,000 shares) may be used for grants of restricted stock, restricted stock units or other non-stock option awards. Awards of restricted stock units vest in equal increments on each of the first three anniversaries of the grant of the award. Stock-based compensation expense associated with the restricted stock units is charged for the market value of the Company's stock on the date of grant, assuming nominal forfeitures, and is amortized over the awards' vesting period on a straight-line basis. The Company recorded stock-based compensation expense related to restricted stock of \$625,000 for the year ended January 31, 2007 and \$43,000 for the year ended January 31, 2006. The Company had no stock-based compensation expense related to restricted stock for the year ended January 31, 2005. Performance-based stock compensation of \$248,000 was accrued during fiscal 2007 for restricted stock units earned and vested by the Company's senior executives in the fiscal year ended January 31, 2007. Grants for these restricted stock units will occur in fiscal 2008. As of January 31, 2007, 2006 and 2005 there were 98,667, 273,000 and zero shares, respectively, of SeaChange common stock available for grants of restricted stock, restricted stock units or other non-option awards under the 2005 Plan.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the restricted stock unit activity as of and for the years ended January 31, 2007, 2006 and 2005:

	Fiscal Year ended January 31, 2007		Fiscal Year ended January 31, 2006		Fiscal Year ended January 31, 2005	
	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value	Shares	Weighted average grant date fair value
Nonvested at beginning of period .....	102,000	\$ 8.01	—	\$ —	—	\$ —
Granted .....	181,000	8.85	102,000	8.01	—	—
Vested .....	(35,657)	8.08	—	—	—	—
Forfeited/expired/cancelled.....	(6,667)	8.77	—	—	—	—
Nonvested at end of period .....	<u>240,676</u>	<u>\$ 8.61</u>	<u>102,000</u>	<u>\$ 8.01</u>	<u>—</u>	<u>\$ —</u>

As of January 31, 2007, the unrecognized stock-based compensation related to the unvested restricted stock units was \$1.7 million. This cost will be recognized over an estimated weighted average amortization period of 1.9 years.

### Employee Stock Purchase Plan

In September 1996, SeaChange's Board of Directors adopted and the stockholders approved an employee stock purchase plan (the "ESPP"), effective January 1, 1997 and amended on July 17, 2002 and July 16, 2003, which provides for the issuance of a maximum of 1,100,000 shares of common stock to participating employees who meet eligibility requirements. The authorized number of shares to be issued under the ESPP was increased from 1,100,000 to 1,600,000 by shareholder vote during the Company's annual shareholder meeting in July 2006. Employees who would immediately after the purchase own 5% or more of the total combined voting power or value of SeaChange's stock and directors who are not employees of SeaChange may not participate in the Stock Purchase Plan. The purchase price of the stock is 85% of the lesser of the average market price of the common stock on the first or last business day of each six-month plan period. In the most recent period under the ESPP ended November 31, 2006, employees purchased an aggregate of 127,572 shares at a discounted price of \$5.30 per share. During the fiscal years ended January 31, 2007, 2006 and 2005, 250,082, 203,972 and 107,579 shares of common stock, respectively, were issued under the Stock Purchase Plan.

### 6. Investments in Affiliates

*Casa Systems.* In the second quarter of fiscal 2006, the Company invested \$8.2 million in convertible preferred stock, representing a 19.8% ownership interest, of Casa Systems, Inc. ("Casa"), a Massachusetts development stage company that specializes in video-on-demand products within the telecommunications and television markets. The investment is represented by shares of convertible preferred stock, and the shares are convertible at SeaChange's option into shares of Casa's common stock on a one-to-one basis. The convertible preferred stock accrues dividends at the rate per annum of \$0.3832 per share and the payment of the cumulative accruing dividends must be declared by the Board of Directors of Casa. At the time of the investment, SeaChange also entered into agreements with Casa, its stockholders and its optionholders and which grant SeaChange the right of first refusal on the issuance of additional shares of Casa securities or transfers of stock or options by holders. In addition, SeaChange had a call option exercisable until January 31, 2007 to purchase all of the outstanding stock and options not owned by SeaChange for an aggregate price of \$92 million.

In February 2005, SeaChange entered into a Supply Agreement with Casa in which Casa would provide certain products to SeaChange at agreed upon prices, which are at fair value. SeaChange was granted exclusive rights in July 2005 to sell these products in North America until January 31, 2007, as long as the Company met certain sales levels over this time period.

SeaChange reviewed the Preferred Stock Purchase Agreement and related agreements and determined that Casa was a variable interest entity ("VIE") as defined by the accounting guidance of FIN No. 46R. SeaChange concluded that it is not the primary beneficiary in Casa. Consequently, SeaChange accounts for this investment under the cost method of accounting. At January 31, 2007, SeaChange again reviewed the Casa investment as part of its annual review of this arrangement and determined that Casa was still a variable interest entity ("VIE") as defined by the accounting guidance of FIN No. 46R and concluded again that SeaChange is not the primary beneficiary in Casa.

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In determining whether the Company's convertible preferred stock investment in Casa was in-substance an investment in common stock, the Company considered whether its investment has substantive liquidation preferences over Casa's common stock. The Company also considered whether Casa had little or no subordinated equity from a fair value perspective and whether the stated liquidation preference of the convertible preferred stock was significant in relation to the purchase price of the investment. The estimated fair value of Casa's common stock significantly exceeded the estimated fair value of Casa's convertible preferred stock (including the liquidation preference and purchase call option), all of which were determined by an independent valuation expert. As a result, SeaChange's convertible preferred stock investment retained a "substantive liquidation preference," as defined by paragraph 6a. of EITF 02-14, over the holders of Casa's common stock. The Company considered Example 2 of Exhibit 02-14A, "Examples of the Application of the Characteristics of In-Substance Common Stock" of EITF 02-14 as it was substantially similar to the facts and circumstances involving SeaChange's convertible preferred stock investment in Casa. In that example, the stated liquidation preference of a preferred stock investment is equal to the fair value of the preferred stock and the fair value of the common stock exceeds that of the preferred stock. The conclusion from this example is that because the liquidation preference is substantive, the subordination characteristics of the preferred stock are not substantially similar to the subordination characteristics of the common stock. As a result, the preferred stock investment in this example is not in-substance common stock and no further evaluation for equity accounting treatment is required.

The Company also evaluated the other agreements with Casa, including the Company's right of first refusal on the issuance of additional shares of Casa securities or the transfer of stock or options by holders, and the Company's call option to purchase all of the outstanding stock and options not owned by the Company. The right of first refusal represents an option to allow SeaChange to maintain its relative ownership interest in Casa. The option to purchase the outstanding common stock of Casa is limited in duration and subject to both the Company and Casa meeting certain stated performance targets. When considered together with the preferred stock investment and the guidance within EITF 02-14, the Company does not believe that these agreements give SeaChange "significant influence" over Casa as defined in APB No. 18. In addition, SeaChange does not retain a representative on the Casa board of directors.

Accordingly, since the Company's convertible preferred stock investment was not "in-substance" common stock, and the investment is not a FAS 115 security, the cost method of accounting would be required to record its convertible preferred investment as long as the estimated fair value of Casa's common stock continued to be sufficient to support a determination that the convertible preferred stock was not "in-substance" common stock. The Company has evaluated the characteristics of EITF 02-14 and APB No. 18 and has concluded that it does not have the ability to exercise significant influence over Casa and that, as a result, the use of the cost method of investment is appropriate.

SeaChange did not exercise the option to purchase Casa by January 31, 2007. In addition, the supply agreement expired and was not renewed.

*Minerva.* In the fourth quarter of fiscal 2005, SeaChange entered into a Stock Purchase Agreement with Minerva Networks, Inc. ("Minerva"), a California based company specializing in software products for the telecommunications and television markets. As part of Minerva's Series H preferred financing, SeaChange invested \$1.0 million for 1.3 million shares of preferred stock of Minerva representing 2.5% of the total capital stock of Minerva. The preferred shares are convertible to 1.3 million shares of common stock under certain conditions as defined in the Stock Purchase Agreement. SeaChange accounts for this investment under the cost method of accounting. At the time of the investment in Minerva, SeaChange entered into a Software License Agreement with Minerva in which SeaChange agreed to purchase from Minerva a license for its iTV manager Software and related source code for \$3.8 million. The license and source code was purchased during the second quarter of fiscal 2006. The Company capitalized the purchase of the license and source code and will amortize the amount over the expected life of the software license and source code starting with the first shipment of the product to a customer.

*InSite One.* In the first quarter of fiscal 2006, the Company invested \$2.0 million for 5.9 million shares of 8% cumulative convertible preferred stock of InSite One, Inc. ("InSite"). This investment represented approximately 11% of the total capital stock of InSite. In conjunction with the Stock Purchase Agreement, SeaChange and InSite entered into a Master Purchase Agreement in which InSite agreed to purchase SeaChange digital storage products and services under the terms and conditions defined in the agreement. Under the terms of this agreement and during the second quarter of fiscal 2007, SeaChange recorded revenue for equipment sold to InSite. In exchange for the equipment, InSite issued a convertible note receivable to SeaChange in the amount of \$407,000, with an interest rate of 9% per annum. The sale of equipment is considered substantive due to the utility of the equipment to InSite and to the customer's ability to pay for the equipment without the additional financing. During the fourth quarter of fiscal 2007, InSite One converted the note and accrued interest into approximately 600,000 shares of 8% cumulative convertible preferred stock as part of an effort by InSite One to refinance its capital structure. The Company maintained its approximate 11% share of the total capital stock of InSite One

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

subsequent to this recapitalization. SeaChange accounts for this investment under the cost method of accounting. In total, for fiscal years 2007 and 2006, SeaChange recognized revenues of \$1.2 million and \$ 0, respectively, from InSite One.

*Filmflex.* In the third quarter of fiscal 2006, SeaChange acquired the remaining 72.4% of outstanding capital stock of the On Demand Group Limited ("ODG") that it did not own. As a result of this step acquisition of ODG, SeaChange holds a 33.3% investment in Filmflex, a company based in the United Kingdom. Filmflex was founded in 2004 by ODG, Columbia Pictures Corporation Limited and the Walt Company Limited to provide high-quality movies for use in on-demand service. Each of the investors owns 33.3% of Filmflex, and the investment agreement includes a put and call provision for the sale of ODG's ownership percentage provided certain conditions are met. Filmflex provides its on-demand content from the libraries of Sony Pictures Television International, Sony Classics, Walt Disney Television International, Warner Brothers, Pathe, MGM, Dreamworks, Hollywood Pictures, Touchstone Pictures, Miramax Film Corporation, Buena Vista International Inc., Paramount Pictures, Columbia Pictures, TriStar, Icon and other sources. In fiscal 2005, ODG and Filmflex executed an outsourcing services agreement in which ODG provides Filmflex with financial planning, scheduling, marketing, production and operations support services. ODG's share of profits from this agreement in proportion to its equity ownership interest is eliminated in consolidation. In fiscal year 2007 SeaChange recognized revenues of \$3.3 million from Filmflex. In fiscal year 2006, subsequent to the acquisition of ODG, SeaChange recognized revenues of \$1.3 million from Filmflex. SeaChange's original investment in Filmflex reflects the historical basis of ODG's recorded assets and liabilities; whereas, the additional investment in Filmflex that resulted from the step acquisition of ODG was recorded at its estimated fair value as of the date of the acquisition of ODG. The Company determined the fair value of Filmflex and Filmflex's customer contracts based on the net present value of the expected future cash flows. The value of the customer contracts was recorded as an intangible asset with the balance of the Filmflex fair value recorded as goodwill.

In connection with the step acquisition of ODG, SeaChange reconsidered its investments and other contractual arrangements with Filmflex and determined that Filmflex was not a VIE and SeaChange would not be the primary beneficiary as defined by the accounting guidance of FIN No. 46R. Consequently, SeaChange accounts for this investment under the equity method of accounting. SeaChange's proportionate share of Filmflex's income is reported one month in arrears.

*Visible World.* In fiscal 2002, SeaChange entered into a Joint Development and Marketing Agreement with Visible World. The purpose of the partnership is to integrate the advertising insertion product offerings that SeaChange offers with the software technologies of Visible World, which would enable advertisers an end-to-end solution for providing target advertising to their customers. The agreement is terminable on 90-days notice given by either party. In conjunction with the arrangement, Visible World issued SeaChange a fully vested warrant to purchase one million shares of Series B Preferred Stock at an exercise price of \$0.01 per share. The warrant expires at the earliest of a) the consummation of a qualified public offering, as defined in the agreement, by Visible World, b) the sale of Visible World, as defined in the warrant agreement and c) 10 years. Because the issuance of the warrant to SeaChange under the terms of the agreement is in exchange for services to be provided by SeaChange, the warrant is accounted for under the guidance of EITF 00-08, "Accounting by a Grantee for an Equity Instrument to be Received in Conjunction with Providing Goods or Services." Management determined the fair value of the warrant as of the date of the grant based on available financial information using the Black-Scholes valuation model. The assumptions used in this valuation included: a fair value of Visible World stock of \$0.50 per share, a weighted average volatility factor of 100%, a dividend yield of 0.0%, a risk-free interest rate of 4.22%, and an expected warrant term of 5 years. SeaChange recorded the value of the warrant of \$493,000 as an investment in affiliate and deferred revenue. SeaChange recognized the deferred revenue over the five year period that ended in the fourth quarter of fiscal year 2007.

In fiscal 2004, Visible World completed the first phase of a private financing in which it raised \$4.6 million in exchange for preferred stock. As a result of the financing, SeaChange determined that the fair value of the warrant had declined and recorded a \$313,000 charge related to the other than temporary loss on the investment. In connection with this financing, SeaChange's warrant to purchase one million shares of Series B preferred stock of Visible World was amended to be exercisable for one million shares of common stock of Visible World; and SeaChange exercised the warrant to purchase one million shares of Visible World common stock. SeaChange subsequently exchanged 95,517 shares of Visible World common stock for 1,192,311 shares of Series A-1 Preferred Stock. In addition, as part of Visible World's private financing, SeaChange invested \$96,000 for an additional 1,192,311 shares of Series A-1 Preferred Stock. In fiscal 2004, SeaChange and Visible World signed a revised Marketing Agreement in which SeaChange agreed to receive warrants to purchase 2.8 million shares of preferred stock of Visible World in lieu of future royalties that would have been earned by SeaChange relating to revenue earned by Visible World in accordance with an agreement between Visible World and Comcast Cable Corporation ("Comcast"). The warrants will vest over the five year term of the agreement between Visible World and Comcast ending in the fourth quarter of fiscal year 2009. SeaChange estimated the fair value of these warrants to be \$223,000 and included the amount in investments in affiliates with an offsetting amount included in deferred revenue. SeaChange will recognize the deferred revenue over a five year period, the term of the agreement. In the second quarter of fiscal 2006, in conjunction with a round of additional financing, Visible World had an across the board reverse stock split in a ratio of 12.48271 to 1 which

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

reduced the number of shares and warrants owned by SeaChange as follows: common stock from 904,483 shares to 72,459 shares; preferred stock from 2.4 million shares to 191,034 shares and warrants from 2.8 million to 225,000. This split, by itself, did not change SeaChange's proportional ownership. As of January 31, 2007, SeaChange owned less than 5% of the common and preferred stock of Visible World and is accounting for this investment under the cost method of accounting.

For fiscal years 2007 and 2006, SeaChange recognized revenues of approximately \$500,000 and \$400,000, respectively, from Visible World.

SeaChange periodically reviews indicators of the fair value of its investments in affiliate companies in order to assess whether available facts or circumstances, both internally and externally, may suggest an other than temporary decline in the fair value of the investment. In the fourth quarter of fiscal 2007, SeaChange wrote off the remaining \$150,000 balance of its investment in Planet Pictures. There were no other indications of other than temporary declines in fair value of investments in affiliates as of January 31, 2007.

#### 7. Acquisitions

##### *On Demand Group Limited*

In the third quarter of fiscal 2006, SeaChange purchased the remaining 72.4% of the outstanding capital stock of the On Demand Group Limited, a company incorporated under the laws of the United Kingdom. As a result of this acquisition, SeaChange owned 100% of ODG and acquired a 33.3% equity investment in Filmflex. The acquisition provides SeaChange with a broader range of service offerings that complement its existing video-on-demand products and services. As a wholly-owned subsidiary, the financial position and results of operations of ODG have been consolidated subsequent to the acquisition date. Prior to the acquisition, SeaChange owned 27.6% of ODG and accounted for the investment under the equity method of accounting.

Under the terms of the purchase agreement, SeaChange acquired the outstanding shares in ODG it did not previously own in exchange for approximately \$14.0 million in cash consideration, including transaction costs of \$500,000. Two of the former shareholders of ODG became executive officers of SeaChange in conjunction with the acquisition. One of these former shareholders is an immediate family of the remaining two former shareholders of ODG. The purchase agreement provides for additional contingent consideration to the former shareholders of ODG, if ODG meets certain annual performance goals related to net income in three specified annual measurement periods ending January 31, 2008. SeaChange may pay up to a maximum aggregate contingent consideration of \$11.9 million (based on the exchange rate in effect at January 31, 2007 as any contingent consideration is to be made in British Pounds Sterling) including up to 50% payable in shares of SeaChange common stock, par value \$0.01 per share, with the remainder payable in cash provided that these performance goals are met. The contingent consideration is comprised of three installments, each to be made annually, beginning with the year ended January 31, 2006, for annual baseline amounts of \$2.2 million, \$2.3 million and \$4.9 million, respectively. These amounts are subject to upward and downward adjustment based on the actual net income related performance of ODG, as clarified in the agreement, during these periods, provided that the aggregate maximum contingent consideration payable is the sum of these baseline amounts plus a maximum of \$2.6 million (based on the exchange rate in effect at January 31, 2007). The contingent consideration will be recorded as an additional cost of the purchase and recorded as goodwill if the performance measures are met by ODG and it becomes payable. On January 31, 2006, the first earnout measurement period ended and the Company recorded an additional \$2.8 million (USD equivalent) of goodwill to reflect the earned contingent consideration based upon the actual performance of ODG. In May 2006, the Company paid \$3.0 million (USD equivalent) to satisfy this obligation. On June 30, 2006, SeaChange and the former stockholders of ODG amended the original purchase agreement to provide for the acceleration of the second installment of contingent consideration (for the year ended January 31, 2007) in exchange for the issuance to the sellers of 341,360 shares of SeaChange's common stock having a fair market value of \$2.3 million as of the date of the amendment. Consequently, the Company recorded an additional \$2.3 million of goodwill to reflect the accelerated second installment of contingent consideration.

As a result of this purchase, SeaChange acquired a 33.3% equity investment in Filmflex. The investment agreement includes a put option for ODG and a call option for the other two investors in Filmflex for the sale of ODG's ownership interest provided certain conditions are met. If either of these options is exercised and the sale price exceeds a certain threshold, up to twenty percent of the proceeds will be recorded as additional consideration payable for the step acquisition of ODG and recorded as goodwill.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The acquisition was accounted for as a step acquisition under the purchase method of accounting which requires that SeaChange's pre-acquisition investment (27.6%) be allocated at historical cost and that the 72.4% step acquisition be allocated at fair value. The allocation of the purchase price to the assets acquired and liabilities assumed based upon estimates of fair values as of September 23, 2005 and the additional contingent consideration earned as of January 31, 2007, is as follows:

<b>(Amounts in thousands)</b>	
Consideration exchanged:	
Cash payment .....	\$ 13,555
Cash payment - contingent consideration earned through January 31, 2006 .....	2,804
SeaChange common stock - contingent consideration for the year ended January 31, 2007 .....	2,287
Transaction costs .....	510
	<hr/>
Purchase Price .....	19,156
Liabilities assumed .....	(2,508)
Cash acquired .....	4,706
Deferred tax liabilities .....	(2,019)
Estimated fair value of equity investment in Filmflex .....	634
Tangible assets acquired .....	1,375
Estimated fair value of identifiable intangible assets acquired - ODG customer contracts .....	1,440
Estimated fair value of identifiable intangible assets acquired - ODG trademark and completed technology ..	936
Estimated fair value of identifiable intangible assets acquired - Filmflex customer contracts .....	4,355
	<hr/>
Goodwill .....	\$ 10,237
	<hr/>

SeaChange determined that the goodwill included the value of ODG's work force and expected synergies in global sales and marketing, especially within the European market, and in software development activities. The goodwill generated from the acquisition is not tax deductible. The acquired assets are part of the Company's Services segment.

### *Liberate Technologies Non-North America Business*

In the second quarter of fiscal 2006, SeaChange acquired substantially all of the assets of Liberate Technologies' business outside of North America. The acquisition enables SeaChange to combine Liberate's middleware software platform with SeaChange's digital video delivery systems and video-on-demand software applications. Under the terms of the agreement, SeaChange acquired certain customer contracts, patents and other intellectual property, and assumed certain liabilities related to Liberate's business outside of North America in exchange for approximately \$23.7 million in cash consideration, including transaction costs of \$192,000. As part of the agreement, SeaChange cannot license or sell the purchased intellectual property in North America for a period of five years. The acquisition was accounted for under the purchase method of accounting. Accordingly, the financial position and results of operations of Liberate Technologies former non-North American business have been consolidated subsequent to the acquisition date.

The purchase price was allocated as follows:

<b>(Amounts in thousands)</b>		<b>At July 12, 2005</b>
Consideration exchanged:		
Cash payment .....	\$	23,555
Transaction costs .....		192
		<hr/>
Purchase price .....		23,747
Liabilities assumed .....		(104)
Estimated fair value of tangible assets acquired .....		364
Estimated fair value of identifiable intangible assets acquired - customer contracts .....		12,800
Estimated fair value of identifiable intangible assets acquired - completed technology .....		1,200
Estimated fair value of identifiable intangible assets acquired - trademarks .....		200
		<hr/>
Goodwill .....	\$	9,287
		<hr/>

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

SeaChange determined that the goodwill included the value of Liberate's work force and expected synergies in the product development and marketing of product offerings. The acquired assets are part of the Company's Broadband segment. The goodwill is not tax deductible.

*ZQ Interactive, Ltd.*

In the second quarter of fiscal 2005, SeaChange acquired all of the outstanding stock of ZQ Interactive, Ltd., a company incorporated in the British Virgin Islands with its principal office in Shanghai, China. According to the terms of the purchase agreement, \$1.0 million of the purchase price was to be paid to the sellers in two equal annual installments of \$500,000 on May 17, 2005 and 2006. The Company deposited the \$1 million into escrow in 2004. The first \$500,000 installment was paid in July 2005 and the second and final installment of \$500,000 was paid in July 2006. The financial position and results of operations of ZQ Interactive have been consolidated subsequent to the acquisition date.

**8. Goodwill and Intangible Assets**

At January 31, 2007 and 2006, the Company had goodwill of \$23.7 million and \$20.4 million, respectively. The change in the carrying amount of goodwill for the years ended January 31, 2007 and 2006 are as follows:

	<u>Broadband Segment</u>	<u>Services Segment</u>	<u>Total</u>
	(in thousands)		
Balance at January 31, 2005 .....	\$ 1,882	\$ —	\$ 1,882
Goodwill acquired - Liberate .....	9,287	—	9,287
Goodwill related to reclassification of ODG equity method goodwill .....	—	1,276	1,276
Goodwill acquired - ODG .....	—	7,934	7,934
Balance at January 31, 2006 .....	11,169	9,210	20,379
Contingent consideration - ODG .....	—	2,287	2,287
Goodwill acquired - ODG .....	—	15	15
Foreign exchange impact on ODG goodwill .....	—	1,045	1,045
Balance at January 31, 2007 .....	<u>\$ 11,169</u>	<u>\$ 12,557</u>	<u>\$ 23,726</u>

At January 31, 2007 and 2006, the Company had recorded net intangible assets of \$13.1 million and \$18.9 million respectively, consisting of customer contracts, patents, completed technology and trademarks.

Intangible assets, net, consisted of the following:

<u>Intangible Assets</u>	<u>Patents</u>	<u>Customer Contracts</u>	<u>Completed Technology</u>	<u>Trademark and Other</u>	<u>Total</u>
Outstanding as of January 31, 2006 .....	\$ 5,423,000	\$ 18,594,000	\$ 2,999,000	\$ 1,008,000	\$ 28,024,000
Foreign exchange impact .....	—	525,000	59,000	26,000	610,000
Outstanding as of January 31, 2007 .....	<u>\$ 5,423,000</u>	<u>\$ 19,119,000</u>	<u>\$ 3,058,000</u>	<u>\$ 1,034,000</u>	<u>\$ 28,634,000</u>
<u>Accumulated Amortization</u>	<u>Patents</u>	<u>Customer Contracts</u>	<u>Completed Technology</u>	<u>Trademark and Other</u>	<u>Total</u>
Outstanding as of January 31, 2006 .....	\$ 5,423,000	\$ 1,948,000	\$ 1,343,000	\$ 406,000	\$ 9,120,000
Current period amortization .....	—	5,446,000	618,000	243,000	6,307,000
Foreign exchange impact .....	—	139,000	8,000	6,000	153,000
Outstanding as of January 31, 2007 .....	<u>\$ 5,423,000</u>	<u>\$ 7,533,000</u>	<u>\$ 1,969,000</u>	<u>\$ 655,000</u>	<u>\$ 15,580,000</u>
Intangible Assets, net, as of January 31, 2007 .....	<u>\$ —</u>	<u>\$ 11,586,000</u>	<u>\$ 1,089,000</u>	<u>\$ 379,000</u>	<u>\$ 13,054,000</u>



# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	<u>Estimated Useful Life and Amortization Basis</u>
Patents.....	2 - 4 years using straight-line basis
Customer contracts ....	1 - 8 years using economic consumption life basis
Completed technology	4 - 6 years using economic consumption life basis
Trademarks and other	5 years using economic consumption life basis

Amortization expense for intangible assets was \$6.3 million, \$2.5 million and \$1.3 million for the years ended January 31, 2007, 2006 and 2005, respectively. In the years ended January 31, 2007 and 2006, \$643,000 and \$297,000, respectively, were charged to cost of product revenues. In the years ended January 31, 2007 and 2006, \$5.7 million and \$2.2 million, respectively, were charged to operating expense. Amortization expense is estimated to be approximately \$3.7 million in fiscal 2008, \$2.8 million in fiscal 2009, \$2.8 million in fiscal 2010, \$1.7 million in fiscal 2011 and \$1.0 million in fiscal 2012.

### 9. Lines of Credit and Long-Term Bank Debt

In the second quarter of fiscal 2007, SeaChange renewed the revolving line of credit with Citizens Bank (a subsidiary of the Royal Bank of Scotland Group) for a one year period ending on June 30, 2007 for the committed amount of \$15.0 million. Loans made under this revolving line of credit bear interest at a rate per annum equal to the bank's prime rate, 8.25% on January 31, 2007. Borrowings under this line of credit are collateralized by substantially all of SeaChange's assets. For the year ended and as of January 31, 2007, SeaChange had no borrowings outstanding under this revolving line of credit. The loan agreement requires that SeaChange provide Citizens 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 when amounts are outstanding under the loan agreement. As of January 31, 2007, the Company was not in compliance with the financial covenants but received a waiver from the bank for the quarter ended January 31, 2007.

### 10. Income Taxes

The components of (loss) income before income taxes are as follows:

	<u>Year ended January 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Domestic .....	\$ (11,391,000)	\$ (18,542,000)	\$ 13,325,000
Foreign.....	313,000	3,245,000	(39,000)
	<u>\$ (11,078,000)</u>	<u>\$ (15,297,000)</u>	<u>\$ 13,286,000</u>

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

	<u>Year ended January 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current benefit (expense):			
Federal .....	\$ 1,188,000	\$ 3,380,000	\$ (2,467,000)
State .....	—	—	(490,000)
Foreign.....	(49,000)	(439,000)	(243,000)
	<u>1,139,000</u>	<u>2,941,000</u>	<u>(3,200,000)</u>
Deferred benefit (expense):			
Federal .....	—	—	—
State .....	—	—	—
Foreign.....	493,000	—	—
	<u>493,000</u>	<u>—</u>	<u>—</u>
	<u>\$ 1,632,000</u>	<u>\$ 2,941,000</u>	<u>\$ (3,200,000)</u>

**SEACHANGE INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The components of deferred income taxes are as follows:

	January 31, 2007	January 31, 2006
Deferred tax assets:		
Inventories.....	\$ 1,880,000	\$ 1,902,000
Allowance for doubtful accounts .....	140,000	155,000
Deferred revenue.....	1,256,000	1,824,000
Accrued litigation reserve and patent costs.....	616,000	3,648,000
Accrued expenses.....	144,000	342,000
Capitalized intangible costs.....	1,475,000	1,591,000
Various tax credit carryforwards—federal and state.....	7,766,000	3,122,000
Federal net operating loss carryforwards .....	4,352,000	—
State net operating loss carryforwards .....	1,023,000	466,000
Foreign net operating loss carryforwards.....	1,063,000	359,000
Acquired net operating loss carryforwards and basis differences .....	—	3,361,000
Other .....	192,000	112,000
Deferred tax assets .....	19,907,000	16,882,000
Less: Valuation allowance .....	(18,501,000)	(15,423,000)
Net deferred tax assets .....	1,406,000	1,459,000
Deferred tax liabilities:		
Property and equipment .....	1,268,000	1,371,000
Intangible assets .....	1,469,000	1,912,000
Deferred tax liabilities.....	2,737,000	3,283,000
Total net deferred tax liabilities .....	\$ 1,331,000	\$ 1,824,000

Deferred tax assets relating to the accrued litigation reserve and patent costs declined from the January 31, 2006 balance due to the litigation settlement payments. The deferred tax assets for federal and state net operating losses and various tax credit carryforwards increased in 2007 due to the current year's tax loss and the full utilization of the federal tax carryback potential. Prior years' tax credits were released due to the federal net operating loss carrybacks of 2006 and 2007 which in turn increased the related deferred tax balances. The decline in deferred tax assets related to acquired net operating loss carryforwards and basis differences was due to an offset of net operating loss carryforwards from a 1997 acquisition against the related valuation allowance. Since its origination, this deferred tax asset has been fully reserved with a valuation allowance and therefore, this write-off has had no impact to the financial statements. The increase in the foreign net operating loss carryforwards from fiscal 2006 to fiscal 2007 is partially the result of this reclassification and also due to current year operating losses in certain foreign subsidiaries.

SeaChange reviews quarterly the adequacy of the valuation allowance for deferred tax assets. At January 31, 2007, the Company assessed the need for a valuation allowance based on all available evidence and, as a result, maintained a full valuation allowance against the U.S. deferred tax assets primarily due to the significant pre-tax losses that were recorded in fiscal 2006 and 2007 and the significant ongoing uncertainties surrounding the ability of the U.S. entity, SeaChange International, Inc., to generate pre-tax income for fiscal 2008 and thereafter. The significant uncertainties surrounding the ability of the U.S. entity to generate pre-tax income in future years includes the timing and magnitude of orders from new customers located primarily outside the United States and from the existing world-wide base. In addition, there may continue to be pricing pressures and competitive new products from existing competitors across all product lines. Revenues for fiscal year 2008 are also dependent upon the timely introduction and customer acceptance of new products within each of the product families. If SeaChange generates sufficient pre-tax income in the future, some portion or all of the valuation allowance could be reversed and a corresponding increase in net income would be reported in future periods.

At January 31, 2007, the Company has indefinitely reinvested \$4.6 million of the cumulative undistributed earnings of certain foreign subsidiaries. Such earnings would be subject to U.S. taxes if repatriated to the U.S. Through January 31, 2007, the Company has not provided deferred income taxes on the undistributed earnings of its foreign subsidiaries because such earnings are considered to be indefinitely reinvested outside the U.S. Determination of the potential deferred income tax liability on these undistributed earnings is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At January 31, 2007, SeaChange had federal, state, and foreign net operating loss carryforwards of \$12.4 million, \$30.0 million, and \$3.8 million respectively, which can be used to offset future tax liabilities and expire at various dates through 2027. Utilization of these net operating loss carryforwards may be limited pursuant to provisions of the respective local jurisdiction. When realized, \$219,000 of the federal losses will result in an adjustment to APIC due to the adoption of FAS 123R in fiscal 2007.

At January 31, 2007, SeaChange had federal and state research and development credit carryforwards of \$5.8 million and \$1.2 million, respectively and state investment tax credit carryforwards of \$240,000. The federal credit carryforwards will expire at various dates through 2027 if not utilized. Certain state credit carryforwards will expire at various dates through 2022 if not utilized, while certain other state credit carryforwards may be carried forward indefinitely. Utilization of these credit carryforwards may be limited pursuant to provisions of the respective local jurisdiction. SeaChange also has alternative minimum tax credit carryforwards of \$558,000 which is available to reduce future federal regular income taxes, if any, over an indefinite period.

The Internal Revenue Service is currently conducting an examination of the Company's U.S. federal income tax returns for the years ended January 31, 2004 through January 31, 2006. We are also under routine examination by certain state and non-US tax authorities. We believe that we have adequately provided reserves for any reasonably foreseeable outcome related to these audits.

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

	Year ended January 31,		
	2007	2006	2005
Statutory U.S. federal tax rate .....	\$ 3,877,000	\$ 5,354,000	\$ (4,650,000)
State taxes, net of federal tax benefit .....	557,000	516,000	(594,000)
Change in valuation allowance on U.S. net deferred tax assets .....	(3,847,000)	(4,444,000)	2,927,000
Non-deductible stock compensation expense .....	(996,000)	—	—
Other .....	314,000	(448,000)	(195,000)
Alternative minimum tax .....	—	—	(638,000)
Research and development tax credits .....	1,080,000	2,332,000	122,000
Foreign tax rate differential.....	647,000	(369,000)	(172,000)
	<u>\$ 1,632,000</u>	<u>\$ 2,941,000</u>	<u>\$ (3,200,000)</u>

SeaChange's effective tax rate was (15%), (19%) and 24% in the years ended January 31, 2007, 2006 and 2005, respectively. For the fiscal year 2007, the income tax benefit was primarily attributable to \$315,000 of net operating losses generated during the current fiscal year that are expected to be carried back to recover taxes paid in prior years and the change in estimate of the prior year's tax provision relating to the tax benefit booked for the fiscal 2006 federal loss carryback versus the actual cash refund received of \$422,000.

For the fiscal year 2006, SeaChange's income tax benefit was primarily attributable to operating losses generated during the current fiscal year that were carried back to recover taxes paid in prior years. Included in income tax expense for fiscal year 2005 was a \$2.1 million benefit primarily related to the implementation of a tax law change relating to the tax treatment of deferred revenues which resulted in the realization of a deferred tax asset and a corresponding valuation allowance release as SeaChange began to follow that same method for both book and tax purposes for recognizing revenue for maintenance service contracts.

## 11. Stockholders' Equity

### *Stock Authorization*

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

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *Comcast Warrants*

In fiscal 2001, the Company entered into a video-on-demand purchase agreement and a common stock and warrant purchase agreement with Comcast Corporation (“Comcast”). As part of these agreements, Comcast was issued common stock and earned incentive common stock purchase warrants based on the number of cable subscribers being served by our equipment which had been purchased by Comcast. The Company determined the fair value of the common stock and the incentive common stock purchase warrants using the Black-Scholes valuation method and amortized this fair value as an offset to gross revenue in proportion to the revenue recognized from the sale of the equipment to Comcast. The assumptions used in this valuation included a weighted average volatility factor, a dividend yield, a risk-free interest rate and an expected warrant term. If management had used another valuation method or different valuation assumptions, the fair value of the common stock and the warrants may have significantly changed, which could have materially impacted the results of operations. During the year ended January 31, 2004, Comcast earned the remaining common stock purchase warrants available under the agreement. In October 2004, the Company issued Comcast the remaining 433,878 incentive common stock purchase warrants. The original estimate of the value of the warrants was based on management’s determination that Comcast earned the incentive common stock warrants when the video-on-demand equipment was delivered to Comcast and the Company recorded the revenue. The Company agreed to revise the number of incentive common stock purchase warrants to be issued at each of the determination dates defined above when we reached a final agreement with Comcast on when the warrants were earned. As a result of the adjustment, the Company determined that the estimated fair market value of the incentive common stock purchase warrants was lower than the amount previously recorded which resulted in a \$1.1 million reduction in the accrual estimate with an offsetting increase in product revenues in the accompanying statement of operations for the fiscal year ended January 31, 2005. No further adjustments were made in the fiscal years ended January 31, 2007 or January 31, 2006 in connection with the warrants issued to Comcast.

#### *Cumulative Effect Adjustment*

In September 2006, the SEC staff released Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the “roll-over” method and the “iron curtain” method. The roll-over method focuses primarily on the impact of a misstatement on the income statement, including the reversing effect of prior year misstatements, but its use can lead to the accumulation of misstatements in the balance sheet. The iron curtain method focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. The Company previously used the roll-over method for quantifying identified financial statement misstatements.

In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effect of the misstatements on each of the Company’s financial statements and the related financial statement disclosures. This model is commonly referred to as a “dual approach” because it requires quantification of errors under both the iron curtain and the roll-over methods.

SAB 108 permits public companies to initially apply its provisions either by (i) restating prior financial statements as if the “dual approach” had always been used or (ii) recording the cumulative effect of initially applying the “dual approach” as adjustments to the carrying values of assets and liabilities as of the beginning of the year of adoption, February 1, 2006, for the Company, with an offsetting adjustment recorded to the opening balance of retained earnings. The Company elected to record the effects of applying SAB 108 using the cumulative effect transition method.

The Company identified two errors, quantified them under the roll-over method and concluded they were immaterial, individually and in the aggregate. The Company increased inventory by \$623,000 to reflect labor and overhead costs that had, in the past, been treated as period costs and had not been capitalized as a component of inventory. The Company decreased accumulated other comprehensive income (loss) by \$130,000 to reflect a realized gain which should have been recognized in fiscal 2005. To record the initial application of SAB 108, the Company recorded a \$753,000 adjustment to decrease accumulated deficit at February 1, 2006.

# SEACHANGE INTERNATIONAL, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### *Accumulated Other Comprehensive Income (Loss)*

SeaChange's accumulated other comprehensive income (loss) is as follows:

	January 31, 2007	January 31, 2006
	(in thousands)	
Accumulated other comprehensive income (loss)		
Accumulated unrealized loss on marketable securities .....	\$ (14)	\$ (398)
Accumulated foreign currency translation adjustments.....	1,589	(64)
Total .....	<u>\$ 1,575</u>	<u>\$ (462)</u>

As of January 31, 2006 the accumulated unrealized loss on marketable securities of \$398,000 includes \$268,000 of unrealized loss on marketable securities and \$130,000 of a realized gain which should have been recognized in fiscal 2005. This unadjusted gain was deemed as immaterial in prior years and was adjusted in fiscal 2007 through a cumulative effect adjustment upon adoption of SAB 108 (see above).

### **12. Commitments and Contingencies**

SeaChange leases certain of its operating facilities and certain office equipment under non-cancelable capital and operating leases, which expire at various dates through 2012. Rental expense under operating leases was \$1,686,000, \$1,831,000 and \$1,384,000 for the years ended January 31, 2007, 2006 and 2005, respectively. Future commitments under minimum lease payments as of January 31, 2007 are as follows:

	Operating Leases
Fiscal Year ended January 31, 2008 .....	\$ 1,407,000
2009.....	699,000
2010 and beyond .....	112,000
Minimum lease payments .....	<u>\$ 2,218,000</u>

SeaChange has guaranteed minimum purchase commitments for studio content of approximately \$3.7 million at January 31, 2007, as follows:

	Studio Content
Fiscal Year ended January 31, 2008 .....	\$ 960,000
2009.....	2,568,000
2010 and beyond .....	219,000
Minimum guaranteed studio content payments .....	<u>\$ 3,747,000</u>

SeaChange has non-cancellable purchase commitments for its inventories of approximately \$6.5 million at January 31, 2007. In addition, SeaChange has a contingent consideration commitment to the former shareholders of ODG up to a maximum of \$6.8 million based on performance of the ODG business through January 31, 2008. In addition, under the terms of the Filmflex agreement among the studios and ODG, SeaChange could have a contingent consideration to the former shareholders of ODG if the studios exercise their option to acquire the portion of Filmflex owned by ODG.

### **Guarantees and Indemnification Obligations**

SeaChange provides indemnification, to the extent permitted by law, to its officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee, or agent, is or was serving, at SeaChange's request in such capacity. With respect to acquisitions, SeaChange provides indemnification to or assumes indemnification obligations for the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' bylaws and charter. As a matter of practice, SeaChange has maintained directors and officers liability insurance coverage including coverage for directors and officers of acquired companies.

## SEACHANGE INTERNATIONAL, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SeaChange enters into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require SeaChange to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to SeaChange's products. From time to time, SeaChange also indemnifies customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of SeaChange's products and services or resulting from the acts or omissions of SeaChange, its employees, authorized agents or subcontractors. For example, in a letter dated May 16, 2005 from Cablevision Systems Corp., in a letter dated May 19, 2005 from Time Warner Cable, Inc., and in a letter dated July 22, 2005 from Insight Communications Company, Inc., all SeaChange customers, SeaChange and other suppliers were notified that each party was served on May 3, 2005, April 25, 2005 and April 26, 2005 respectively with a complaint by Acacia Media Technologies, Corp. for allegedly infringing U.S. Patent Nos.: 5,132,992; 5,253,275; 5,550,863; and 6,144,702 by providing broadcast video and video-on-demand services to end user customers. In addition, in a letter dated August 4, 2006 from Cox Communications, Inc., in a letter dated June 29, 2006 from Time Warner Inc. and in a letter dated October 6, 2006 from Comcast Cable Communications, LLC, SeaChange and other suppliers were notified that each party was served on June 13, 2006 with a complaint by USA Video Technology Corporation for allegedly infringing U.S. Patent No. 5,130,792 by providing video-on-demand services to end use customers. These customers have requested SeaChange's support under its indemnification obligations. SeaChange continues to review its potential obligations under its indemnification agreements with these customers, in view of the claims by Acacia and USA Video Technology Corporation and the indemnity obligations to these customers from other vendors that also provided equipment and services to these customers.

SeaChange warrants that its products, including software products, will substantially perform in accordance with its standard published specifications in effect at the time of delivery. Most warranties have at least a one year duration that generally commence upon installation. In addition, SeaChange provides maintenance support to all customers and therefore allocates a portion of the product purchase price to the initial warranty period and recognizes revenue on a straight line basis over that warranty period related to both the warranty obligation and the maintenance support agreement. When SeaChange receives revenue for extended warranties beyond the standard duration, it is deferred and recognized on a straight line basis over the contract period. Related costs are expensed as incurred. As of January 31, 2007 and January 31, 2006, SeaChange had revenue deferrals related to initial and extended warranties of \$15.2 million and \$16.5 million, respectively.

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

With respect to its agreements covering product, business or entity divestitures and acquisitions, SeaChange provides certain representations and warranties and agrees to indemnify and hold such purchasers harmless against breaches of such representations, warranties and covenants. Many of the indemnification claims have a definite expiration date while some remain in force indefinitely. With respect to its acquisitions, SeaChange may, from time to time, assume the liability for certain events or occurrences that took place prior to the date of acquisition.

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

#### **13. Employee Benefit Plan**

SeaChange sponsors a 401(k) retirement savings plan (the "Plan"). Participation in the Plan is available to full-time employees who meet eligibility requirements. Eligible employees may contribute up to 25% of their annual salary, subject to certain limitations. SeaChange matches contributions up to 25% of the first 6% of compensation contributed by the employee to the Plan. During the fiscal years ended January 31, 2007, 2006 and 2005, SeaChange contributed \$482,000, \$451,000 and \$439,000, respectively, to the Plan.

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## Schedule II

### SEACHANGE INTERNATIONAL, INC.

#### VALUATION OF QUALIFYING ACCOUNTS AND RESERVES

	Balance at beginning of period	Charged to costs and expenses	Deductions and write- offs	Recovery	Balance at end of period
<b>Accounts Receivable Allowance:</b>					
Year ended January 31, 2005.....	\$ 1,197,000	\$ 200,000	\$ (434,000)	\$ (314,000)	\$ 649,000
Year ended January 31, 2006.....	649,000	100,000	(154,000)	(190,000)	405,000
Year ended January 31, 2007.....	405,000	403,000	(305,000)	(37,000)	466,000

Recovery represents amounts collected from customers whose accounts receivable balances had previously been reserved.

	Balance at beginning of period	Additions	Deletions	Adjustments	Balance at end of period
<b>Deferred Tax Asset Valuation</b>					
<b>Allowance:</b>					
Year ended January 31, 2005.....	\$ 14,452,500	—	\$ (2,956,500)	—	\$ 11,496,000
Year ended January 31, 2006.....	11,496,000	\$ 3,927,000	—	—	15,423,000
Year ended January 31, 2007.....	15,423,000	6,439,000	—	\$ (3,361,000)	18,501,000



**SEACHANGE INTERNATIONAL, INC.****LIST OF SIGNIFICANT SUBSIDIARIES**

<u>Subsidiary Name</u>	<u>Subsidiary Jurisdiction</u>
The On Demand Group Limited .....	United Kingdom
ZQ Interactive, Limited .....	British Virgin Islands
SeaChange International UK, Limited.....	United Kingdom

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our reports dated April 13, 2007 (which report expresses an unqualified opinion and includes explanatory paragraphs relating to the application of Statement of Financial Accounting Standards No. 123(R) and SAB 108 as of January 31, 2007) accompanying the consolidated financial statements and schedule and management's assessment of the effectiveness of internal control over financial reporting included in the 2007 Annual Report of SeaChange International, Inc. and subsidiaries on Form 10-K for the year ended January 31, 2007. We hereby consent to the incorporation by reference of said reports in the Registration Statements of SeaChange International, Inc. on Form S-3 (No. 333-56410 with an effective date of April 30, 2002) and Forms S-8 (Nos. 333-136322 with an effective date of August 4, 2006, 333-17379 with an effective date of December 6, 1996, 333-100160 with an effective date of September 27, 2002, 333-65854 with an effective date of July 25, 2001, 333-113761 with an effective date of March 19, 2004 and 333-128987 with an effective date of October 13, 2005).

/s/ Grant Thornton LLP

April 13, 2007  
Boston, Massachusetts

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (No. 333-56410) and Form S-8 (Nos. 333-136322, 333-17379, 333-100160, 333-65854, 333-113761 and 333-128987 ) of SeaChange International, Inc. of our report dated April 17, 2006 relating to the financial statements and financial statement schedules, which appears in this Form 10-K.

PricewaterhouseCoopers LLP  
Boston, Massachusetts  
April 13, 2007

## CERTIFICATION

I, William C. Styslinger, III, certify that:

1. I have reviewed this annual report on Form 10-K of SeaChange International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 13, 2007

By:

/s/ WILLIAM C. STYSLINGER, III

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

## CERTIFICATION

I, Kevin M. Bisson, certify that:

1. I have reviewed this annual report on Form 10-K of SeaChange International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 13, 2007

By:

/s/ Kevin M. Bisson

**Kevin M. Bisson,  
Chief Financial Officer,  
Senior Vice President,  
Finance and Administration,  
Treasurer and Secretary  
(Principal Financial and Accounting  
Officer)**

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of SeaChange International, Inc. (the “*Company*”) on Form 10-K for the year ended January 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the “*Report*”), I, William C. Styslinger, III, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ WILLIAM C. STYSLINGER, III

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

April 13, 2007

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of SeaChange International, Inc. (the “*Company*”) on Form 10-K for the year ended January 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the “*Report*”), I, Kevin M. Bisson, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Kevin M. Bisson

**Kevin M. Bisson**  
**Chief Financial Officer, Senior Vice President,**  
**Finance and Administration, Treasurer and**  
**Secretary**

April 13, 2007

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