

SEACHANGE INTERNATIONAL INC

Form 10-Q

December 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2017

OR

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

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

Commission File Number: 0-21393

SEACHANGE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

50 Nagog Park, Acton, MA 01720

(Address of principal executive offices, including zip code)

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

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

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

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

|                         |                           |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer         |
| Non-accelerated filer   | Smaller reporting company |
| Emerging growth company |                           |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the registrant’s Common Stock on December 1, 2017 was 35,503,871.

SEACHANGE INTERNATIONAL, INC.

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## PART I – FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## SEACHANGE INTERNATIONAL, INC.

## CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share data)

|   | October 31,<br>2017<br>(Unaudited) | January<br>31,<br>2017 |
|---|------------------------------------|------------------------|
| <b>Assets</b>   |                                    |                        |
| Current assets:   |                                    |                        |
| Cash and cash equivalents   | \$ 27,155                          | \$28,302               |
| Restricted cash   | 8                                  | 109                    |
| Marketable securities   | 4,990                              | 5,253                  |
| Accounts and other receivables, net of allowance for doubtful accounts of \$294 |                                    |                        |
| and \$876 at October 31, 2017 and January 31, 2017, respectively                | 28,437                             | 25,985                 |
| Unbilled receivables  | 3,630                              | 6,553                  |
| Inventories, net  | 850                                | 770                    |
| Prepaid expenses and other current assets                                       | 2,856                              | 2,393                  |
| Total current assets  | 67,926                             | 69,365                 |
| Property and equipment, net   | 10,131                             | 11,485                 |
| Marketable securities, long-term  | 4,485                              | 4,991                  |
| Investments in affiliates   | 2,000                              | 2,000                  |
| Intangible assets, net  | 1,616                              | 2,603                  |
| Goodwill, net   | 24,506                             | 23,287                 |
| Other assets  | 1,200                              | 2,336                  |
| Total assets  | \$ 111,864                         | \$ 116,067             |
| <b>Liabilities and Stockholders' Equity</b>                                     |                                    |                        |
| Current liabilities:  |                                    |                        |
| Accounts payable  | \$ 1,631                           | \$4,978                |
| Deferred revenues   | 12,558                             | 12,517                 |
| Other accrued expenses  | 12,788                             | 9,928                  |
| Total current liabilities   | 26,977                             | 27,423                 |
| Deferred revenue, long-term   | 3,058                              | 2,419                  |
| Deferred tax liabilities, long-term   | 16,253                             | 14,732                 |
| Taxes payable, long-term  | 973                                | 1,427                  |
| Other liabilities, long-term  | —                                  | 530                    |
| Total liabilities   | 47,261                             | 46,531                 |
| <b>Commitments and contingencies (Note 7)</b>                                   |                                    |                        |
| <b>Stockholders' equity:</b>  |                                    |                        |
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 35,544,361       | 355                                | 353                    |

|   |            |           |
|---|------------|-----------|
| shares issued and 35,503,871 outstanding at October 31, 2017, and 35,339,232      |            |           |
| shares issued and 35,298,742 outstanding at January 31, 2017                      |            |           |
| Additional paid-in capital  | 238,955    | 236,677   |
| Treasury stock, at cost; 40,490 common shares at October 31, 2017 and January 31, |            |           |
| 2017, respectively  | (5 )       | (5 )      |
| Accumulated loss  | (169,238 ) | (162,118) |
| Accumulated other comprehensive loss  | (5,464 )   | (5,371 )  |
| Total stockholders' equity  | 64,603     | 69,536    |
| Total liabilities and stockholders' equity  | \$ 111,864 | \$116,067 |

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

## SEACHANGE INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited, amounts in thousands, except per share data)

|  | Three Months<br>Ended<br>October 31, |            | Nine Months<br>Ended<br>October 31, |             |
|--|--------------------------------------|------------|-------------------------------------|-------------|
|  | 2017                                 | 2016       | 2017                                | 2016        |
| <b>Revenues:</b>                                   |                                      |            |                                     |             |
| Products   | \$11,119                             | \$3,746    | \$18,907                            | \$10,481    |
| Services   | 12,311                               | 16,215     | 38,415                              | 49,502      |
| Total revenues                                     | 23,430                               | 19,961     | 57,322                              | 59,983      |
| <b>Cost of revenues:</b>                           |                                      |            |                                     |             |
| Products   | 1,198                                | 1,824      | 3,088                               | 4,506       |
| Services   | 5,612                                | 7,470      | 15,810                              | 26,336      |
| Amortization of intangible assets                  | 255                                  | 315        | 764                                 | 947         |
| Stock-based compensation expense                   | 1                                    | (26 )      | 3                                   | 131         |
| Total cost of revenues                             | 7,066                                | 9,583      | 19,665                              | 31,920      |
| Gross profit                                       | 16,364                               | 10,378     | 37,657                              | 28,063      |
| <b>Operating expenses:</b>                         |                                      |            |                                     |             |
| Research and development                           | 5,634                                | 7,325      | 17,411                              | 23,751      |
| Selling and marketing                              | 3,916                                | 3,988      | 9,292                               | 12,487      |
| General and administrative                         | 3,868                                | 3,673      | 10,595                              | 11,579      |
| Amortization of intangible assets                  | 370                                  | 540        | 1,075                               | 1,572       |
| Stock-based compensation expense                   | 696                                  | 791        | 2,224                               | 1,685       |
| Change in fair value of earn-outs                  | —                                    | —          | —                                   | 249         |
| Professional fees - other                          | —                                    | 24         | 21                                  | 328         |
| Severance and other restructuring costs            | 960                                  | 2,373      | 3,670                               | 5,991       |
| Loss on impairment of long-lived assets            | —                                    | 99         | —                                   | 99          |
| Total operating expenses                           | 15,444                               | 18,813     | 44,288                              | 57,741      |
| Income (loss) from operations                      | 920                                  | (8,435 )   | (6,631 )                            | (29,678 )   |
| Other income (expenses), net                       | 14                                   | (67 )      | 969                                 | 220         |
| Income (loss) before income taxes                  | 934                                  | (8,502 )   | (5,662 )                            | (29,458 )   |
| Income tax provision (benefit)                     | 1,154                                | (420 )     | 1,458                               | 14,415      |
| Net loss   | \$(220 )                             | \$(8,082 ) | \$(7,120 )                          | \$(43,873 ) |
| Net loss   | \$(220 )                             | \$(8,082 ) | \$(7,120 )                          | \$(43,873 ) |
| <b>Other comprehensive loss, net of tax:</b>       |                                      |            |                                     |             |
| Foreign currency translation adjustment            | (79 )                                | (619 )     | (76 )                               | (316 )      |
| Unrealized loss on marketable securities           | (12 )                                | (20 )      | (17 )                               | (2 )        |
| Comprehensive loss                                 | \$(311 )                             | \$(8,721 ) | \$(7,213 )                          | \$(44,191 ) |
| <b>Net loss per share:</b>                         |                                      |            |                                     |             |
| Basic  | \$(0.00 )                            | \$(0.23 )  | \$(0.20 )                           | \$(1.26 )   |
| Diluted  | \$(0.00 )                            | \$(0.23 )  | \$(0.20 )                           | \$(1.26 )   |
| <b>Weighted average common shares outstanding:</b> |                                      |            |                                     |             |
| Basic  | 35,479                               | 35,186     | 35,381                              | 34,889      |

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Diluted | 35,479 | 35,186 | 35,381 | 34,889 |
|---------|--------|--------|--------|--------|

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

## SEACHANGE INTERNATIONAL, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, amounts in thousands)

|   | Nine Months<br>Ended<br>October 31, |             |
|---|-------------------------------------|-------------|
|   | 2017                                | 2016        |
| Cash flows from operating activities:   |                                     |             |
| Net loss  | \$(7,120 )                          | \$(43,873 ) |
| Adjustments to reconcile net loss to net cash used in operating activities:   |                                     |             |
| Depreciation and amortization of property and equipment                       | 1,758                               | 2,289       |
| Provision for inventory obsolescence  | 90                                  | 318         |
| Amortization of intangible assets   | 1,839                               | 2,519       |
| Fair value of acquisition-related contingent consideration                    | —                                   | 249         |
| Stock-based compensation expense  | 2,227                               | 1,816       |
| Deferred income taxes   | 102                                 | 14,649      |
| Other   | (14 )                               | 113         |
| Changes in operating assets and liabilities, excluding impact of acquisition: |                                     |             |
| Accounts receivable   | (1,401 )                            | 1,987       |
| Unbilled receivables  | 3,289                               | 2,913       |
| Inventories   | (165 )                              | 338         |
| Prepaid expenses and other assets   | 62                                  | 428         |
| Accounts payable  | (3,199 )                            | (2,102 )    |
| Accrued expenses  | 942                                 | (4,833 )    |
| Deferred revenues   | 355                                 | (3,864 )    |
| Other   | 327                                 | 173         |
| Total cash used in operating activities                                       | (908 )                              | (26,880 )   |
| Cash flows from investing activities:   |                                     |             |
| Purchases of property and equipment   | (386 )                              | (521 )      |
| Purchases of marketable securities  | (7,246 )                            | (2,252 )    |
| Proceeds from sale and maturity of marketable securities                      | 7,993                               | 4,249       |
| Acquisition of business, net of cash acquired                                 | —                                   | (5,243 )    |
| Other investing activities  | 176                                 | 28          |
| Total cash provided by (used in) investing activities                         | 537                                 | (3,739 )    |
| Cash flows from financing activities:   |                                     |             |
| Proceeds from issuance of common stock  | 53                                  | 64          |
| Payments of withholding tax on RSU vesting                                    | (52 )                               | (109 )      |
| Other financing activities  | —                                   | (4 )        |
| Total cash provided by (used in) financing activities                         | 1                                   | (49 )       |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (878 )                              | (555 )      |
| Net decrease in cash, cash equivalents, and restricted cash                   | (1,248 )                            | (31,223 )   |
| Cash, cash equivalents and restricted cash, beginning of period               | 28,411                              | 58,815      |
| Cash, cash equivalents and restricted cash, end of period                     | \$27,163                            | \$27,592    |
| Supplemental disclosure of cash flow information:                             |                                     |             |



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|   |       |         |
|---|-------|---------|
| Income taxes paid   | \$267 | \$120   |
| Supplemental disclosure of non-cash investing and financing activities:       |       |         |
| Fair value of common stock issued for acquisition of DCC Labs                 | \$—   | \$2,640 |
| Fair value of common stock issued for deferred stock consideration obligation | \$—   | \$3,454 |
| Asset group classified as held for sale                                       | \$—   | \$235   |
| Transfer of items originally classified as inventories to equipment           | \$—   | \$24    |

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

SEACHANGE INTERNATIONAL, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business and Basis of Presentation

The Company

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

Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries (“SeaChange” or the “Company”) and are prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial reports as well as rules and regulations of the Securities and Exchange Commission (“SEC”). All intercompany transactions and balances have been eliminated. Certain information and footnote disclosures normally included in financial statements prepared under U.S. GAAP have been condensed or omitted pursuant to such regulations. However, we believe that the disclosures are adequate to make the information presented not misleading. In the opinion of management, the accompanying financial statements include all adjustments, consisting of only normal recurring items, necessary to present a fair presentation of the consolidated financial statements for the periods shown. These consolidated financial statements should be read in conjunction with our most recently audited financial statements and related footnotes included in our Annual Report on Form 10-K (“Form 10-K”) as filed with the SEC. The balance sheet data as of January 31, 2017 that is included in this Quarterly Report on Form 10-Q (“Form 10-Q”) was derived from our audited financial statements. We have reclassified certain amounts previously reported in our financial statements to conform to current presentation.

Effective February 1, 2017, the Company changed how it classifies costs associated with its solution architect employees. In fiscal 2017, all solution architect costs were classified as cost of revenues. However, beginning in fiscal 2018, the Company began reflecting in cost of revenues only those costs associated with revenue-generating projects, based on the hours worked by solutions architect employees. Solutions architect costs that are not associated with revenue-generating projects are recognized as selling and marketing expenses since these employees are involved in pre-sales and other customer-facing activities.

We have adjusted prior fiscal year amounts to conform to the current fiscal year presentation. The effect of this change in methodology, which is a decrease to cost of revenues and an increase to selling and marketing expenses, is reflected in our current statements of operations and comprehensive loss for the three and nine months ended October 31, 2016 as follows:

|                                | Adjustment<br>to  |   |   |
|--------------------------------|---|---|---|
|                                | As<br>Filed<br>Fiscal<br>2017<br>Three<br>Months<br>Ended<br>October<br>31,<br>2016<br>(Amounts in thousands) | Conform to<br>Current<br>Year<br>Presentation | Adjusted<br>Three<br>Months<br>Ended<br>October<br>31, 2016 |
| Cost of revenues - service     | \$8,036   | \$ (566 )                                     | \$ 7,470  |
| Selling and marketing expenses | \$3,422   | \$ 566  | \$ 3,988  |

|                                | Adjustment<br>to  |   |  |
|--------------------------------|---|---|--|
|                                | As Filed<br>Fiscal<br>2017<br>Nine<br>Months<br>Ended<br>October<br>31,<br>2016<br>(Amounts in thousands) | Conform to<br>Current<br>Year<br>Presentation | Adjusted<br>Nine<br>Months<br>Ended<br>October<br>31, 2016 |
| Cost of revenues - service     | \$27,982  | \$ (1,646 )                                   | \$ 26,336  |
| Selling and marketing expenses | \$10,841  | \$ 1,646                                      | \$ 12,487  |

The preparation of these financial statements in conformity with U.S. GAAP, requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Interim results are not necessarily indicative of the operating results for the full fiscal year or any future periods and actual results may differ from our estimates. During the three and nine months ended October 31, 2017, there have been no material changes to our significant accounting policies that were described in our fiscal 2017 Form 10-K, as filed with the SEC.

The Company believes that existing funds and cash provided by future operating activities are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months. However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In the future, we may enter into other arrangements for potential investments in, or acquisitions of, complementary businesses, services or technologies, which could require us to seek additional equity or debt financing. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access cash resulting from earnings in prior fiscal years that had previously been deemed permanently restricted for foreign investment would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we changed our permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings. The balance of the deferred tax liability is \$16.3 million as of October 31, 2017.

## 2. Significant Accounting Policies

### Cash, cash equivalents, and restricted cash

Cash and cash equivalents include cash on hand and on deposit and highly liquid investments in money market mutual funds, government sponsored enterprise obligations, treasury bills, commercial paper and other money market securities with remaining maturities at date of purchase of 90 days or less. All cash equivalents are carried at cost, which approximates fair value. Restricted cash represents cash that is restricted as to withdrawal or usage and consists primarily of cash held as collateral for performance obligations with our customers.

We early adopted the new Financial Accounting Standards Board ("FASB") guidance on August 1, 2017, which changed the presentation of our consolidated statements of cash flows and related disclosures for all periods presented (see Note 14, "Recent Accounting Standard Updates," for more information on the adoption of this guidance). Accordingly, the following is a summary of our cash, cash equivalents, and restricted cash total as presented in our consolidated statements of cash flows for the nine months ended October 31, 2017 and 2016:

Nine Months  
Ended

|   | October 31,            |          |
|---|------------------------|----------|
|   | 2017                   | 2016     |
|   | (Amounts in thousands) |          |
| Cash and cash equivalents                         | \$27,155               | \$27,484 |
| Restricted cash                                   | 8                      | 108      |
| Total cash, cash equivalents, and restricted cash | \$27,163               | \$27,592 |

## Revenue Recognition

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

- persuasive evidence of an arrangement exists;
- delivery has occurred, and title and risk of loss have passed to the customer;
- fees are fixed or determinable; and
- collection of the related receivable is considered probable.

Customers are billed for installation, training, project management and at least one year of product maintenance and technical support at the time of the product sale. Revenue from these activities is deferred at the time of the product sale and recognized ratably over the period these services are performed. Revenue from ongoing product maintenance and technical support

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

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

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

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

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

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

of the product, discounts provided and profit objectives. Management believes that BESP is reflective of reasonable pricing of that deliverable as if priced on a stand-alone basis.

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

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

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

#### Impairment of Assets

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



We also evaluate property and equipment, intangible assets with finite useful lives 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. 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 primary asset in the asset group and compare that value to the carrying value of the assets. In August 2017, we placed our corporate headquarters and the adjacent land (the “Corporate Headquarters”), located in Acton, Massachusetts, on the market for sale. We assessed whether the Corporate Headquarters would qualify as an asset held for sale and determined that it would not since it did not meet all six of the criteria of an asset held for sale under current accounting guidance. During the assessment, we received information from a third-party real estate broker which led management to believe that there was a significant decrease in the fair value of the Corporate Headquarters. We considered this to be a triggering event and were required to test the Corporate Headquarters for recoverability. We evaluated the undiscounted future cash flows over the remaining useful life of the primary asset of the asset group and determined that an impairment did not exist as of the date of the triggering event. Our cash flow estimates contain management’s best estimates, using appropriate and customary assumptions and projections at the time.

In addition, since we considered the significant decrease in fair value of the Corporate Headquarters a triggering event, we were required to complete an additional goodwill impairment test as of the date of the triggering event. We completed the additional goodwill impairment test and determined that the implied fair value of the reporting unit exceeds its carrying value as of the date of the triggering event. Accordingly, no impairment charge was recognized as of October 31, 2017.

## Liquidity

We continue to realize the savings related to our restructuring activities. During fiscal 2018, we made significant reductions to our headcount as part of our ongoing restructuring effort from which we expect to generate annualized savings of approximately \$18 million. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash expected to be provided by future operating activities, augmented by the plans highlighted above, are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

## 3. Fair Value Measurements

### Definition and Hierarchy

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

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

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

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

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

#### Valuation Techniques

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

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs that are observable either directly or indirectly. In periods of market inactivity, the

observability of prices and inputs may be reduced for certain instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3.

#### Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following tables set forth our financial assets and liabilities that were accounted for at fair value on a recurring basis as of October 31, 2017 and January 31, 2017. There were no fair value measurements of our financial assets and liabilities using significant Level 3 inputs for the periods presented:

|  | October<br>31,<br>2017<br>(Amounts in thousands) | Fair Value at<br>October 31, 2017<br>Using<br>Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Inputs<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
|--|--|--|---|
| Financial assets:                            |  |  |   |
| Cash equivalents (a)                         | \$3,550  | \$500  | \$ 3,050  |
| Available-for-sale marketable securities:    |  |  |   |
| Current marketable securities:               |  |  |   |
| U.S. treasury notes and bonds - conventional | 1,993  | 1,993  | —   |
| U.S. government agency issues                | 2,997  | —  | 2,997   |
| Non-current marketable securities:           |  |  |   |
| U.S. treasury notes and bonds - conventional | 1,735  | 1,735  | —   |
| U.S. government agency issues                | 993  | —  | 993   |
| Corporate bonds                              | 1,757  | —  | 1,757   |
| Total  | \$13,025   | \$4,228  | \$ 8,797  |

|  | January<br>31,<br>2017<br>(Amounts in thousands) | Fair Value at<br>January 31, 2017<br>Using<br>Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Inputs<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
|--|--|--|---|
|--|--|--|---|

|  | 2017                   | (Level 1) | (Level 2) |
|--|------------------------|-----------|-----------|
|  | (Amounts in thousands) |           |           |
| Financial assets:                            |                        |           |           |
| Cash equivalents (a)                         | \$2,726                | \$2,726   | \$ —      |
| Available-for-sale marketable securities:    |                        |           |           |
| Current marketable securities:               |                        |           |           |
| U.S. treasury notes and bonds - conventional | 4,253                  | 4,253     | —         |
| U.S. government agency issues                | 1,000                  | —         | 1,000     |
| Non-current marketable securities:           |                        |           |           |
| U.S. treasury notes and bonds - conventional | 1,997                  | 1,997     | —         |
| U.S. government agency issues                | 2,994                  | —         | 2,994     |
| Total  | \$12,970               | \$8,976   | \$ 3,994  |

(a) Money market funds and U.S. treasury bills are included in cash and cash equivalents on the accompanying consolidated balance sheets.

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

Assets and liabilities that are measured at fair value on a nonrecurring basis relate primarily to our tangible property and equipment, goodwill, and other intangible assets, which are re-measured when the derived fair value is below carrying value on our consolidated balance sheets. For these assets and liabilities, we do not periodically adjust carrying value to fair value except in the event of impairment. If we determine that impairment has occurred, the carrying value of the asset is reduced to fair value and the difference is recorded to loss on impairment of long-lived assets in our consolidated statements of operations and comprehensive loss.

In the third quarter of fiscal 2018, we finalized the “Step 1” analysis of our annual goodwill impairment test for fiscal 2018. Based on this analysis, we determined that fair value of our reporting unit exceeded its carrying value, which was \$64.2 million at August 1, 2017. As a result, no impairment charge was required related to the annual test.

In August 2017, we placed the Corporate Headquarters on the market for sale. We assessed whether the Corporate Headquarters would qualify as an asset held for sale and determined that it would not since it did not meet all six of the criteria of an asset held for sale under current accounting guidance. During the assessment, we received information from a third-party real estate broker that led management to believe that there was a significant decrease in the fair value of the Corporate Headquarters. We considered this to be a triggering event and were required to test the Corporate Headquarters for recoverability. We evaluated the undiscounted future cash flows over the remaining useful life of the primary asset of the asset group and determined that an impairment did not exist as of the date of the triggering event.

In addition, since we considered the significant decrease in fair value of the Corporate Headquarters a triggering event, we were required to complete an additional goodwill impairment test as of the date of the triggering event. We completed the additional goodwill impairment test and determined that the implied fair value of the reporting unit exceeds its carrying value as of the date of the triggering event. Accordingly, no impairment charge was recognized as of October 31, 2017.

During the three and nine months ended October 31, 2016, we recorded a \$0.1 million loss on impairment of long-lived assets in our consolidated statements of operations and comprehensive loss. This impairment was taken on an asset group classified as an asset held for sale on our consolidated balances sheet as of October 31, 2016, (as disclosed in Note 5, “Consolidated Balances Sheet Detail”).

We also have direct investments in privately-held companies, over which we do not have significant influence of their operating and financial activities and account for under the cost-method of accounting. Management periodically assesses these investments for other-than-temporary impairment, considering available information provided by the investees and any other readily available market data. If we determine that an other-than-temporary impairment has occurred, we write-down the investment to its fair value. Our ability to realize value from these investments depends on the success of those companies’ businesses and their ability to obtain sufficient capital to execute their business plans. Because private markets are not as liquid as public markets, there is also increased risk that we will not be able to sell these investments, or that when we desire to sell them, we will not be able to obtain fair value for them.

During the three and nine months ended October 31, 2017, the Company did not recognize any impairment charges related to goodwill, intangible assets, long-lived assets or cost-method investments.

#### Available-For-Sale Securities

We determine the appropriate classification of debt investment securities at the time of purchase and reevaluate such designation as of each balance sheet date. Our investment portfolio consists of money market funds, U.S. treasury notes and bonds, U.S. government agency notes and bonds and corporate bonds as of October 31, 2017 and January 31, 2017. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. Our marketable securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses, net of tax, reported in stockholders' equity as a component of accumulated other comprehensive loss. The amortization of premiums and accretion of discounts to maturity are computed under the effective interest method and are included in other income (expenses), net, in our consolidated statements of operations and comprehensive loss. Interest on securities is recorded as earned and is also included in other income (expenses), net. Any realized gains or losses would be shown in the accompanying consolidated statements of operations and comprehensive loss in other income (expenses), net. We provide fair value measurement disclosures of available-for-sale securities in accordance with one of the three levels of fair value measurement mentioned above.

The following is a summary of cash, cash equivalents and available-for-sale securities, including the cost basis, aggregate fair value and gross unrealized gains and losses, for short- and long-term marketable securities portfolio as of October 31, 2017 and January 31, 2017:

|  | Amortized<br>Cost<br>(Amounts in thousands) | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|---|------------------------------|-------------------------------|----------------------------|
| October 31, 2017                                       |   |                              |                               |                            |
| Cash   | \$23,605                                    | \$ —                         | \$ —                          | \$ 23,605                  |
| Cash equivalents                                       | 3,549                                       | 1                            | —                             | 3,550                      |
| Cash and cash equivalents                              | 27,154                                      | 1                            | —                             | 27,155                     |
| U.S. treasury notes and bonds - short-term             | 2,001                                       | —                            | (8 )                          | 1,993                      |
| U.S. treasury notes and bonds - long-term              | 1,740                                       | —                            | (5 )                          | 1,735                      |
| U.S. government agency issues - short-term             | 2,982                                       | 17                           | (2 )                          | 2,997                      |
| U.S. government agency issues - long-term              | 1,003                                       | —                            | (10 )                         | 993                        |
| Corporate bonds - long-term                            | 1,761                                       | —                            | (4 )                          | 1,757                      |
| Total cash, cash equivalents and marketable securities | \$36,641                                    | \$ 18                        | \$ (29 )                      | \$ 36,630                  |
| January 31, 2017                                       |   |                              |                               |                            |
| Cash   | \$25,576                                    | \$ —                         | \$ —                          | \$ 25,576                  |
| Cash equivalents                                       | 2,726                                       | —                            | —                             | 2,726                      |
| Cash and cash equivalents                              | 28,302                                      | —                            | —                             | 28,302                     |
| U.S. treasury notes and bonds - short-term             | 4,248                                       | 5                            | —                             | 4,253                      |
| U.S. treasury notes and bonds - long-term              | 2,003                                       | —                            | (6 )                          | 1,997                      |
| U.S. government agency issues - short-term             | 991   | 9                            | —                             | 1,000                      |
| U.S. government agency issues - long-term              | 2,996                                       | —                            | (2 )                          | 2,994                      |
| Total cash, cash equivalents and marketable securities | \$38,540                                    | \$ 14                        | \$ (8 )                       | \$ 38,546                  |

The gross realized gains and losses on sale of available-for-sale securities as of October 31, 2017 and January 31, 2017 were immaterial. For purposes of determining gross realized gains and losses, the cost of securities is based on specific identification.

Contractual maturities of available-for-sale investments as of October 31, 2017 are as follows (amounts in thousands):

|                                     | Estimated<br>Fair<br>Value |
|-------------------------------------|----------------------------|
| Maturity of one year or less        | \$ 4,990                   |
| Maturity between one and five years | 4,485                      |
| Total                               | \$ 9,475                   |

Cash, Cash Equivalents and Marketable Securities

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

The fair value of cash, cash equivalents, restricted cash and marketable securities at October 31, 2017 and January 31, 2017 was \$36.6 million and \$38.7 million, respectively.

#### Restricted Cash

At times, we may be required to maintain cash held as collateral for performance obligations with our customers which we classify as restricted cash on our consolidated balance sheets.



#### 4. Acquisitions

##### DCC Labs

On May 5, 2016, we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.7 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. The stock consideration was determined by dividing the total value of \$2.7 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all the stock (681,278 shares) were initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement, with one-third of the stock in escrow to be released to the former DCC Labs owners annually on the anniversary date of the acquisition beginning on May 5, 2017 and ending May 5, 2019, and one-half of the cash in escrow to be released to the former DCC Labs owners on May 5, 2017 and May 5, 2018. On May 5, 2017, \$0.3 million in cash and 227,090 shares of our common stock initially deposited with an Escrow Agent were disbursed to the sellers.

The acquisition of DCC Labs enables us to optimize the operations of our In-Home business, which develops home video gateway software including SeaChange's Nucleus and NitroX products. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe's Digital Video Broadcasting community and an HTML5 framework for building additional user experience client applications across a variety of CPE devices, including Android TV STBs, tablets, mobile and computer devices.

We accounted for the acquisition of DCC Labs as a business combination, which requires us to record the assets acquired and liabilities assumed at fair value. The amount by which the purchase price exceeds the fair value of the net assets acquired was recorded as goodwill. We engaged an independent appraiser to assist management in assessing the fair values of the tangible and intangible assets acquired and liabilities assumed and the amount of goodwill to be recognized as of the acquisition date. Assets acquired in the acquisition include receivables, prepaid expenses and property and equipment while liabilities assumed include accounts payable, other accrued expenses, deferred taxes and income taxes payable. The amounts recorded for these assets and liabilities are final, based on information obtained about the facts and circumstances that existed as of the acquisition date.

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

|  |         |
|--|---------|
| Estimated Fair value of consideration:                           |         |
| Cash, net of cash acquired                                       | \$5,243 |
| Stock consideration  | 2,640   |
| Total purchase price   | \$7,883 |
| Estimated Fair value of assets acquired and liabilities assumed: |         |
| Current assets   | 826     |
| Other long-term assets   | 116     |
| Finite-life intangible assets                                    | 810     |
| Goodwill   | 7,255   |
| Current liabilities  | (618 )  |
| Other long-term liabilities                                      | (506 )  |
| Allocated purchase price   | \$7,883 |

### Acquired Goodwill

We recorded the \$7.3 million excess of the purchase price over the fair value of the identified tangible and intangible assets as goodwill, primarily due to expected synergies between the combined companies and expanded market opportunities. The goodwill is not deductible for tax purposes.

### Intangible Assets

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

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

|                        | Useful life | Fair Value             |
|------------------------|-------------|------------------------|
|                        |             | (Amounts in thousands) |
| Tradename              | 4 years     | \$ 60                  |
| Customer contracts     | 2 years     | 230                    |
| Non-compete agreements | 2 years     | 30                     |
| Existing technology    | 3 years     | 490                    |
|                        |             | \$ 810                 |

#### Impact to Fiscal 2017 Financial Results

DCC Labs' financial results have only been included in our fiscal 2017 consolidated financial results for the period from the May 5, 2016 acquisition date through January 31, 2017. As a result, our consolidated financial results for the nine months ended October 31, 2016 does not include DCC Labs' results for the period from February 1, 2016 to May 4, 2016. For that period, DCC Labs' revenue was not significant and its operating loss was approximately \$1.2 million.

#### Acquisition-related Costs

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

#### 5. Consolidated Balance Sheet Detail

##### Inventories, net

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

|                           | As of       | As of       |
|---------------------------|-------------|-------------|
|                           | October 31, | January 31, |
|                           | 2017        | 2017        |
|                           | (Amounts in | (Amounts in |
|                           | thousands)  | thousands)  |
| Components and assemblies | \$ 506      | \$ 500      |
| Finished products         | 344         | 270         |
| Total inventories, net    | \$ 850      | \$ 770      |

##### Property and equipment, net

Property and equipment, net consists of the following:

|  | Estimated<br>Useful<br>Life<br>(Years) | As of<br>October<br>31,<br>2017<br>(Amounts in<br>thousands) | January<br>31,<br>2017 |
|--|--|--|------------------------|
| Land   |  | \$2,780  | \$2,780                |
| Buildings  | 20                                     | 11,839   | 11,726                 |
| Office furniture and equipment                           | 5                                      | 1,222  | 1,091                  |
| Computer equipment, software and demonstration equipment | 3                                      | 16,428   | 18,194                 |
| Service and spare components                             | 5                                      | 1,158  | 1,158                  |
| Leasehold improvements                                   | 1-7                                    | 1,081  | 1,064                  |
|  |  | 34,508   | 36,013                 |
| Less - Accumulated depreciation and amortization         |  | (24,377)   | (24,528)               |
| Total property and equipment, net                        |  | \$10,131   | \$11,485               |

Depreciation and amortization expense on property and equipment, net was \$0.6 million and \$1.8 million for the three and nine months ended October 31, 2017 and \$0.7 million and \$2.3 million for the three and nine months ended October 31, 2016.

## Loss on Impairment of Long-Lived Assets

During the third quarter of fiscal 2017, we began actively marketing our facility in Greenville, New Hampshire for sale and identified a potential buyer. Accordingly, we determined at the time that the sale of the asset group was probable by the end of the fourth quarter of fiscal 2017. We determined that the asset group met all the criteria of held for sale accounting and classified the asset group as held for sale on our consolidated balance sheets beginning in the third quarter of fiscal 2017. We originally placed the asset group for sale in August 2016 for \$0.3 million, which was the net book value of the asset group at that time. To be more competitive in the real estate market in which the property is located, we reduced the selling price in September 2016 to \$0.2 million. As a result, we recorded a loss on impairment of long-lived assets of \$0.1 million in our consolidated statements of operations and comprehensive loss during the three and nine months ended October 31, 2016. Subsequently, in January 2017, after a potential buyer declined to purchase this facility, we determined that the sale of the facility was not imminent due to the location of the building and the overall market conditions in the area. Consequently, we decided to fully impair the facility since we felt that carrying amount was greater than the fair value. As a result, we recorded a \$0.3 million loss on impairment of long-lived assets in our consolidated statements of operations and comprehensive loss at January 31, 2017.

## Other accrued expenses

Other accrued expenses consist of the following:

|                                      | As of<br>October<br>31,<br>2017 | January<br>31,<br>2017 |
|--------------------------------------|---------------------------------|------------------------|
|                                      | (Amounts in<br>thousands)       |                        |
| Accrued compensation and commissions | \$ 1,880                        | \$ 1,799               |
| Accrued bonuses                      | 2,467                           | 1,871                  |
| Accrued restructuring                | 850                             | 1,023                  |
| Employee benefits                    | 372                             | 885                    |
| Taxes                                | 3,850                           | 919                    |
| Accrued other                        | 3,369                           | 3,431                  |
| <b>Total other accrued expenses</b>  | <b>\$ 12,788</b>                | <b>\$ 9,928</b>        |

## 6. Goodwill and Intangible Assets

### Goodwill

Goodwill represents the difference between the purchase price and the estimated fair value of identifiable assets acquired and liabilities assumed. We are required to perform impairment tests related to our goodwill annually, which we perform during the third quarter of each fiscal year, or when we identify certain triggering events or circumstances that would more likely than not reduce the estimated fair value of the goodwill of the Company below its carrying amount. At October 31, 2017 and January 31, 2017, we had goodwill of \$24.5 million and \$23.3 million, respectively. The change in the carrying amount of goodwill for the nine months ended October 31, 2017 is due to the impact of foreign currency translation adjustments related to goodwill balances that are recorded in currencies other than the

U.S. dollar. The following table represents the changes in the carrying amount of goodwill for the nine months ended October 31, 2017 (amounts in thousands):

|                                   |          |
|-----------------------------------|----------|
| Balance as of February 1, 2017:   |          |
| Goodwill, gross                   | \$62,566 |
| Accumulated impairment losses     | (39,279) |
| Goodwill, net                     | 23,287   |
| Cumulative translation adjustment | 1,219    |
| Balance as of October 31, 2017:   |          |
| Goodwill, gross                   | 63,785   |
| Accumulated impairment losses     | (39,279) |
| Goodwill, net                     | \$24,506 |

We are required to perform impairment tests related to our goodwill annually, which we perform during the third quarter of each fiscal year or sooner if an indicator of impairment occurs. In the third quarter of fiscal 2018, we finalized the “Step 1” analysis of our annual goodwill impairment test for fiscal 2018. Based on this analysis, we determined that fair value of our reporting unit exceeded its carrying value, which was \$64.2 million at August 1, 2017. As a result, no impairment charge was required related to

the annual test. See “Critical Accounting Policies and Significant Judgment and Estimates – Goodwill,” in Part I, Item 2 of this Form 10-Q for more information.

During the third quarter of fiscal 2018, we determined that there was a significant decrease in fair value of the Corporate Headquarters (see Note 2, “Significant Accounting Policies – Impairment of Assets,” for more information). We considered this significant decrease in fair value a triggering event. As a result, we were required to complete an additional goodwill impairment test as of the date of the triggering event. We completed the additional goodwill impairment test and determined that the implied fair value of the reporting unit exceeds its carrying value as of the date of the triggering event. Accordingly, no impairment charge was recognized as of October 31, 2017.

Other than the potential impairment indicator of goodwill mentioned above, we noted no other indicators that would require us to perform an impairment test in the fiscal third quarter ended October 31, 2017.

#### Intangible Assets

Intangible assets, net, consisted of the following at October 31, 2017 and January 31, 2017:

|                                     | As of October 31, 2017                        |          |                             |         | As of January 31, 2017 |                             |         |  |
|-------------------------------------|---|----------|-----------------------------|---------|------------------------|-----------------------------|---------|--|
|                                     | Weighted average<br>remaining life<br>(Years) | Gross    | Accumulated<br>Amortization | Net     | Gross                  | Accumulated<br>Amortization | Net     |  |
|                                     | (Amounts in thousands)                        |          |                             |         |                        |                             |         |  |
| Finite-life intangible assets:      |   |          |                             |         |                        |                             |         |  |
| Customer contracts                  | 2.3   | \$30,982 | \$ (29,743 )                | \$1,239 | \$30,056               | \$ (28,019 )                | \$2,037 |  |
| Non-compete agreements              | 0.5   | 2,517    | (2,509 )                    | 8       | 2,374                  | (2,356 )                    | 18      |  |
| Completed technology                | 2.6   | 11,024   | (10,697 )                   | 327     | 10,496                 | (9,997 )                    | 499     |  |
| Trademarks, patents and other       | 2.5   | 7,159    | (7,117 )                    | 42      | 7,125                  | (7,076 )                    | 49      |  |
| Total finite-life intangible assets | 2.4   | \$51,682 | \$ (50,066 )                | \$1,616 | \$50,051               | \$ (47,448 )                | \$2,603 |  |

As of October 31, 2017, the estimated future amortization expense for our finite-life intangible assets is as follows (amounts in thousands):

| Fiscal Year Ended January 31,         | Estimated<br>Amortization<br>Expense |
|---------------------------------------|--------------------------------------|
| 2018 (for the remaining three months) | \$ 478                               |
| 2019                                  | 873                                  |
| 2020                                  | 260                                  |
| 2021                                  | 5                                    |
| 2022                                  | —                                    |

|                     |                 |
|---------------------|-----------------|
| 2023 and thereafter | —               |
| <b>Total</b>        | <b>\$ 1,616</b> |

## 7. Commitments and Contingencies

### Indemnification and Warranties

We provide indemnification, to the extent permitted by law, to our officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee or agent is, or was, serving at our request in such capacity. With respect to acquisitions, we provide indemnification to, or assume indemnification obligations for, the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies' governing documents. As a matter of practice, we have maintained directors' and officers' liability insurance including coverage for directors and officers of acquired companies.

We enter into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require us to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to our products. From time to time, we also indemnify customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of our products and services or resulting from the acts or omissions of us, our employees, authorized agents or subcontractors. From time to time we have received requests from customers for indemnification



of patent litigation claims. Management cannot reasonably estimate any potential losses, but these claims could result in material liability for us. There are no current pending legal proceedings, in the opinion of management, that would have a material adverse effect on our financial position, results from operations and cash flows. There is no assurance that future legal proceedings arising from ordinary course of business or otherwise, will not have a material adverse effect on our financial position, results from operations or cash flows.

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

#### 8. Severance and Other Restructuring Costs

##### Restructuring Costs

During the nine months ended October 31, 2017, we incurred restructuring charges of \$3.3 million primarily from employee-related benefits for terminated employees and costs to close facilities.

The following table shows the activity in accrued restructuring reported as a component of other accrued expenses on the consolidated balance sheet as of October 31, 2017 (amounts in thousands):

|  | Employee-Related<br>Benefits | Closure<br>of<br>Leased<br>Facilities | Other<br>Restructuring | Total    |
|--|------------------------------|---------------------------------------|------------------------|----------|
| Accrual balance as of January 31, 2017 | \$ 785                       | \$ 130                                | \$ 108                 | \$ 1,023 |
| Restructuring charges incurred         | 2,937                        | 89                                    | 262                    | 3,288    |
| Cash payments                          | (2,938)                      | (228)                                 | (312)                  | (3,478)  |
| Other charges                          | 17                           | —                                     | —                      | 17       |
| Accrual balance as of October 31, 2017 | \$ 801                       | \$ (9)                                | \$ 58                  | \$ 850   |

During the third quarter of fiscal 2017, we implemented a restructuring program (“Restructuring Plan”) with the purpose of reducing costs and assisting in restoring SeaChange to profitability and positive cash flow. This program included measures intended to allow the Company to more efficiently operate in a leaner, more direct cost structure. These measures included reductions in workforce, consolidation of facilities, transfers of certain business processes to lower cost regions and reduction in third-party service costs. The total estimated restructuring costs associated with the Restructuring Plan are anticipated to be approximately \$7.5 million and will be recorded in severance and other restructuring costs in our consolidated statements of operations and comprehensive loss as they are incurred. We recorded \$3.2 million of restructuring expense in connection with this plan during the nine months ended October 31, 2017, which was primarily made up of employee-related costs. Since its implementation, we have recognized \$6.3 million in restructuring charges related to the Restructuring Plan and we expect to incur any remaining charges by the end of fiscal 2018.

During the second quarter of fiscal 2017, we restructured our operations in connection with the acquisition of DCC Labs. This restructuring resulted in a workforce reduction within our In-Home engineering and services organization and in the closing of our facility in Portland, Oregon and a substantial reduction to our facility in Milpitas, California. We recorded \$0.1 million of restructuring expense in connection with this action during the nine months ended October 31, 2017, which was primarily made up of facility and other costs not related to employees. We incurred charges totaling \$2.0 million in severance and other restructuring costs from the second quarter of fiscal 2017 through the third quarter of fiscal 2018 related to the acquisition. Once we complete our integration plan, any further reduction in workforce may result in additional restructuring charges.

## 9. Stockholders' Equity

### 2011 Compensation and Incentive Plan

In July 2011, our stockholders approved the adoption of our 2011 Compensation and Incentive Plan (the "2011 Plan"). The 2011 Plan provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units ("RSUs"), deferred stock units ("DSUs") and other equity based non-stock option awards as determined by the plan administrator to officers, employees, consultants, and directors of the Company.

On July 13, 2017, our stockholders approved an amendment to the 2011 Plan which increased the number of shares under the 2011 Plan by 4,000,000 shares and correspondingly increased the number of incentive stock options that can be authorized for issuance under the 2011 Plan.

We may satisfy awards upon the exercise of stock options or the vesting of stock units with newly issued shares or treasury shares. The Board of Directors is responsible for the administration of the 2011 Plan and determining the terms of each award, award exercise price, the number of shares for which each award is granted and the rate at which each award vests. In certain instances, the Board of Directors may elect to modify the terms of an award. As of October 31, 2017, there were 3,989,268 shares available for future grant under the 2011 Plan.

Option awards may be granted to employees at an exercise price per share of not less than 100% of the fair market value per common share on the date of the grant. Stock units may be granted to any officer, employee, director, or consultant at a purchase price per share as determined by the Board of Directors. Option awards granted under the 2011 Plan generally vest over a period of one to four years and expire ten years from the date of the grant.

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

We have granted market-based options to certain officers concurrent with their appointment. These stock options have an exercise price equal to our closing stock price on the date of grant and will vest in approximately equal increments based upon the closing price of SeaChange's common stock. We record the fair value of these stock options using the Monte Carlo simulation model, since the stock option vesting is variable depending on the closing price of our traded common stock. The model simulated the daily trading price of the market-based stock options expected terms to determine if the vesting conditions would be triggered during the term. Effective April 6, 2016, Ed Terino, who previously served as our Chief Operating Officer ("COO"), was appointed Chief Executive Officer ("CEO") of SeaChange and was granted 600,000 market-based options, bringing the total of his market-based options, when added to the 200,000 market-based options he received upon hire as COO in June 2015, to 800,000 market-based options. The fair value of these 800,000 stock options was estimated to be \$2.1 million. As of October 31, 2017, \$0.4 million remained unamortized on these market-based stock options, which will be expensed over the next 1.7 years, the remaining weighted average amortization period.

### 2015 Employee Stock Purchase Plan

In July 2015, we adopted the 2015 Employee Stock Purchase Plan (the "ESPP"). The purpose of the ESPP is to provide eligible employees, including executive officers of SeaChange, with the opportunity to purchase shares of our common stock at a discount through accumulated payroll deductions of up to 15%, but not less than one percent of their eligible compensation, subject to any plan limitations. Offering periods typically commence on October 1<sup>st</sup> and

April 1<sup>st</sup> and end on March 31<sup>st</sup> and September 30<sup>th</sup> with the last trading day being the exercise date for the offering period. On each purchase date, eligible employees will purchase our stock at a price per share equal to 85% of the closing price of our common stock on the exercise date, but no less than par value. The maximum number of shares of our common stock which will be authorized for sale under the ESPP is 1,150,000 shares. Stock-based compensation expense related to the ESPP was not significant for the three and nine months ended October 31, 2017.

## 10. Accumulated Other Comprehensive Loss

The following shows the changes in the components of accumulated other comprehensive loss for the nine months ended October 31, 2017:

|                             | Changes in<br>Fair Value                         |   |           |
|-----------------------------|--|---|-----------|
|                             | Foreign<br>Currency<br>Translation<br>Adjustment | of<br>Available-<br>for-Sale<br>Investments | Total     |
|                             | (Amounts in thousands)                           |   |           |
| Balance at January 31, 2017 | \$(5,377)  | \$ 6  | \$(5,371) |
| Other comprehensive loss    | (76 )  | (17 )                                       | (93 )     |
| Balance at October 31, 2017 | \$(5,453)  | \$ (11 )                                    | \$(5,464) |

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

Comprehensive loss consists of our net loss and other comprehensive loss, which includes foreign currency translation adjustments and changes in unrealized gains and losses on marketable securities available-for-sale. Except in unusual circumstances, we do not recognize tax effects on foreign currency translation adjustments because they are not expected to result in future taxable income or deductions.

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

#### Segment Information

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

#### Significant Customers

One customer accounted for 10% or more of our total revenues for the three and nine months ended October 31, 2017 and 2016 as follows:

|            | Three<br>Months<br>Ended<br>October 31,<br>2017 |     | Nine<br>Months<br>Ended<br>October 31,<br>2016 |     |
|------------|---|-----|--|-----|
| Customer A | 53%   | 33% | 38%  | 31% |

#### Geographic Information

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

|   | Three Months Ended October 31, |      |          |      | Nine Months Ended October 31, |      |          |      |
|---|--------------------------------|------|----------|------|-------------------------------|------|----------|------|
|   | 2017                           |      | 2016     |      | 2017                          |      | 2016     |      |
|   | Amount                         | %    | Amount   | %    | Amount                        | %    | Amount   | %    |
| Revenues by customers' geographic locations: (Amounts in thousands, except percentages) |                                |      |          |      |                               |      |          |      |
| North America (1)   | \$6,931                        | 29 % | \$9,116  | 45 % | \$23,577                      | 41 % | \$28,306 | 47 % |
| Europe and Middle East  | 14,560                         | 62 % | 8,518    | 43 % | 28,203                        | 49 % | 26,098   | 44 % |
| Latin America   | 1,545                          | 7 %  | 1,334    | 7 %  | 4,408                         | 8 %  | 3,785    | 6 %  |
| Asia Pacific  | 394                            | 2 %  | 993      | 5 %  | 1,134                         | 2 %  | 1,794    | 3 %  |
| Total   | \$23,430                       |      | \$19,961 |      | \$57,322                      |      | \$59,983 |      |

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

|                     | Three Months Ended October 31, |         | Nine Months Ended October 31, |          |
|---------------------|--------------------------------|---------|-------------------------------|----------|
|                     | 2017                           | 2016    | 2017                          | 2016     |
| U.S. Revenue        | \$6,105                        | \$6,905 | \$20,180                      | \$22,040 |
| % of total revenues | 26.1 %                         | 34.6 %  | 35.2 %                        | 36.7 %   |

## 12. Income Taxes

We recorded an income tax provision of \$1.2 million and an income tax benefit of \$(0.4) million for the three months ended October 31, 2017 and 2016, respectively. The tax provision for the nine months ended October 31, 2017 includes a \$0.6 million tax benefit related to the reversal of tax reserves for uncertain tax positions due to the expiration of the Irish statute of limitations and \$1.8 million of tax expense that is largely attributable to a shift in the jurisdictions where income is earned. We recorded a tax provision of \$1.5 million and \$14.4 million, respectively, for the nine months ended October 31, 2017 and 2016. In the second quarter of fiscal 2017, we recorded a charge of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2018 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of October 31, 2017, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

We file income tax returns in the U.S. federal jurisdiction, various state jurisdictions, and various foreign jurisdictions. We have closed out an audit with the Internal Revenue Service (“IRS”) through fiscal 2013. We are no longer subject to U.S. federal examinations before fiscal 2015. However, the taxing authorities will still have the ability to review the propriety of certain tax attributes created in closed years if such tax attributes are utilized in an open tax year, such as our federal research and development credit carryovers.

## 13. Net Loss Per Share

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

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

|  | Three Months<br>Ended<br>October 31,<br>2017 |             | Nine Months<br>Ended<br>October 31,<br>2016 |              |
|--|--|-------------|---|--------------|
| Net loss   | \$ (220 )                                    | \$ (8,082 ) | \$ (7,120 )                                 | \$ (43,873 ) |
| Weighted average shares used in computing net loss per |  |             |   |              |
| share - basic and diluted                              | 35,479                                       | 35,186      | 35,381                                      | 34,889       |

Net loss per share:

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | \$ (0.00 ) | \$ (0.23 ) | \$ (0.20 ) | \$ (1.26 ) |
| Diluted | \$ (0.00 ) | \$ (0.23 ) | \$ (0.20 ) | \$ (1.26 ) |



The number of common shares used in the computation of diluted net loss per share for the three and nine months ended October 31, 2017 and 2016 does not include the effect of the following potentially outstanding common shares because the effect would have been anti-dilutive (amounts in thousands):

|                         | Three Months<br>Ended<br>October 31,<br>2017 |       | Nine Months<br>Ended<br>October 31,<br>2017 |       |
|-------------------------|--|-------|---|-------|
|                         | 2017   | 2016  | 2017  | 2016  |
| Stock options           | 1,588  | 1,756 | 1,676                                       | 1,443 |
| Restricted stock units  | 483  | 514   | 349   | 472   |
| Deferred stock units    | 42   | 28    | 88  | 55    |
| Performance stock units | 339  | 331   | 494   | 315   |
| Total                   | 2,452  | 2,629 | 2,607                                       | 2,285 |

#### 14. Recent Accounting Standard Updates

We consider the applicability and impact of all ASUs on our consolidated financial statements. Updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations. Recently issued ASUs which we feel may be applicable to us are as follows:

#### Recently Issued Accounting Standard Updates – Not Yet Adopted

##### Revenue from Contracts with Customers (Topic 606)

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies using International Financial Reporting Standards and U.S. GAAP. The core principle requires entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB voted to approve a one year deferral, making the standard effective for public entities for annual and interim periods beginning after December 15, 2017.

In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” The purpose of ASU 2016-08 is to clarify the guidance on principal versus agent considerations. It includes indicators that help to determine whether an entity controls the specified good or service before it is transferred to the customer and to assist in determining when the entity satisfied the performance obligation and as such, whether to recognize a gross or a net amount of consideration in their consolidated statement of operations.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies that entities are not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. ASU 2016-10 also addresses how to determine whether promised goods or services are separately identifiable and permits entities to make a policy election to treat shipping and handling costs as fulfillment activities. In addition, it clarifies key provisions in Topic 606 related to licensing.

In May 2016, the FASB issued ASU 2016-11, “Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815).” ASU 2016-11 rescinds previous SEC comments that were codified in Topic 605, Topic 932 and Topic 815.

Upon adoption of Topic 606, certain SEC comments including guidance on accounting for shipping and handling fees and costs and consideration given by a vendor to a customer should not be relied upon.

In May 2016, the FASB also issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients.” ASU 2016-12 provides clarity around collectability, presentation of sales taxes, non-cash consideration, contract modifications at transition and completed contracts at transition. ASU 2016-12 also includes a technical correction within Topic 606 related to required disclosures if the guidance is applied retrospectively upon adoption.

In December 2016, the FASB issued ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.” ASU 2016-20 allows entities not to make quantitative disclosures about remaining performance obligations in certain cases and requires entities that use any of the optional exemptions to expand their qualitative disclosures. ASU 2016-20 also clarifies other areas of the new revenue standard, including disclosure requirements for prior period performance obligations, impairment guidance for contract costs and the interaction of impairment guidance in ASC 340-40 with other guidance elsewhere in the Codification.

The Company will adopt Topic 606 effective February 1, 2018 under the modified retrospective method and will only apply this method to contracts that are not completed as of the date of adoption. The modified retrospective method will result in a cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at the date of

initial application for any open contracts as of the adoption date. The Company has established an implementation team to assist with its assessment of the impact of the new revenue guidance on its operations, consolidated financial statements and related disclosures. In addition, the Company has made investments in systems to enable timely and accurate reporting under the new standard. To date, the Company's assessment has included (1) utilizing questionnaires to assist with the identification of revenue streams, (2) performing sample contract analyses for each revenue stream identified, (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard, (4) performing detailed analyses of contracts with larger customers, (5) testing transactions for consistency with contract provisions that affect revenue recognition, and (6) developing a standalone selling price for all performance obligations. Based on the results of the assessment, the Company currently believes the most significant potential changes to be in the identification of performance obligations, the timing of revenue recognition and the allocation of transaction price to the performance obligations. As part of the procedures completed by the Company, incremental costs to obtain a contract and costs incurred in fulfilling a contract have also been assessed. Based on preliminary results of the assessment, which is still in process, the Company currently believes that the most significant potential changes to be accounting for commissions associated with the initial year of contract, as incremental costs are expected to be capitalized as a contract asset and they will be amortized over the estimated customer life, which could extend beyond the contract life. The Company also anticipates changes to the consolidated balance sheet related to accounts receivable, contract assets, and contract liabilities, as well as, significant changes to its disclosures, to comply with the new disclosure requirements under Topic 606. The Company is continuing to design the necessary changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Further, the Company is continuing to assess what incremental disaggregated revenue and other disclosures will be required in its consolidated financial statements, which the Company believes will be significant.

Based on the procedures performed, the Company expects the following impacts:

Currently, the Company recognizes revenue from perpetual licenses with extended payment terms over the term of the agreement as payments are received, provided all other criteria for revenue recognition have been met, and any corresponding maintenance over the term of the agreement. The adoption of ASC 606 will result in revenue for performance obligations being recognized as they are satisfied. Therefore, revenue from perpetual license performance obligations with extended payment terms will be recognized when control is transferred to the customer. Any unrecognized license revenue from the arrangement, included in deferred revenue at January 31, 2018, will not be recognized in revenue in future periods but as a cumulative adjustment to retained earnings. Further, revenue from the maintenance performance obligations is expected to be recognized on a straight-line basis over the contractual term. Due to the revenue from perpetual licenses with extended payment terms being recognized prior to amounts being billed to the customer, the Company expects to recognize a net contract asset on the balance sheet.

Currently, the Company allocates revenue to licenses under the residual method when it has Vendor Specific Objective Evidence ("VSOE") for the remaining undelivered elements, which allocates any future credits or significant discounts entirely to the license. The adoption of ASC 606 will result in future credits, significant discounts, and material rights under ASC 606, being allocated to all performance obligations based upon their relative selling price. Under ASC 606, additional license revenue from the reallocation of such arrangement considerations will be recognized when control is transferred to the customer, which is generally upon delivery of the license.

Currently, the Company does not have VSOE for professional services and maintenance in certain geographical areas, which results in revenue being deferred in such instances until such time as VSOE exists for all undelivered elements or recognized ratably over the longest performance period. The adoption of ASC 606 eliminates the requirement for VSOE and replaces it with the concept of a standalone selling price. Once the transaction price is allocated to each of the performance obligations, the Company can recognize revenue as the performance obligations are delivered, either at a point in time or over time. Under ASC 606, license revenue will be recognized when control is transferred to the customer and professional services revenue will be recognized over time based on labor hours expended. This will result in the acceleration of professional services revenue when compared to the current practice of ratable recognition for professional services when there is a lack of VSOE.

Sales commissions and other third-party acquisition costs resulting directly from securing contracts with customers are currently expensed when incurred. ASC 606 will require these costs to be recognized as an asset when incurred and to be expensed over the associated contract term. However, because the sales commission paid on the maintenance renewals is not commensurate with the original deal, ASC 606 requires that these acquisition costs be expensed over the customer life. The Company expects this change to impact all arrangements that included implicit or explicit maintenance contracts.

ASC 606 provides additional accounting guidance for contract modifications whereby changes must be accounted for either as a retrospective change (creating either a catch up or deferral of past revenues), prospectively with a reallocation

of revenues amongst identified performance obligations, or prospectively as separate contracts which will not require any reallocation. This may result in a difference in the timing of the recognition of revenue as compared to how contract modifications are recognized currently.

There will be a corresponding effect on tax liabilities in relation to all of the above impacts.

## Leases

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

## Recently Issued Accounting Standard Updates – Adopted During the Period

### Cash Flow Statement

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and annual periods beginning in our first quarter of fiscal 2019, and early adoption is permitted. The Company early adopted this standard on August 1, 2017. The adoption of this standard did not have any effect on our consolidated financial statements because the cash receipts and cash payments described in ASU 2016-15 are not applicable to the Company currently or retrospectively.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance is effective for us in the first quarter of fiscal 2019 and early adoption is permitted. The Company early adopted the standard on August 1, 2017 and retrospectively applied the amendment. Other than the change in presentation of restricted cash within the consolidated statements of cash flows, the adoption of this standard did not have a material impact on our consolidated financial statements.

### Intangibles-Goodwill and Other

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which simplifies the subsequent measurement of goodwill by removing “Step 2” of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The

guidance is effective for us beginning in the first quarter of fiscal 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company early adopted ASU 2017-04 effective August 1, 2017 in conjunction with its annual goodwill impairment testing. Because the results of “Step 1” of the impairment test indicated that the fair value of the Company’s goodwill exceeded its carrying amount, the adoption of ASU 2017-04 did not change the impairment testing process for the fiscal 2018 annual goodwill impairment test. See Note 6, “Goodwill and Intangible Assets,” for more information on our annual goodwill impairment test.

#### Stock Compensation

In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment awards require an entity to apply modification accounting under ASC 718. The guidance is effective for us beginning in the first quarter of fiscal 2019 and early adoption is permitted. The Company early adopted ASU 2017-09 in the fiscal quarter ended October 31, 2017. The implementation of this standard had no impact on the Company’s consolidated financial statements.

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

### Forward-Looking Statements

This Form 10-Q contains or incorporates forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, and such statements involve risks and uncertainties. The following information should be read in conjunction with the unaudited consolidated financial information and the notes thereto included in this Form 10-Q. You should not place undue reliance on these forward-looking statements. Actual events or results may differ materially due to competitive factors and other factors referred to in Part I, Item 1A. "Risk Factors" in our Form 10-K for our fiscal year ended January 31, 2017 and elsewhere in this Form 10-Q. These factors may cause our actual results to differ materially from any forward-looking statement. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industry and markets in which we operate, and management's beliefs and assumptions. We undertake no obligation to publicly update or revise the statements in light of future developments. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as "expect," "anticipate," "intend," "plan," "believe," "could," "estimate," "may," "target," "project," or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict.

### Business Overview

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

We address what we see as the continuing rise of Internet Protocol television ("IPTV") and OTT services by such companies as Netflix, Hulu, Amazon, mlbam, Kaltura, Ooyala and Brightcove and by media companies such as HBO, CBS and BBC. This rise of IPTV and OTT video services in the United States has increased the demand for multiscreen capabilities on a range of consumer devices operating on cloud-based platforms. We have been increasing our strategic investments in research and development related to our cloud-based offerings, as well as in sales and marketing as we focus on our go-to-market efforts in these areas.

We continue to invest in developing next generation capabilities in our four main product offerings: video back office, advertising, content management and user experience. Our suite of products allows us to provide customers with end-to-end video delivery capabilities across multiple platforms, thus reducing cost and increasing speed and ease of use for end users. We believe that by delivering innovative solutions to both our existing customer base and to content owners that are looking to provide end-to-end solutions, we can meet their growing needs and help them get to market faster, which will help them drive new revenue growth. We have virtualized our solutions and products to make integrating with existing networks simple and this is a core competency of our platform. We have optimized our software solutions to serve a wide range of consumer devices.

We expect to increase software sales in North America and Europe, the Middle East and Africa ("EMEA") through targeted sales efforts in those regions. In addition, we believe that we have the opportunity for revenue growth by expanding our selling efforts in new geographic areas such as Asia Pacific and Latin America. We also believe that our existing service operator customers will continue upgrading to new features that can increase average revenue per subscriber, reduce operating and capital expenses, and lower customer churn.

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

- Changes to estimated times to complete long-term projects;
- The time required to deliver and install the product and for the customer to accept the product and services;
- Timing of customers in selecting programs to launch our services to their end users;
- The ability of our customers to process the purchase order within their organization in a timely manner;
- The transition from perpetual license to subscription, cloud-based revenue and the associated deviation from our traditional professional services delivery model;
- Budgetary approvals by our customers for capital purchases;
- Uncertainty caused by potential consolidation in the industry; and
- Changes in foreign exchange rates.



These, together with other factors, could result in reductions in sales of our products, longer sales cycles, difficulties in collection of accounts receivable, a longer period of time before we may recognize revenue attributable to a sale, changes in cost estimates on long-term contracts that could result in a loss provision, gross margin deterioration, slower adoption of new technologies, the transition to software-as-a-service (“SaaS”) delivery, and increased price competition.

On May 5, 2016, we acquired a 100% share of DCC Labs in exchange for an aggregate of \$2.7 million in newly issued shares of SeaChange common stock and \$5.2 million in cash, net of cash acquired, resulting in a total net purchase price of \$7.9 million. The stock consideration was determined by dividing the total value of \$2.7 million by the volume weighted average closing price of our common stock for the twenty trading days preceding the closing. DCC Labs is a developer of set-top and multiscreen device software. Of the total consideration, \$0.5 million in cash and all the stock (681,278 shares) were initially held in escrow as security for the indemnification obligations of the former DCC Labs owners to SeaChange under the purchase agreement, with one-third of the stock in escrow to be released to the former DCC Labs owners annually on the anniversary date of the acquisition beginning on May 5, 2017 and ending May 5, 2019, and one-half of the cash in escrow to be released to the former DCC Labs owners on May 5, 2017 and May 5, 2018. On May 5, 2017, \$0.3 million in cash and 227,090 shares of our common stock initially deposited with an Escrow Agent were disbursed to the sellers.

The acquisition of DCC Labs enables us to optimize the operations of our In-Home business, which develops home video gateway software including SeaChange’s Nucleus and NitroX products. In addition, the acquisition brings market-ready products, including an optimized television software stack for Europe’s Digital Video Broadcasting community, and an HTML5 framework for building additional user experience client applications across a variety of CPE devices, including Android TV STBs, tablets, mobile and computer devices.

In conjunction with the DCC Labs acquisition, SeaChange commenced a workforce reduction within its In-Home engineering and services organization, which allowed us to achieve approximately \$8 million in annualized cost savings. This reduction in workforce has resulted in aggregate charges of \$2.0 million in severance and other restructuring costs since its implementation.

In addition to the reduction in workforce associated with the acquisition of DCC Labs, we implemented additional company-wide cost savings efforts during the second half of fiscal 2017, including a worldwide reduction in workforce, to help improve operations and optimize our cost structure with the goal of assisting in restoring SeaChange to profitability and positive cash flow. In the first nine months of fiscal 2018, we recognized \$3.2 million of restructuring costs related to these cost-saving initiatives and have recognized \$6.3 million since the program was implemented.

We recorded an income tax provision of \$14.6 million in fiscal 2017, primarily relating to deferred income tax expense of \$14.7 million related to the undistributed foreign earnings of certain of our foreign subsidiaries. Prior to the end of the second quarter of fiscal 2017, we asserted that the undistributed earnings of all our foreign subsidiaries were permanently reinvested and, accordingly were not subject to U.S. income taxes. In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet the Company’s working capital needs. Accordingly, in the second quarter of fiscal 2017, we changed our permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016, and recorded a deferred tax liability of \$14.7 million related to the foreign income on the \$58.6 million of undistributed earnings. As of October 31, 2017, the balance of the deferred tax liability is \$16.3 million. There is no certainty as to the timing of when such foreign earnings will be distributed via dividend to the United States in whole or in part. In addition, when the foreign earnings are distributed to the United States, we anticipate that a substantial portion of the resulting U.S. income taxes would be reduced by existing tax attributes.

## Results of Operations

The following discussion summarizes the key factors our management believes are necessary for an understanding of our consolidated financial statements. As mentioned in Note 1. “Nature of Business and Basis of Presentation – Basis of Presentation,” to this Form 10-Q, effective February 1, 2017, as a result of a change in how we review our business, costs associated with our Solutions Architect employees which were formerly classified as research and development expenses, are now classified as selling and marketing expenses. Management feels that the tasks of these employees are more in line with the tasks of the sales group rather than with research and development. In addition, all Solutions Architect research and development costs prior to February 1, 2017, which were primarily employee-related costs, were reclassified to cost of revenues because they all related to revenue-generating projects. Beginning on February 1, 2017, this reclassification is from selling and marketing expense to cost of revenues and the amount is determined based on the hours worked on revenue-generating projects by Solutions Architect employees. Prior fiscal year amounts were adjusted to conform to this presentation. The effect of this change in methodology, which has no effect on loss from operations, is reflected in our current statements of operations and comprehensive loss for the three and nine months ended October 31, 2016.

## Revenues

The following table summarizes information about our revenues for the three and nine months ended October 31, 2017 and 2016:

|  | Three Months Ended October 31, |           | Increase/ (Decrease) \$ |  | Increase/ (Decrease) % Change |  | Nine Months Ended October 31, |           | Increase/ (Decrease) \$ |  | Increase/ (Decrease) % Change |   |
|--|--------------------------------|-----------|-------------------------|--|-------------------------------|--|-------------------------------|-----------|-------------------------|--|-------------------------------|---|
|  | 2017                           | 2016      | Amount                  |  | %                             |  | 2017                          | 2016      | Amount                  |  | %                             |   |
| (Amounts in thousands, except for percentage data) |                                |           |                         |  |                               |  |                               |           |                         |  |                               |   |
| Revenues:  |                                |           |                         |  |                               |  |                               |           |                         |  |                               |   |
| Product  | \$ 11,119                      | \$ 3,746  | \$ 7,373                |  | >100%                         |  | \$ 18,907                     | \$ 10,481 | \$ 8,426                |  | 80.4                          | % |
| Service  | 12,311                         | 16,215    | (3,904 )                |  | (24.1 %)                      |  | 38,415                        | 49,502    | (11,087 )               |  | (22.4 %)                      |   |
| Total revenues                                     | 23,430                         | 19,961    | 3,469                   |  | 17.4 %                        |  | 57,322                        | 59,983    | (2,661 )                |  | (4.4 %)                       |   |
| Cost of product revenues                           | 1,453                          | 1,906     | (453 )                  |  | (23.8 %)                      |  | 3,852                         | 4,752     | (900 )                  |  | (18.9 %)                      |   |
| Cost of service revenues                           | 5,613                          | 7,677     | (2,064 )                |  | (26.9 %)                      |  | 15,813                        | 27,168    | (11,355 )               |  | (41.8 %)                      |   |
| Total cost of revenues                             | 7,066                          | 9,583     | (2,517 )                |  | (26.3 %)                      |  | 19,665                        | 31,920    | (12,255 )               |  | (38.4 %)                      |   |
| Gross profit                                       | \$ 16,364                      | \$ 10,378 | \$ 5,986                |  | 57.7 %                        |  | \$ 37,657                     | \$ 28,063 | \$ 9,594                |  | 34.2 %                        |   |
| Gross product profit margin                        | 86.9 %                         | 49.1 %    |                         |  | 37.8 %                        |  | 79.6 %                        | 54.7 %    |                         |  | 25.0 %                        |   |
| Gross service profit margin                        | 54.4 %                         | 52.7 %    |                         |  | 1.7 %                         |  | 58.8 %                        | 45.1 %    |                         |  | 13.7 %                        |   |
| Gross profit margin                                | 69.8 %                         | 52.0 %    |                         |  | 17.9 %                        |  | 65.7 %                        | 46.8 %    |                         |  | 18.9 %                        |   |

**Product Revenue.** The increase in product revenue for the three and nine months ended October 31, 2017 of \$7.4 million and \$8.4 million, respectively, was primarily due to a \$8.6 million and \$9.4 million increase in our video platform revenue for the three and nine months ended October 31, 2017, as compared to the same periods of fiscal 2017. This increase is primarily due to the purchase of software licenses by our largest customer in the third quarter of fiscal 2018 as they continue to build out their back-office solution. This increase was partially offset by a \$1.0 million and \$0.4 million decrease in hardware revenue during those periods, as compared to the same periods of the prior fiscal year.

**Service Revenue.** Service revenue decreased \$3.9 million and \$11.1 million for the three and nine months ended October 31, 2017, as compared to the same periods of fiscal 2017, primarily due to less revenue recognized for professional services provided on our video platform during the current fiscal year. Additionally, there was a decrease in maintenance and support revenue provided on post-warranty contracts.

During each period shown in the table above, one customer accounted for more than 10% of our total revenue. See Note 11, "Segment Information, Significant Customers and Geographic Information," to our consolidated financial statements for more information.

International revenues accounted for approximately 74% and 65% of total revenues in the three months ended October 31, 2017 and 2016, respectively. For the nine months ended October 31, 2017 and 2016, international revenues accounted for 65% and 63% of total revenues. The increase in the international revenues as a percentage of total revenue for the three and nine months ended October 31, 2017, as compared to the same prior periods is primarily due to an increase in revenue outside the United States at a higher rate than the decrease in domestic revenue. Specifically, in the third quarter of fiscal 2018 we sold approximately \$8 million of software licenses to our largest customer in Europe.

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

Our gross profit margin increased 18 percentage points for the three months ended October 31, 2017, as compared to the same period of the prior fiscal year and increased 19 percentage points for the nine months ended October 31, 2017. Product gross margin increased 38 percentage points for the three months and 25 percentage points for the nine months ended October 31, 2017, as compared to the same periods in the prior fiscal year, primarily due to an increase in software license revenues, which carry higher gross margins, and a decrease in costs, specifically employee-related costs resulting from the cost-savings initiatives implemented beginning in the third quarter of fiscal 2017. Service profit margins increased two percentage points for the three months ended and increased 14 percentage points for the nine months ended October 31, 2017, as compared to the same periods of the prior fiscal year, in part due to lower employee-related costs described above.

## Operating Expenses

### Research and Development

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

| Three Months Ended                                 |      | Increase/ (Decrease) |          | Nine Months Ended |      | Increase/ (Decrease) |          |
|--|------|----------------------|----------|-------------------|------|----------------------|----------|
| October 31, 2017                                   | 2016 | \$ Amount            | % Change | October 31, 2017  | 2016 | \$ Amount            | % Change |
| (Amounts in thousands, except for percentage data) |      |                      |          |                   |      |                      |          |

|                                   |         |         |             |          |          |          |             |          |
|-----------------------------------|---------|---------|-------------|----------|----------|----------|-------------|----------|
| Research and development expenses | \$5,634 | \$7,325 | \$ (1,691 ) | (23.1 %) | \$17,411 | \$23,751 | \$ (6,340 ) | (26.7 %) |
| % of total revenues               | 24.0 %  | 36.7 %  |             |          | 30.4 %   | 39.6 %   |             |          |

Research and development expenses consist primarily of employee costs, which include salaries, benefits and related payroll taxes, depreciation of development and test equipment and an allocation of related facility expenses. During the three and nine months ended October 31, 2017, research and development costs decreased \$1.7 million and \$6.3 million, respectively, as compared to the same periods of fiscal 2017. These decreases were primarily due to lower labor costs associated with the reduction in work force and transfer of certain business processes to lower cost regions resulting from the restructuring of the research and development group after our acquisition of DCC Labs in May 2016 as well as other cost-savings efforts implemented in the second half of fiscal 2017.

### Selling and Marketing

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

| Three Months Ended |      | Increase/ (Decrease) |          | Nine Months Ended |      | Increase/ (Decrease) |          |
|--------------------|------|----------------------|----------|-------------------|------|----------------------|----------|
| October 31, 2017   | 2016 | \$ Amount            | % Change | October 31, 2017  | 2016 | \$ Amount            | % Change |

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(Amounts in thousands, except for percentage data)

|                                |         |         |          |         |         |          |             |          |
|--------------------------------|---------|---------|----------|---------|---------|----------|-------------|----------|
| Selling and marketing expenses | \$3,916 | \$3,988 | \$ (72 ) | (1.8 %) | \$9,292 | \$12,487 | \$ (3,195 ) | (25.6 %) |
| % of total revenues            | 16.7 %  | 20.0 %  |          |         | 16.2 %  | 20.8 %   |             |          |

Selling and marketing expenses consist primarily of payroll costs, which include salaries and related payroll taxes, benefits and commissions, travel expenses and certain promotional expenses. Selling and marketing expenses decreased \$0.1 million and \$3.2 million for the three and nine months ended October 31, 2017, respectively, as compared to the same periods of the prior fiscal year, primarily due to lower employee-related costs. These lower costs were a result of the cost-savings initiatives implemented in the second half of fiscal 2017. The decreases for the three and nine month periods were partially offset by a \$0.7 million and \$1.0 million increase, respectively, in commissions paid resulting from higher bookings in the third quarter of fiscal 2018.

#### General and Administrative

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

|  | Three Months Ended October 31, 2017 |         |                                |                               | Nine Months Ended October 31, 2017 |          |                                |                               |
|--|-------------------------------------|---------|--------------------------------|-------------------------------|------------------------------------|----------|--------------------------------|-------------------------------|
|  | 2016                                |         | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change | 2016                               |          | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change |
| (Amounts in thousands, except for percentage data) |                                     |         |                                |                               |                                    |          |                                |                               |
| General and administrative expenses                | \$3,868                             | \$3,673 | \$ 195                         | 5.3 %                         | \$10,595                           | \$11,579 | \$ (984 )                      | (8.5 %)                       |
| % of total revenues                                | 16.5 %                              | 18.4 %  |                                |                               | 18.5 %                             | 19.3 %   |                                |                               |

General and administrative expenses consist primarily of employee costs, which include salaries and related payroll taxes and benefit-related costs, legal and accounting services and an allocation of related facilities expenses. General and administrative expenses increased \$0.2 million for the three months ended October 31, 2017, as compared to the same period of fiscal 2017 due primarily to higher accounting services relating to audit and internal controls consulting services. General and administrative expenses decreased \$1.0 million in the nine months ended October 31, 2017, as compared to the same period of fiscal 2017, primarily due to a decrease in labor costs resulting from the reduction of our headcount as part of our cost-savings initiatives implemented in the second half of fiscal 2017. This decrease was partially offset by an increase in accounting fees, such as internal and external audit fees, and legal fees.

#### Amortization of Intangible Assets

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

|  | Three Months Ended October 31, 2017 |       |           | Increase/ (Decrease) \$ Amount |  |          | Increase/ (Decrease) % Change |         |           | Nine Months Ended October 31, 2017 |  |          | Increase/ (Decrease) \$ Amount |  |  | Increase/ (Decrease) % Change |  |          |
|--|-------------------------------------|-------|-----------|--------------------------------|--|----------|-------------------------------|---------|-----------|------------------------------------|--|----------|--------------------------------|--|--|-------------------------------|--|----------|
|  | 2016                                |       |           | \$ Amount                      |  | % Change | 2016                          |         |           | \$ Amount                          |  | % Change | 2016                           |  |  | \$ Amount                     |  | % Change |
| (Amounts in thousands, except for percentage data) |                                     |       |           |                                |  |          |                               |         |           |                                    |  |          |                                |  |  |                               |  |          |
| Amortization of intangible assets                  | \$625                               | \$855 | \$ (230 ) | (26.9 %)                       |  |          | \$1,839                       | \$2,519 | \$ (680 ) | (27.0 %)                           |  |          |                                |  |  |                               |  |          |
| % of total revenues                                | 2.7 %                               | 4.3 % |           |                                |  |          | 3.2 %                         | 4.2 %   |           |                                    |  |          |                                |  |  |                               |  |          |

Amortization expense relates to the costs of acquired intangible assets and capitalized internally-developed software costs. The decrease in amortization expense for the three and nine months ended October 31, 2017, as compared to the same periods of fiscal 2017, is primarily due to the fully amortized intangible assets from prior acquisitions as well as a change in foreign exchange rates.

#### Stock-based Compensation Expense

The following table provides information regarding the change in stock-based compensation expense during the periods presented:

|  | Three Months Ended October 31, 2017 |                                |                               |         | Nine Months Ended October 31, 2017 |                                |                               |        |
|--|-------------------------------------|--------------------------------|-------------------------------|---------|------------------------------------|--------------------------------|-------------------------------|--------|
|  | 2016                                | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change |         | 2016                               | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change |        |
| (Amounts in thousands, except for percentage data) |                                     |                                |                               |         |                                    |                                |                               |        |
|  | \$697                               | \$765                          | \$ (68 )                      | (8.9 %) | \$2,227                            | \$1,816                        | \$ 411                        | 22.6 % |

### Stock-based compensation expense

|                     |       |       |       |       |
|---------------------|-------|-------|-------|-------|
| % of total revenues | 3.0 % | 3.8 % | 3.9 % | 3.0 % |
|---------------------|-------|-------|-------|-------|

Stock-based compensation expense is related to the issuance of stock grants to our employees, executives and members of our Board of Directors. Stock-based compensation expense decreased \$0.1 million in the three months ended October 31, 2017 primarily due to a decrease in expense related to non-performance based RSUs due to lower grant day stock prices and to a decrease in stock compensation expense on the CEO's market-based stock options. Stock compensation expense increased \$0.4 million for the nine months ended October 31, 2017, as compared to the same period in fiscal 2017, primarily due to the reversal of our former CEO's stock-based compensation in the first quarter of fiscal 2017 upon his departure from the Company. This increase is partially offset by a decrease in stock-based compensation expense related to non-performance based RSUs due to lower grant day stock prices.

### Severance and Other Restructuring Costs

The following table provides information regarding the change in severance and other restructuring costs during the periods presented:

|   | Three Months Ended October 31,                     |         |                                      |                                     | Nine Months Ended October 31, |         |                                      |                                     |
|---|--|---------|--------------------------------------|-------------------------------------|-------------------------------|---------|--------------------------------------|-------------------------------------|
|   | 2017   | 2016    | Increase/<br>(Decrease)<br>\$ Amount | Increase/<br>(Decrease)<br>% Change | 2017                          | 2016    | Increase/<br>(Decrease)<br>\$ Amount | Increase/<br>(Decrease)<br>% Change |
|   | (Amounts in thousands, except for percentage data) |         |                                      |                                     |                               |         |                                      |                                     |
| Severance and other restructuring costs | \$960  | \$2,373 | \$ (1,413 )                          | (59.5 %)                            | \$3,670                       | \$5,991 | \$ (2,321 )                          | (38.7 %)                            |
| % of total revenues                     | 4.1 %  | 11.9 %  |                                      |                                     | 6.4 %                         | 10.0 %  |                                      |                                     |



Severance and other restructuring costs decreased \$1.4 million for the three months ended October 31, 2017, as compared to the same period of fiscal 2017. Charges in fiscal 2018 include \$0.8 million related to a cost reduction initiative implemented in the second half of fiscal 2017, which we expect to be completed by the end of fiscal 2018 and to severance charges not related to a restructuring plan of \$0.2 million. Charges in fiscal 2017 included \$2.1 million related to the cost reduction initiative mentioned above and \$0.3 million related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016.

Severance and other restructuring costs decreased \$2.3 million for the nine months ended October 31, 2017, as compared to the same period of fiscal 2017. Charges in fiscal 2018 include \$3.2 million related to a cost reduction initiative implemented in the second half of fiscal 2017 that we expect to be completed by the end of fiscal 2018, \$0.1 million of charges related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$0.4 million. Charges in fiscal 2017 included \$2.1 million related to the cost reduction initiative mentioned above, \$0.6 million related to the restructuring activities of our Timeline Labs operations, \$1.9 million related to the reduction in force in our In-Home engineering and services organization in conjunction with our acquisition of DCC Labs in May 2016 and to severance charges not related to a restructuring plan of \$1.4 million, including severance related to our former CEO and CFO.

#### Other Income (Expenses), Net

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

|  | Three Months Ended October 31, 2017 |                                |                               |         | Nine Months Ended October 31, 2017 |                                |                               |        |
|--|-------------------------------------|--------------------------------|-------------------------------|---------|------------------------------------|--------------------------------|-------------------------------|--------|
|  | 2016                                | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change |         | 2016                               | Increase/ (Decrease) \$ Amount | Increase/ (Decrease) % Change |        |
| (Amounts in thousands, except for percentage data) |                                     |                                |                               |         |                                    |                                |                               |        |
| Interest income, net                               | \$46                                | \$ 11                          | \$ 35                         | >100%   | \$106                              | \$88                           | \$ 18                         | 20.5 % |
| Foreign exchange (loss) gain                       | (97)                                | (74)                           | (23)                          | 31.1 %  | 748                                | 124                            | 624                           | >100%  |
| Miscellaneous income (expense)                     | 65                                  | (4)                            | 69                            | >(100%) | 115                                | 8                              | 107                           | >100%  |
|  | \$14                                | \$(67)                         | \$ 81                         |         | \$969                              | \$220                          | \$ 749                        |        |

For the nine months ended October 31, 2017, foreign exchange (loss) gain increased by \$0.6 million as compared to the same period of fiscal 2017. The strengthening of the U.S. dollar compared to other foreign currencies during the periods presented, primarily the British Pound and Euro, resulted in this increase.

#### Income Tax Provision (Benefit)

| Three Months Ended October 31, |                      |                      |  | Nine Months Ended October 31, |                      |                      |  |
|--------------------------------|----------------------|----------------------|--|-------------------------------|----------------------|----------------------|--|
|                                | Increase/ (Decrease) | Increase/ (Decrease) |  |                               | Increase/ (Decrease) | Increase/ (Decrease) |  |

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|                                | 2017   | 2016    | \$ Amount | % Change | 2017    | 2016     | \$ Amount   | % Change |
|--------------------------------|--|---------|-----------|----------|---------|----------|-------------|----------|
|                                | (Amounts in thousands, except for percentage data) |         |           |          |         |          |             |          |
| Income tax provision (benefit) | \$1,154  | \$(420) | \$ 1,574  | >(100%)  | \$1,458 | \$14,415 | \$(12,957 ) | (89.9 %) |
| % of total revenues            | 4.9 %  | (2.1 %) |           |          | 2.5 %   | 24.0 %   |             |          |

We recorded an income tax provision of \$1.2 million and an income tax benefit of \$(0.4) million for the three months ended October 31, 2017 and 2016, respectively. The tax provision for the three months ended October 31, 2017 includes a \$0.6 million tax benefit related to the reversal of tax reserves for uncertain tax positions due to the expiration of the Irish statute of limitations and \$1.8 million of tax expense that is largely attributable to a shift in the jurisdictions where income is earned. We recorded a tax provision of \$1.5 million and \$14.4 million, respectively, for the nine months ended October 31, 2017 and 2016. In the second quarter of fiscal 2017, we recorded a charge of \$14.7 million related to the change in assertion regarding the undistributed foreign earnings of certain of our foreign subsidiaries. Our effective tax rate in fiscal 2018 and in future periods may fluctuate on a quarterly basis as a result of changes in our jurisdictional forecasts where losses cannot be benefitted due to the existence of valuation allowances on our deferred tax assets, changes in actual results versus our estimates, or changes in tax laws, regulations, accounting principles, or interpretations thereof.

The Company reviews all available evidence to evaluate the recovery of deferred tax assets, including the recent history of losses in all tax jurisdictions, as well as its ability to generate income in future periods. As of October 31, 2017, due to the uncertainty related to the ultimate use of certain deferred income tax assets, the Company has recorded a valuation allowance on certain of its deferred assets.

We file income tax returns in the U.S. federal jurisdiction, various state jurisdictions, and various foreign jurisdictions. We have closed out an audit with the Internal Revenue Service ("IRS") through fiscal 2013. We are no longer subject to U.S. federal

examinations before fiscal 2015. However, the taxing authorities will still have the ability to review the propriety of certain tax attributes created in closed years if such tax attributes are utilized in an open tax year, such as our federal research and development credit carryovers.

#### Non-GAAP Measures.

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

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

The following table includes the reconciliations of our U.S. GAAP income (loss) from operations, the most directly comparable U.S. GAAP financial measure, to our non-GAAP income (loss) from operations for the three and nine months ended October 31, 2017 and 2016 (amounts in thousands, except per share and percentage data):

|  | Three Months Ended<br>October 31, 2017 |             |           | Three Months Ended<br>October 31, 2016 |             |            |
|--|--|-------------|-----------|--|-------------|------------|
|  | GAAP<br>As Reported                    | Adjustments | Non-GAAP  | GAAP<br>As Reported                    | Adjustments | Non-GAAP   |
| <b>Revenues:</b>                                   |  |             |           |  |             |            |
| Products   | \$11,119                               | \$ —        | \$ 11,119 | \$3,746                                | \$ —        | \$ 3,746   |
| Services   | 12,311                                 | —           | 12,311    | 16,215                                 | —           | 16,215     |
| Total revenues                                     | 23,430                                 | —           | 23,430    | 19,961                                 | —           | 19,961     |
| <b>Cost of revenues:</b>                           |  |             |           |  |             |            |
| Products   | 1,198                                  | —           | 1,198     | 1,824                                  | —           | 1,824      |
| Services   | 5,612                                  | —           | 5,612     | 7,470                                  | —           | 7,470      |
| Amortization of intangible assets                  | 255                                    | (255 )      | —         | 315                                    | (315 )      | —          |
| Stock-based compensation                           | 1                                      | (1 )        | —         | (26 )                                  | 26          | —          |
| Total cost of revenues                             | 7,066                                  | (256 )      | 6,810     | 9,583                                  | (289 )      | 9,294      |
| Gross profit                                       | 16,364                                 | 256         | 16,620    | 10,378                                 | 289         | 10,667     |
| Gross profit percentage                            | 69.8 %                                 | 1.1 %       | 70.9 %    | 52.0 %                                 | 1.4 %       | 53.4 %     |
| <b>Operating expenses:</b>                         |  |             |           |  |             |            |
| Research and development                           | 5,634                                  | —           | 5,634     | 7,325                                  | —           | 7,325      |
| Selling and marketing                              | 3,916                                  | —           | 3,916     | 3,988                                  | —           | 3,988      |
| General and administrative                         | 3,868                                  | —           | 3,868     | 3,673                                  | —           | 3,673      |
| Amortization of intangible assets                  | 370                                    | (370 )      | —         | 540                                    | (540 )      | —          |
| Stock-based compensation expense                   | 696                                    | (696 )      | —         | 791                                    | (791 )      | —          |
| Professional fees: other                           | —                                      | —           | —         | 24                                     | (24 )       | —          |
| Severance and other restructuring costs            | 960                                    | (960 )      | —         | 2,373                                  | (2,373 )    | —          |
| Loss on impairment of long-lived asset             | —                                      | —           | —         | 99                                     | (99 )       | —          |
| Total operating expenses                           | 15,444                                 | (2,026 )    | 13,418    | 18,813                                 | (3,827 )    | 14,986     |
| Income (loss) from operations                      | \$920                                  | \$ 2,282    | \$ 3,202  | \$(8,435 )                             | \$ 4,116    | \$(4,319 ) |
| Income (loss) from operations percentage           | 3.9 %                                  | 9.8 %       | 13.7 %    | (42.3 %)                               | 20.7 %      | (21.6 %)   |
| <b>Weighted average common shares outstanding:</b> |  |             |           |  |             |            |
| Basic  | 35,479                                 | 35,479      | 35,479    | 35,186                                 | 35,186      | 35,186     |
| Diluted  | 35,479                                 | 35,671      | 35,671    | 35,186                                 | 35,209      | 35,186     |
| <b>Non-GAAP operating income (loss) per share:</b> |  |             |           |  |             |            |
| Basic  | \$0.03                                 | \$ 0.07     | \$ 0.10   | \$(0.24 )                              | \$ 0.11     | \$(0.13 )  |

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|         |        |         |         |           |         |            |
|---------|--------|---------|---------|-----------|---------|------------|
| Diluted | \$0.03 | \$ 0.06 | \$ 0.09 | \$(0.24 ) | \$ 0.11 | \$ (0.13 ) |
| 32      |        |         |         |           |         |            |

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|  | Nine Months Ended<br>October 31, 2017 |             |           | Nine Months Ended<br>October 31, 2016 |             |              |
|--|---------------------------------------|-------------|-----------|---------------------------------------|-------------|--------------|
|  | GAAP                                  |             |           | GAAP                                  |             |              |
|  | As Reported                           | Adjustments | Non-GAAP  | As Reported                           | Adjustments | Non-GAAP     |
| <b>Revenues:</b>                                   |                                       |             |           |                                       |             |              |
| Products   | \$ 18,907                             | \$ —        | \$ 18,907 | \$ 10,481                             | \$ —        | \$ 10,481    |
| Services   | 38,415                                | —           | 38,415    | 49,502                                | —           | 49,502       |
| Total revenues                                     | 57,322                                | —           | 57,322    | 59,983                                | —           | 59,983       |
| <b>Cost of revenues:</b>                           |                                       |             |           |                                       |             |              |
| Products   | 3,088                                 | —           | 3,088     | 4,506                                 | —           | 4,506        |
| Services   | 15,810                                | 593         | 16,403    | 26,336                                | —           | 26,336       |
| Amortization of intangible assets                  | 764                                   | (764 )      | —         | 947                                   | (947 )      | —            |
| Stock-based compensation                           | 3                                     | (3 )        | —         | 131                                   | (131 )      | —            |
| Total cost of revenues                             | 19,665                                | (174 )      | 19,491    | 31,920                                | (1,078 )    | 30,842       |
| Gross profit                                       | 37,657                                | 174         | 37,831    | 28,063                                | 1,078       | 29,141       |
| Gross profit percentage                            | 65.7 %                                | 0.3 %       | 66.0 %    | 46.8 %                                | 1.8 %       | 48.6 %       |
| <b>Operating expenses:</b>                         |                                       |             |           |                                       |             |              |
| Research and development                           | 17,411                                | —           | 17,411    | 23,751                                | —           | 23,751       |
| Selling and marketing                              | 9,292                                 | —           | 9,292     | 12,487                                | —           | 12,487       |
| General and administrative                         | 10,595                                | —           | 10,595    | 11,579                                | —           | 11,579       |
| Amortization of intangible assets                  | 1,075                                 | (1,075 )    | —         | 1,572                                 | (1,572 )    | —            |
| Stock-based compensation expense                   | 2,224                                 | (2,224 )    | —         | 1,685                                 | (1,685 )    | —            |
| Change in fair value of earn-outs                  | —                                     | —           | —         | 249                                   | (249 )      | —            |
| Professional fees: other                           | 21                                    | (21 )       | —         | 328                                   | (328 )      | —            |
| Severance and other restructuring costs            | 3,670                                 | (3,670 )    | —         | 5,991                                 | (5,991 )    | —            |
| Loss on impairment of long-lived asset             | —                                     | —           | —         | 99                                    | (99 )       | —            |
| Total operating expenses                           | 44,288                                | (6,990 )    | 37,298    | 57,741                                | (9,924 )    | 47,817       |
| (Loss) income from operations                      | \$(6,631 )                            | \$ 7,164    | \$ 533    | \$(29,678 )                           | \$ 11,002   | \$ (18,676 ) |
| (Loss) income from operations percentage           | (11.6 %)                              | 12.5 %      | 0.9 %     | (49.5 %)                              | 18.4 %      | (31.1 %)     |
| <b>Weighted average common shares</b>              |                                       |             |           |                                       |             |              |
| <b>outstanding:</b>                                |                                       |             |           |                                       |             |              |
| Basic  | 35,381                                | 35,381      | 35,381    | 34,889                                | 34,889      | 34,889       |
| Diluted  | 35,381                                | 35,549      | 35,549    | 34,889                                | 34,955      | 34,889       |
| <b>Non-GAAP operating (loss) income per share:</b> |                                       |             |           |                                       |             |              |
| Basic  | \$(0.19 )                             | \$ 0.21     | \$ 0.02   | \$(0.85 )                             | \$ 0.31     | \$ (0.54 )   |
| Diluted  | \$(0.19 )                             | \$ 0.20     | \$ 0.01   | \$(0.85 )                             | \$ 0.31     | \$ (0.54 )   |

The changes in the table above during the three and nine months ended October 31, 2017, compared to the same period of 2016, were a result of the factors described in connection with revenues and operating expenses under Item 2. “Management’s Discussion and Analysis of Financial Conditions and Results of Operations – Results of Operations,” of this Form 10-Q.

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

**Provision for Loss Contract.** We entered a fixed-price customer contract on a multi-year arrangement, which included multiple vendors. As the system integrator on the project, we are subject to any cost overruns or increases with these vendors resulting in delays of acceptance by our customer. Delays of customer acceptance on this project result in incremental expenditures and require us to recognize a loss on this project in the period the determination is made. As a result, we recorded an estimated loss of \$9.2 million in fiscal 2016. Subsequently, because of changes in the scope of the project and negotiations with the fixed-price customer, we recorded adjustments since fiscal 2016 totaling \$4.7 million to reduce this estimated loss. We believe that the exclusion of this line item amount, which is recorded in cost of revenues services, allows a comparison of operating results that would otherwise impair comparability between periods.

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

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

**Change in Fair Value of Earn-outs.** The change in fair value of earn-outs payable to the former shareholders of the businesses we acquire is considered by management to be non-recurring and therefore, impairs comparability among periods.

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

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

**Loss on Impairment of Long-lived Assets.** We incur losses on impairment of long-lived assets when it is determined that an impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and compare that value to the carrying value of the assets. These charges are considered non-recurring.

#### Off-Balance Sheet Arrangements

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

#### Liquidity and Capital Resources

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



|   | Nine Months<br>Ended<br>October 31, |            | Increase/<br>(Decrease) |
|---|-------------------------------------|------------|-------------------------|
|   | 2017                                | 2016       | \$ Amount               |
| (Amounts in thousands)  |                                     |            |                         |
| Total cash used in operating activities                                       | \$(908 )                            | \$(26,880) | \$ 25,972               |
| Total cash provided by (used in) investing activities                         | 537                                 | (3,739 )   | 4,276                   |
| Total cash provided by (used in) financing activities                         | 1                                   | (49 )      | 50                      |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (878 )                              | (555 )     | (323 )                  |
| Net decrease in cash, cash equivalents and restricted cash                    | \$(1,248)                           | \$(31,223) | \$ 29,975               |

Historically, we have financed our operations and capital expenditures primarily with cash on-hand. Cash, cash equivalents, restricted cash, and marketable securities decreased from \$38.7 million at January 31, 2017 to \$36.6 million at October 31, 2017.

During fiscal 2018, we made significant reductions to our headcount as part of our ongoing restructuring effort from which we expect to generate annualized savings of approximately \$18 million. These measures are important steps in restoring SeaChange to profitability and positive cash flow. The Company believes that existing funds and cash expected to be provided by future

operating activities, augmented by the plans highlighted above, are adequate to satisfy our working capital, potential acquisitions and capital expenditure requirements and other contractual obligations for the foreseeable future, including at least the next 12 months.

However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In the future, we may enter other arrangements for potential investments in, or acquisitions of, complementary businesses, services or technologies, which could require us to seek additional equity or debt financing. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

In the second quarter of fiscal 2017, following a review of our operations, liquidity and funding, and investment in our product roadmap, we determined that the ability to access cash resulting from earnings in prior fiscal years that had previously been deemed permanently restricted for foreign investment would provide greater flexibility to meet the Company's working capital needs. Accordingly, in the second quarter of fiscal 2017, we changed our permanent reinvestment assertion on \$58.6 million of earnings generated by our Irish operations through July 2016. We recorded a deferred tax liability of \$14.7 million related to the foreign income taxes on \$58.6 million of undistributed earnings. The balance of the deferred tax liability as of October 31, 2017 is \$16.3 million.

### Operating Activities

Below are key line items affecting cash from operating activities:

|  | Nine Months |            |                        |
|--|-------------|------------|------------------------|
|  | Ended       |            | Increase/              |
|  | October 31, |            | (Decrease)             |
|  | 2017        | 2016       | \$ Amount              |
|  |             |            | (Amounts in thousands) |
| Net loss   | \$(7,120)   | \$(43,873) | \$ 36,753              |
| Adjustments to reconcile net loss to cash used in operating activities | 6,002       | 21,953     | (15,951 )              |
| Net loss including adjustments   | (1,118)     | (21,920)   | 20,802                 |
| Decrease in receivables  | 1,888       | 4,900      | (3,012 )               |
| (Increase) decrease in inventory                                       | (165 )      | 338        | (503 )                 |
| Decrease in prepaid expenses and other current assets                  | 62          | 428        | (366 )                 |
| Decrease in accounts payable   | (3,199)     | (2,102 )   | (1,097 )               |
| Increase (decrease) in accrued expenses                                | 942         | (4,833 )   | 5,775                  |
| Increase (decrease) in deferred revenues                               | 355         | (3,864 )   | 4,219                  |
| All other - net  | 327         | 173        | 154                    |
| Net cash used in operating activities                                  | \$(908 )    | \$(26,880) | \$ 25,972              |

We used net cash in operating activities of \$0.9 million for the nine months ended October 31, 2017. This cash used in operating activities was primarily the result of our net loss including adjustments of \$1.1 million, offset by changes in working capital, which include a decrease in receivables of \$1.9 million due to the timing of customer payments and an increase in accrued expenses of \$0.9 million primarily due to restructuring accruals relating to the reduction of workforce in the Philippines. This was offset by a \$3.2 million decrease in accounts payable due to cost-savings initiatives and the timing of payments to vendors.

## Investing Activities

Cash flows from investing activities are as follows:

|  | Nine Months<br>Ended<br>October 31, |           | Increase/<br>(Decrease) |
|--|-------------------------------------|-----------|-------------------------|
|  | 2017                                | 2016      | \$ Amount               |
| (Amounts in thousands)                                   |                                     |           |                         |
| Purchases of property and equipment                      | \$(386 )                            | \$(521 )  | \$ 135                  |
| Purchases of marketable securities                       | (7,246)                             | (2,252)   | (4,994 )                |
| Proceeds from sale and maturity of marketable securities | 7,993                               | 4,249     | 3,744                   |
| Acquisition of business, net of cash acquired            | —                                   | (5,243)   | 5,243                   |
| Other investing activities                               | 176                                 | 28        | 148                     |
| Net cash provided by (used in) investing activities      | \$537                               | \$(3,739) | \$ 4,276                |

Cash provided by investing activities includes \$0.2 million in proceeds from the sale of property and equipment during the quarter and the proceeds from the sale or maturity of marketable securities, net of purchases, during the fiscal year of \$0.7 million. This was offset by cash used of \$0.4 million for the purchase of capital assets during the fiscal year.

## Financing Activities

Cash flows from financing activities are as follows:

|   | Nine Months<br>Ended<br>October 31, |         | Increase/<br>(Decrease) |
|---|-------------------------------------|---------|-------------------------|
|   | 2017                                | 2016    | \$ Amount               |
|   | (Amounts in thousands)              |         |                         |
| Proceeds from issuance of common stock              | \$53                                | \$64    | \$ (11 )                |
| Payments of withholding tax on RSU vesting          | (52)                                | (109)   | 57                      |
| Other financing activities                          | —                                   | (4 )    | 4                       |
| Net cash provided by (used in) financing activities | \$1                                 | \$(49 ) | \$ 50                   |

In the nine months ended October 31, 2017, cash provided by financing activities reflects proceeds received from the issuance of common stock for the employee stock purchase plan. This was offset by employee taxes paid when we withhold shares of common stock for tax-withholding purposes.

The effect of exchange rate changes decreased cash, cash equivalents and restricted cash by \$0.9 million for the nine months ended October 31, 2017, primarily due to the translation of European subsidiaries' cash balances, which use the Euro as their functional currency, to U.S. dollars.

## Effects of Inflation

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

## Contractual Obligations

There have been no significant changes outside the ordinary course of our business in our contractual obligations disclosed in our Form 10-K for the fiscal year ended January 31, 2017.

## Critical Accounting Policies and Significant Judgment and Estimates

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

## Revenue Recognition

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

- persuasive evidence of an arrangement exists;
- delivery has occurred, and title and risk of loss have passed to the customer;
- fees are fixed or determinable; and
- collection of the related receivable is considered probable.

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

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

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

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

accounting is applied for revenue recognition purposes to the entire arrangement except for maintenance and technical support.

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

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

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

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

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

## Goodwill

In connection with acquisitions of businesses, we recognize the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired as goodwill. Goodwill is not amortized, but is evaluated for impairment at least annually, in our third quarter beginning August 1<sup>st</sup>, or more frequently if indicators are present or changes in circumstances suggest that an impairment exists. The process of evaluating goodwill for impairment requires several judgments and assumptions to be made to determine the fair value, including the method used to determine fair value, discount rates, expected levels of cash flows, revenues and earnings, and the selection of comparable companies used to develop market-based assumptions. We may employ the three generally accepted approaches for valuing businesses: the market approach, the income approach, and the asset-based (cost) approach to arrive at the fair value. The choice of which approach and methods to use in a situation depends on the facts and circumstances.



In evaluating goodwill for impairment, we chose to use the market approach and the income approach to determine the fair value. The market approach provides value indications through a comparison with guideline public companies or guideline transactions. The valuation multiple is an expression of what investors believe to be a reasonable valuation relative to a measure of financial information such as revenues, earnings or cash flows. The income approach provides value indications through an analysis of its projected earnings, discounted to present value. We employed a weighted-average cost of capital rate based on the risk-free interest rate and other factors such as equity risk premiums and the ratio of total debt to equity capital. In performing the annual impairment test, we took steps to ensure appropriate and reasonable cash flow projections and assumptions were used.

Our projections for the next two and a half years included increased operating expenses in line with the expected revenue growth based on current market and economic conditions and our historical knowledge. Historical growth rates served as only one input to the projected future growth used in the goodwill impairment analysis. These historical growth rates were adjusted based on other inputs regarding anticipated customer contracts. The forecasts have incorporated any changes to the revenue and operating expenses through the end of fiscal 2018. We estimated the operating expenses based on a rate consistent with the current experience and estimated revenue growth over the next two and a half years. Future adverse changes in market conditions or poor operating results could result in losses, thereby possibly requiring an impairment charge in the future.

In the third quarter of fiscal 2018, we finalized the “Step 1” analysis of our annual goodwill impairment test for fiscal 2018. Based on this analysis, we determined that fair value of our reporting unit exceeded its carrying value, which was \$64.2 million at August 1, 2017. As a result, no impairment charge was required related to the annual test.

In August 2017, we placed our corporate headquarters and the adjacent land (the “Corporate Headquarters”), located in Acton, Massachusetts, on the market for sale. We assessed whether the Corporate Headquarters would qualify as an asset held for sale and determined that it would not since it did not meet all six of the criteria of an asset held for sale under current accounting guidance. During the assessment, we received information from a third-party real estate broker which led management to believe that there was a significant decrease in the fair value of the Corporate Headquarters. We considered this to be a triggering event and were required to test the Corporate Headquarters for recoverability. We evaluated the undiscounted future cash flows over the remaining useful life of the primary asset of the asset group and determined that an impairment did not exist as of the date of the triggering event. Our cash flow estimates contain management’s best estimates, using appropriate and customary assumptions and projections at the time.

In addition, since we considered the significant decrease in fair value of the Corporate Headquarters a triggering event, we were required to complete an additional goodwill impairment test as of the date of the triggering event. We completed the additional goodwill impairment test and determined that the implied fair value of the reporting unit exceeds its carrying value as of the date of the triggering event. Accordingly, no impairment charge was recognized as of October 31, 2017.

#### Recent Accounting Standard Updates

We consider the applicability and impact of all ASUs. Updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position or results of operations. Recently issued ASUs which we feel may be applicable to us but have not yet been adopted are as follows:

#### Recently Issued Accounting Standard Updates – Not Yet Adopted

##### Revenue from Contracts with Customers (Topic 606)

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies using International Financial Reporting Standards and U.S. GAAP. The core principle requires entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. In July 2015, the FASB voted to approve a one year deferral, making the standard effective for public entities for annual and interim periods beginning after December 15, 2017.

In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” The purpose of ASU 2016-08 is to clarify the guidance on principal versus agent considerations. It includes indicators that help to determine whether an entity controls the specified good or service before it is transferred to the customer and to assist in determining when the entity satisfied the performance obligation and as such, whether to recognize a gross or a net amount of consideration in their consolidated statement of operations.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies that entities are not required to assess whether promised goods or services are performance obligations if they are immaterial in the context of the contract. ASU 2016-10 also addresses how to determine whether promised goods or services are separately identifiable and permits entities to make a policy election to treat shipping and handling costs as fulfillment activities. In addition, it clarifies key provisions in Topic 606 related to licensing.

In May 2016, the FASB issued ASU 2016-11, “Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815).” ASU 2016-11 rescinds previous SEC comments that were codified in Topic 605, Topic 932 and Topic 815. Upon adoption of Topic 606, certain SEC comments including guidance on accounting for shipping and handling fees and costs and consideration given by a vendor to a customer should not be relied upon.

In May 2016, the FASB also issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients.” ASU 2016-12 provides clarity around collectability, presentation of sales taxes, non-cash consideration, contract modifications at transition and completed contracts at transition. ASU 2016-12 also includes a technical correction within Topic 606 related to required disclosures if the guidance is applied retrospectively upon adoption.

In December 2016, the FASB issued ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers.” ASU 2016-20 allows entities not to make quantitative disclosures about remaining performance obligations in certain cases and requires entities that use any of the optional exemptions to expand their qualitative disclosures.

ASU 2016-20 also clarifies other areas of the new revenue standard, including disclosure requirements for prior period performance obligations, impairment guidance for contract costs and the interaction of impairment guidance in ASC 340-40 with other guidance elsewhere in the Codification.

The Company will adopt Topic 606 effective February 1, 2018 under the modified retrospective method and will only apply this method to contracts that are not completed as of the date of adoption. The modified retrospective method will result in a cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings at the date of initial application for any open contracts as of the adoption date. The Company has established an implementation team to assist with its assessment of the impact of the new revenue guidance on its operations, consolidated financial statements and related disclosures. In addition, the Company has made investments in systems to enable timely and accurate reporting under the new standard. To date, the Company's assessment has included (1) utilizing questionnaires to assist with the identification of revenue streams, (2) performing sample contract analyses for each revenue stream identified, (3) assessing the noted differences in recognition and measurement that may result from adopting this new standard, (4) performing detailed analyses of contracts with larger customers, (5) testing transactions for consistency with contract provisions that affect revenue recognition, and (6) developing a standalone selling price for all performance obligations. Based on the results of the assessment, the Company currently believes the most significant potential changes to be in the identification of performance obligations, the timing of revenue recognition and the allocation of transaction price to the performance obligations. As part of the procedures completed by the Company, incremental costs to obtain a contract and costs incurred in fulfilling a contract have also been assessed. Based on preliminary results of the assessment, which is still in process, the Company currently believes that the most significant potential changes to be accounting for commissions associated with the initial year of contract, as incremental costs are expected to be capitalized as a contract asset and they will be amortized over the estimated customer life, which could extend beyond the contract life. The Company also anticipates changes to the consolidated balance sheet related to accounts receivable, contract assets, and contract liabilities, as well as, significant changes to its disclosures, to comply with the new disclosure requirements under Topic 606. The Company is continuing to design the necessary changes to its business processes, systems and controls to support recognition and disclosure under the new standard. Further, the Company is continuing to assess what incremental disaggregated revenue and other disclosures will be required in its consolidated financial statements, which the Company believes will be significant.

Based on the procedures performed, the Company expects the following impacts:

Currently, the Company recognizes revenue from perpetual licenses with extended payment terms over the term of the agreement as payments are received, provided all other criteria for revenue recognition have been met, and any corresponding maintenance over the term of the agreement. The adoption of ASC 606 will result in revenue for performance obligations being recognized as they are satisfied. Therefore, revenue from perpetual license performance obligations with extended payment terms will be recognized when control is transferred to the customer. Any unrecognized license revenue from the arrangement, included in deferred revenue at January 31, 2018, will not be recognized in revenue in future periods but as a cumulative adjustment to retained earnings. Further, revenue from the maintenance performance obligations is expected to be recognized on a straight-line basis over the contractual term. Due to the revenue from perpetual licenses with extended payment terms being recognized prior to amounts being billed to the customer, the Company expects to recognize a net contract asset on the balance sheet.

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Currently, the Company allocates revenue to licenses under the residual method when it has Vendor Specific Objective Evidence (“VSOE”) for the remaining undelivered elements, which allocates any future credits or significant discounts entirely to the license. The adoption of ASC 606 will result in future credits, significant discounts, and material rights under ASC 606, being allocated to all performance obligations based upon their relative selling price. Under ASC 606, additional license revenue from the reallocation of such arrangement considerations will be recognized when control is transferred to the customer, which is generally upon delivery of the license.

Currently, the Company does not have VSOE for professional services and maintenance in certain geographical areas, which results in revenue being deferred in such instances until such time as VSOE exists for all undelivered elements or recognized ratably over the longest performance period. The adoption of ASC 606 eliminates the requirement for VSOE and replaces it with the concept of a standalone selling price. Once the transaction price is allocated to each of the performance obligations, the Company can recognize revenue as the performance obligations are delivered, either at a point in time or over time. Under ASC 606, license revenue will be recognized when control is transferred to the customer and professional services revenue will be recognized over time based on labor hours expended. This will result in the acceleration of professional services revenue when compared to the current practice of ratable recognition for professional services when there is a lack of VSOE.

Sales commissions and other third-party acquisition costs resulting directly from securing contracts with customers are currently expensed when incurred. ASC 606 will require these costs to be recognized as an asset when incurred and to be expensed over the associated contract term. However, because the sales commission paid on the maintenance renewals is

not commensurate with the original deal, ASC 606 requires that these acquisition costs be expensed over the customer life. The Company expects this change to impact all arrangements that included implicit or explicit maintenance contracts.

ASC 606 provides additional accounting guidance for contract modifications whereby changes must be accounted for either as a retrospective change (creating either a catch up or deferral of past revenues), prospectively with a reallocation of revenues amongst identified performance obligations, or prospectively as separate contracts which will not require any reallocation. This may result in a difference in the timing of the recognition of revenue as compared to how contract modifications are recognized currently.

There will be a corresponding effect on tax liabilities in relation to all of the above impacts.

#### Leases

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

#### Recently Issued Accounting Standard Updates – Adopted During the Period

##### Cash Flow Statement

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” ASU 2016-15 provides guidance on the classification of certain cash receipts and payments in the statement of cash flows where diversity in practice exists. The guidance is effective for interim and annual periods beginning in our first quarter of fiscal 2019, and early adoption is permitted. The Company early adopted this standard on August 1, 2017. The adoption of this standard did not have any effect on our consolidated financial statements because the cash receipts and cash payments described in ASU 2016-15 are not applicable to the Company currently nor retrospectively.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance is effective for us in the first quarter of fiscal 2019 and early adoption is permitted. The Company early adopted the standard on August 1, 2017 and retrospectively applied the amendment. Other than the change in presentation of restricted cash within the consolidated statements of cash flows, the adoption of this standard did not have a material impact on our consolidated financial statements.

##### Intangibles-Goodwill and Other

In January 2017, the FASB issued ASU 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which simplifies the subsequent measurement of goodwill by removing “Step 2” of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. A goodwill impairment will be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance is effective for us beginning in the first quarter of fiscal 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company early adopted ASU 2017-04 effective August 1, 2017 in conjunction with its annual goodwill impairment testing. Because the results of “Step 1” of the impairment test indicated that the fair value of the Company’s goodwill exceeded its carrying amount, the adoption of ASU 2017-04 did not change the impairment testing process for the fiscal 2018 annual goodwill impairment test. See Note 6, “Goodwill and Intangible Assets,” for more information on our annual goodwill impairment test.

## Stock Compensation

In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting, which provides guidance about which changes to the terms or conditions of a share-based payment awards require an entity to apply modification accounting under ASC 718. The guidance is effective for us beginning in the first quarter of fiscal 2019 and early adoption is permitted. The Company early adopted ASU 2017-09 in the fiscal quarter ended October 31, 2017. The implementation of this standard had no impact on the Company’s consolidated financial statements.



### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

#### Foreign Currency Exchange Risk

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

Our principal currency exposures relate primarily to the U.S. dollar, the Euro and the Philippine peso. All foreign currency gains and losses are included in other income (expenses), net, in the accompanying consolidated statements of operations and comprehensive loss. For the nine months ended October 31, 2017, we recorded \$0.7 million in gains due to the international subsidiary translations and cash settlements of revenues and expenses.

A substantial portion of our earnings are generated by our foreign subsidiaries whose functional currency is other than the U.S. dollar. Therefore, our earnings could be materially impacted by movements in foreign currency exchange rates upon the translation of the subsidiary's earnings into the U.S. dollar. If the U.S. dollar had strengthened by 10% compared to the Euro, our total revenues would have decreased by \$1.4 million and \$2.4 million for the three and nine months ended October 31, 2017, respectively, and it would have decreased our income from operations by \$1.0 million and \$1.4 million for the same periods.

#### Interest Rate Risk

Exposure to market risk for changes in interest rates relates primarily to our investment portfolio of marketable debt securities of various issuers, types and maturities. We do not use derivative instruments in our investment portfolio, and our investment portfolio only includes highly liquid instruments. Our cash and marketable securities include cash equivalents, which we consider to be investments purchased with original maturities of 90 days or less. There is risk that losses could be incurred if we were to sell any of our securities prior to stated maturity. Given the short maturities and investment grade quality of the portfolio holdings at October 31, 2017, a hypothetical 10% adverse change in interest rates should not have a material adverse impact on the fair value of our investment portfolio.

### ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this Form 10-Q. Edward Terino, our Chief Executive Officer, and Peter R. Faubert, our Chief Financial Officer, reviewed and participated in this evaluation. Based upon that evaluation, Messrs. Terino and Faubert concluded that our disclosure controls and procedures were not operating effectively as of October 31, 2017. Our disclosure controls and procedures were not effective because of the continued impact of the material weaknesses identified and described in the "Report of Management on Internal Control over Financial Reporting" included in Item 9A of our Form 10-K for fiscal year ended January 31, 2017 relating to the design of controls around certain professional services revenue recognition on projects generating revenue of less than \$25,000 per month, deferred revenue related to undelivered products reconciled the month prior to quarter end and rolled forward and journal entry review processes at an international subsidiary for journal entries less than \$50,000. In addition, as of January 31, 2017, we identified an ineffective control related to currency translation adjustments arising from intercompany notes.

Notwithstanding the material weaknesses discussed above, our management, including our Chief Executive Officer and Chief Financial Officer, believes that the consolidated financial statements contained in this Form 10-Q present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with U.S. GAAP. The material weaknesses described above did not result in any adjustments or restatements of our audited and unaudited consolidated financial statements or disclosures for any prior period previously reported by the Company.

In fiscal 2018, we have continued to implement our comprehensive remediation plan related to our internal control over financial reporting. This plan includes enhancing existing internal controls and designing and implementing new ones aimed at remediating the material weaknesses. The status of our remediation plan for each material weakness described above as of the date of this report is as follows:

- We have enhanced the design and implemented new internal controls over financial reporting to expand our review of professional services revenue to include revenue recognized on projects below \$25,000;
- We have enhanced the design and implemented new internal controls over financial reporting to include a review of all journal entries at an international subsidiary for completeness and accuracy; and
- We have implemented a new internal control over financial reporting whereby the corporate controller and tax director review the impact of currency translation adjustments on intercompany notes payable on a quarterly basis.

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The status of our remediation plan has been, and will continue to be, reported by management to the Audit Committee of the Board of Directors on a regular basis. In addition, we have assigned personnel to oversee the improvements to the overall design of our internal control environment and to address the root causes of our material weaknesses. Remediation generally requires making changes to the design of internal controls and then adhering to those changes for a sufficient period of time such that the operating effectiveness of those changes may be demonstrated through testing.

As we continue to evaluate and work to improve our internal control over financial reporting, we may take additional measures to address these control deficiencies or modify our remediation plan. We cannot make assurances, however, of when we will remediate such weaknesses, nor can we be certain of whether additional actions will be required.

Changes in internal control over financial reporting. As a result of the evaluation completed by us, and in which Messrs. Terino and Faubert participated, we have concluded that, except as described above with respect to our remediation plan, there were no changes during the fiscal quarter ended October 31, 2017 in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

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

### ITEM 1A. Risk Factors

In addition to other information set forth in this Form 10-Q, you should carefully consider the risk factors discussed in Part I, “Item 1A. Risk Factors” in our Form 10-K for the fiscal year ended January 31, 2017, which could materially affect our business, financial conditions, and results of operations. The risks described in our Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

### ITEM 6. Exhibits

(a) Exhibits

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

Index to Exhibits

| No.     | Description   |
|---------|---|
| 31.1    | <u>Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u> |
| 31.2    | <u>Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).</u> |
| 32.1    | <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).</u>         |
| 32.2    | <u>Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).</u>         |
| 101.INS | XBRL Instance Document  |
| 101.SCH | XBRL Taxonomy Extension Schema  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase   |

SIGNATURES

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

Dated: December 7, 2017

SEACHANGE INTERNATIONAL, INC.

by: /s/ PETER R. FAUBERT

Peter R. Faubert

Chief Financial Officer, Senior Vice President,

Finance and Administration and

Treasurer