SEACHANGE INTERNATIONAL INC
Form 10-Q
December 10, 2010

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2010

OR

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

For the transition period from to

Commission File Number: 0-21393

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. YES x 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 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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨	Smaller reporting company ¨

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

The number of shares outstanding of the registrant's Common Stock on December 3, 2010 was 31,594,027.

SEACHANGE INTERNATIONAL, INC.

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PART I – FINANCIAL INFORMATION

ITEM 1. Financial Statements

SEACHANGE INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	October 31, 2010 (unaudited)	January 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 61,417	$ 37,647
Restricted cash	1,335	73
Marketable securities	5,077	2,114
Accounts receivable, net of allowance for doubtful accounts of $995 and $852, respectively	44,458	50,337
Unbilled receivables	5,145	3,941
Inventories, net	15,489	17,830
Prepaid expenses and other current assets	5,465	7,253
Deferred tax assets	4,326	2,474
Total current assets	142,712	121,669
Property and equipment, net	37,808	39,682
Marketable securities, long-term	7,205	8,688
Investments in affiliates	4,799	13,697
Intangible assets, net	32,251	26,264
Goodwill	67,002	55,876
Other assets	3,328	1,271
Total assets	$ 295,105	$ 267,147
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 11,070	$ 10,371
Other accrued expenses	14,938	11,174
Customer deposits	3,259	4,279
Deferred revenues	32,521	34,158
Deferred tax liabilities	717	800
Total current liabilities	62,505	60,782
Deferred revenue, long-term	12,864	12,635
Other liabilities, long-term	11,087	6,574
Distribution and losses in excess of investment	1,836	1,469
Deferred tax liabilities	7,516	7,765
Total liabilities	95,808	89,225
Stockholders Equity:		
Convertible preferred stock, $0.01 par value, 5,000,000 shares authorized, none issued or outstanding	—	—
Common stock, $0.01 par value;100,000,000 shares authorized; 31,596,084 and 32,563,063 shares issued; 31,556,300 and 31,216,267 shares outstanding respectively	316	326
Additional paid-in capital	205,487	211,504

Treasury stock, at cost 39,784 and 1,346,796 common shares, respectively	(1)	(8,757)
Accumulated earnings (deficit)	1,166	(17,450)
Accumulated other comprehensive loss	(7,671)	(7,701)
Total stockholders’ equity	199,297	177,922
Total liabilities and stockholders’ equity	$ 295,105	$ 267,147

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

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

	Three Months Ended October 31, 2010	Three Months Ended October 31, 2009	Nine Months Ended October 31, 2010	Nine Months Ended October 31, 2009
Revenues:				
Products	$ 18,378	$ 27,349	$ 64,993	$ 76,317
Services	30,757	25,941	90,367	72,356
Total revenues	49,135	53,290	155,360	148,673
Cost of revenues:				
Products	7,299	10,046	26,082	27,804
Services	18,595	15,687	53,799	44,580
Total cost of revenues	25,894	25,733	79,881	72,384
Gross profit	23,241	27,557	75,479	76,289
Operating expenses:				
Research and development	11,570	13,353	37,351	37,433
Selling and marketing	5,726	7,067	18,315	19,582
General and administrative	6,112	5,986	18,089	16,036
Amortization of intangibles	805	571	2,512	1,844
Restructuring	2,435	-	6,944	-
Total operating expenses	26,648	26,977	83,211	74,895
(Loss) income from operations	(3,407)	580	(7,732)	1,394
Gain on sale of investment in affiliate	-	-	25,188	-
Other income (expense), net	173	455	(257)	739
(Loss) income before income taxes and equity loss in earnings of affiliates	(3,234)	1,035	17,199	2,133
Income tax provision (benefit)	1,942	105	(1,700)	337
Equity loss in earnings of affiliates, net of tax	(39)	(273)	(284)	(517)
Net (loss) income	$ (5,215)	$ 657	$ 18,615	$ 1,279
(Loss) earnings per share:				
Basic	$ (0.17)	$ 0.02	$ 0.59	$ 0.04
Diluted	$ (0.17)	$ 0.02	$ 0.58	$ 0.04
Weighted average common shares outstanding:				
Basic	31,496	30,871	31,409	30,838
Diluted	31,496	31,659	31,929	31,407

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

SEACHANGE INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended October 31, 2010	Nine Months Ended October 31, 2009
Cash flows from operating activities:		
Net income	$ 18,615	$ 1,279
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	6,288	5,893
Amortization of intangibles and capitalized software	3,916	2,393
Disposal of fixed assets	1,283	-
Inventory valuation charge	404	434
Provision for doubtful accounts receivable	2	75
Discounts earned and amortization of premiums on marketable securities	49	108
Equity loss in earnings of affiliates	284	517
Gain on sale of investment in affiliate	(25,188)	-
Stock-based compensation expense	1,258	2,365
Deferred income taxes	(5,903)	(422)
Changes in operating assets and liabilities:		
Accounts receivable	8,803	8,254
Unbilled receivables	(1,204)	1,023
Inventories	38	(4,385)
Prepaid expenses and other assets	1,469	(3,583)
Accounts payable	461	(4,170)
Accrued expenses	3,894	(594)
Customer deposits	(1,020)	1,140
Deferred revenues	(3,903)	(143)
Other	(120)	165
Net cash provided by operating activities	9,426	10,349
Cash flows from investing activities:		
Purchases of property and equipment	(3,525)	(6,823)
Purchases of marketable securities	(7,818)	(28,932)
Proceeds from sale and maturity of marketable securities	6,258	28,816
Payments for acquisitions, net of cash acquired	(9,870)	(34,734)
Payments of contingent consideration	(4,751)	-
Investment in affiliates	(720)	(1,402)
Gross proceeds from sale of investment in affiliate	34,086	-
(Increase) release of restricted cash	(54)	1,511
Net cash provided (used) by investing activities	13,606	(41,564)
Cash flows from financing activities:		
Purchases of treasury stock	(1,435)	(1,720)
Excess tax benefit related to share based compensation expense	4	159
Proceeds from issuance of common stock relating to the stock plans	2,286	1,120
Net cash provided (used) in financing activities	855	(441)
Effect of exchange rate changes on cash and cash equivalents	(117)	710
Net increase (decrease) in cash and cash equivalents	23,770	(30,946)

Cash and cash equivalents, beginning of period		37,647		62,458
Cash and cash equivalents, end of period	$	61,417	$	31,512
Supplemental disclosure of cash flow activities:				
Income taxes paid	$	3,114	$	-
Supplemental disclosure of non-cash activities:				
Transfer of items originally classified as inventories to equipment	$	1,914	$	2,349
Issuance of equity for eventIS accrued consideration	$	614	$	-

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

SEACHANGE INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries ("SeaChange" or the "Company") in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial reports and the instructions for Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared under generally accepted accounting principles have been condensed or omitted pursuant to such regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the Company's most recently audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K and Form 10-K/A as filed with the SEC for the fiscal year ended January 31, 2010. In the opinion of management, the accompanying financial statements include all adjustments necessary to present a fair presentation of the consolidated financial statements for the periods shown. Interim results are not necessarily indicative of the operating results for the full fiscal year or any future periods. The preparation of these financial statements in conformity with U.S. GAAP requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Actual results may differ from management's estimates.

There have been no significant changes in our accounting policies during the nine months ended October 31, 2010, as compared to the significant accounting policies described in our Annual Report on Form 10-K and Form 10-K/A for the year ended January 31, 2010.

2. Fair Value Measurements

The Company determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each balance sheet date. SeaChange's investment portfolio consists of money market funds, corporate debt investments, asset-backed securities, government-sponsored enterprises, and state and municipal obligations. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. SeaChange's marketable securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses, net of tax, reported in stockholders' equity as a component of accumulated other comprehensive income or loss. The amortization of premiums and accretion of discounts to maturity are computed under the effective interest method and are included in interest income. Interest on securities is recorded as earned and is also included in interest income. Any realized gains or losses would be shown in the accompanying consolidated statements of operations in other income or expense. The Company provides fair value measurement disclosures of its available for sale securities in accordance with one of three levels of fair value measurement.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement. A fair value hierarchy enables the reader of the financial statements to assess the inputs used to develop fair value measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. Assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The Company's financial assets and liabilities that are measured at fair value on a recurring basis as of October 31, 2010 are as follows:

	October 31, 2010	Fair Value Measurements Using Level 1	Level 2 (in thousands)	Level 3
Financial assets:				
Money market accounts (a)	$ 6,052	$ 6,052	$ -	$ -
U.S. government agency issues (a)	12,031	12,031	-	-
Certificate of deposit (a)	251	251	-	-
Total assets	$ 18,334	$ 18,334	$ -	$ -
Other liabilities:				
Acquisition-related consideration (b)	$ 12,582	$ -	$ -	$ 12,582

(a) Money market funds and US government agency securities, included in cash and cash equivalents in the accompanying balance sheet, are valued at quoted market prices for identical instruments in active markets.
(b) The fair value of our contingent consideration arrangement is determined based on the Company's evaluation as to the probability and amount of any earn-out that will be achieved based on expected future performance by the acquired entity, as well as the fair value of fixed purchase price.

There have been no transfers between Level 1 and Level 2. The following table sets forth a reconciliation of assets measured at fair value on a recurring basis with the use of significant unobservable inputs (Level 3) for the three months ended October 31, 2010:

	Level 3 Accrued Contingent Consideration (in thousands)
Ending balance July 31, 2010	$ 16,037
Change in fair value of contingent consideration	105
Increase in contingent consideration	83
Contingency payment	(4,751)
Translation adjustment	1,108
Ending balance October 31, 2010	$ 12,582

The following is a summary of available for sale securities:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
October 31, 2010:				
Cash	$ 55,365	$ -	$ -	$ 55,365
Cash equivalents	6,052	-	-	6,052
Cash and cash equivalents	61,417	-	-	61,417
U.S. government agency issues		-	-	-
Marketable securities—short-term	5,005	72	-	5,077
U.S. government agency issues	6,819	135	-	6,954
Corporate debt securities	250	1	-	251
Marketable securities—long-term	7,069	136	-	7,205
Total cash, cash equivalents, and marketable securities	$ 73,491	$ 208	$ -	$ 73,699
January 31, 2010:				
Cash	$ 32,725	$ -	$ -	$ 32,725
Cash equivalents	4,922	-	-	4,922
Cash and cash equivalents	37,647	-	-	37,647
U.S. government agency issues	2,023	91	-	2,114
Marketable securities—short-term	2,023	91	-	2,114
U.S. government agency issues	8,276	161	-	8,437
Corporate debt securities	250	1	-	251
Marketable securities—long-term	8,526	162	-	8,688
Total cash, cash equivalents, and marketable securities	$ 48,196	$ 253	$ -	$ 48,449

The following is a schedule of our investment maturities:

	October 31, 2010	January 31, 2010
	(in thousands)	
Investment Maturities:		
Less than 1 year	$ 5,077	$ 2,114
One to three years	7,205	8,688
	$ 12,282	$ 10,802

3. Inventories

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

	October 31, 2010	January 31, 2010
	(in thousands)	
Components and assemblies	$ 8,124	$ 11,316
Finished products	7,366	6,514

Total inventory, net	$	15,489	$	17,830

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4. Investments in Affiliates

On Demand Deutschland GmbH & Co. KG

On February 27, 2007, the On Demand Group Limited ("ODG"), a wholly-owned U.K. subsidiary of SeaChange, entered into an agreement with Tele-Munchen Fernseh GmbH & Co. Produktionsgesellschaft (TMG) to create a joint venture named On Demand Deutschland GmbH & Co. KG. On Demand Deutschland specializes in establishing on-demand and pay-per-view services on multiple platforms in German-speaking Europe. ODG contributed $2.8 million to acquire its 50% ownership interest in the joint venture of which $2.6 million consisted of the fair value of customer contracts and content license agreements contributed by ODG and $154,000 represented a cash contribution. The customer contracts and licensed content had no book value. SeaChange determined that this investment is an operating joint venture and does not require consolidation. Consequently, SeaChange accounts for this investment under the equity method of accounting.

ODG's original investment in the joint venture was recorded at $154,000 representing the U.S. dollar equivalent of the initial cash contribution. The difference between the book and fair value of the customer contracts and content license agreements is being accreted over the expected five year life of the contracts and recorded as a gain and an increase in the investment. This gain will be partially offset by ODG's 50% share of the joint venture's amortization expense over the same period related to the acquired contracts and content license agreements. ODG also recorded a net payable amount to the joint venture of $337,000 as of the joint venture formation date reflecting the transfer of net liabilities incurred by ODG related to the joint venture as well as the joint venture's reimbursement of previously incurred costs by ODG of $787,000 related to joint venture activities prior to its formation. Consistent with authoritative guidance regarding non-monetary transactions, ODG did not record other income in connection with the reimbursement of these costs or any other gains as ODG is deemed to have a commitment to support the operations of the joint venture. ODG treated the reimbursement and other gain for a total of $869,000 as a capital distribution in excess of the carrying value of its investment in the joint venture. This capital distribution is being accreted over the expected five year life of the customer contracts and recorded as a gain and an increase in the investment in the joint venture.

ODG entered into a Service Agreement with the joint venture whereby ODG provides content aggregation, distribution, marketing and administration services to the joint venture under an arm's length fee structure. In the three months and nine months ended October 31, 2010 and 2009, ODG recorded revenues of $750,000 and $510,000, respectively, and $1.5 million and $1.2 million, respectively, related to the Service Agreement. ODG's share of profits from this agreement in proportion to its equity ownership interest is eliminated in consolidation.

The Shareholder's Agreement requires both ODG and TMG to provide cash contributions up to $4.2 million upon the request of the joint venture's management and approval by the shareholders of the joint venture. To date, the Company has contributed $1.2 million as required per the shareholders agreement.

ODG recorded its proportionate share of the joint venture's losses for the three months ended October 31, 2010 and 2009 of $39,000 and $273,000, respectively. ODG recorded its proportionate share of the joint venture's losses of $284,000 and $517,000 for the nine months ended October 31, 2010 and 2009, respectively. Due to the capital distribution and ODG's share of the joint venture's net loss exceeding the book value of its investment in the joint venture, the investment is recorded as a long-term liability of $1.8 million and $1.5 million at October 31, 2010 and January 31, 2010, respectively.

5. Acquisitions and Dispositions

VividLogic, Inc.

On February 1, 2010, the Company acquired of all the outstanding capital stock of VividLogic, Inc. ("VividLogic"). VividLogic, based in Fremont, California provides in-home infrastructure software for high definition televisions, home gateways, and set-top boxes to cable television service providers, set-top box manufacturers and consumer electronics (CE) suppliers. The Company acquired VividLogic to expand its in-home solutions. The results of VividLogic's operations have been included in the consolidated financial statements since the acquisition date. The fair value and allocation of the purchase price is based on the valuation as of February 1, 2010.

Fair Value of Consideration Transferred

At the closing, the Company made a cash payment of $12.0 million. In addition, the VividLogic shareholders are entitled to $8.5 million in cash from available working capital of which $3.5 million was paid at the closing, $1.5 million was paid on June 1, 2010, and $1.5 million was paid on August 1, 2010. The remaining $2.0 million will be paid on February 1, 2011. In addition, on each of the first, second and third anniversaries of the closing date, the Company is obligated to make additional fixed payments of deferred purchase price of $1.0 million in cash. The Company may also be obligated to make earnout payments if certain performance goals are met over each of the three annual periods ending February 1, 2011, 2012 and 2013. The purchase price allocated to current assets included an indemnification asset held in escrow for $1.2 million representing an estimate of the selling shareholders obligation to indemnify the Company for the outcome of a potential contingent liability relating to an uncertain tax position. The indemnification asset was measured on the same basis as the liability for the uncertain tax position. VividLogic has been under tax examination by the State of California since January 2009 for the tax years 2006 and 2007. As of October 31, 2010, the Company has not received nor agreed upon any final adjustments relating to this potential liability. The indemnification asset will be settled once the results of the audit by the State of California are complete.

Allocation of Consideration Transferred

The identifiable assets acquired and liabilities assumed in the VividLogic acquisition were recognized and measured as of the acquisition date, February 1, 2010, based on their estimated fair values. The excess of the acquisition date fair value of consideration transferred over the estimated fair value of the net tangible assets and intangible assets acquired was recorded as goodwill.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the VividLogic acquisition date:

	February 1, 2010 (in thousands)	
Payment of cash to VividLogic shareholders	$	15,470
Acquisition-related deferred consideration		8,388
Total acquisition-date fair value	$	23,858
Cash and cash equivalents	$	5,932
Accounts receivable		2,917
Other assets		1,739
Deferred tax assets		1,250
Intangible assets		9,900
Total identifiable assets acquired		21,738
Accounts payable and other liabilities		(1,740)
Deferred tax liabilities		(3,665)
Deferred revenue		(2,500)
Total liabilities assumed		(7,905)
Goodwill		10,025
Net assets acquired	$	23,858

Intangible Assets

In determining the fair value of the intangible assets, the Company considered, among other factors, the intended use of acquired assets, analyses of historical financial performance, and estimates of future performance of VividLogic's products. The fair values of identified intangible assets were calculated using an income approach based on estimates and assumptions provided by VividLogic's and the Company's management. The following table sets forth the components of identified intangible assets associated with the VividLogic acquisition and their estimated useful lives:

	Useful life	Fair Value (in thousands)	
Existing technology	5-9 years	$	2,200
Non-compete agreements	5 years		700
Customer contracts	9 years		6,200
Trade name	indefinite		200
Backlog	1 year		600
Total intangible assets		$	9,900

SeaChange determined the useful life of intangible assets based on the expected future cash flows associated with the respective asset. Existing technology is comprised of products that have reached technological feasibility and are part of VividLogic's product line. Non-compete agreements represent the fair value of the non-compete with the former shareholders and key employees and will be amortized over the respective terms of the agreements. Customer contracts represent the underlying relationships and agreements with VividLogic's installed customer base. Trade name represents the value of the VividLogic name. Backlog represents the discounted value of the orders received from customers but unfulfilled. Amortization of existing technology is included in cost of product revenue, and amortization expense for customer relationships, non-compete and backlog are included in operating expenses. The weighted average life of the remaining amortization expense is approximately eight years.

Goodwill

Of the total VividLogic purchase price of $23.9 million, $10.0 million was allocated to goodwill. Goodwill represents the excess of the purchase price of an acquired business over the fair value of the underlying net tangible and intangible assets. SeaChange determined that the goodwill included the value of VividLogic's work force and expected synergies in global sales and marketing. SeaChange considers the acquired business an addition to the Company's Software reporting segment. The Company made this determination based upon the financial information provided and reviewed by our Chief Executive Officer (the chief operating decision maker) and the similar economic characteristics to our other products in our Software segment. None of the goodwill associated with the VividLogic acquisition is deductible for income tax purposes.

Deferred Revenue

In connection with the allocation of consideration transferred, SeaChange recorded the fair value of the customer contract obligations assumed from VividLogic. The fair value of the customer contract obligations was determined using a cost build-up approach. The cost build-up approach determines fair value by estimating the costs relating to fulfilling the obligations plus a normal profit margin. The sum of the costs and operating profit approximates, in theory, the amount that SeaChange would be required to pay a third party to assume the service obligations. The estimated costs to fulfill the service obligations were based on the historical direct costs and indirect costs related to VividLogic's contracts with its customers. Direct costs include personnel directly engaged in providing service and support activities, while indirect costs consist of estimated general and administrative expenses based on normalized levels as a percentage of revenue. Profit associated with selling efforts was excluded because VividLogic had concluded the selling efforts on the service contracts prior to the date of the Company's acquisition. The research and development costs associated with the customer contracts have been included in the fair value determination, as these costs were deemed to represent a legal obligation to the customers at the time of acquisition. SeaChange recorded $2.5 million of deferred revenue as of the acquisition date to reflect the fair value of VividLogic's service obligations assumed.

Acquisition-related Consideration

A liability was recognized for the acquisition date fair value of the acquisition-related consideration for the deferred fixed purchase price, the estimated earnout payments and working capital adjustments. Any change in the fair value of the acquisition-related consideration subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the meeting of performance goals, will be recognized in earnings in the period the estimated fair value changes. The fair value estimate for the earnout payment was estimated at $700,000 and is based on the probability weighted bookings to be achieved over the earnout period. A change in fair value of the acquisition-related consideration could have a material effect on the statement of operations and financial position in the period of the change in estimate. The fair value of the acquisition-related consideration to be distributed directly to the VividLogic shareholders was estimated by the Company at the acquisition date to be $8.4 million.

Acquisition-related Costs

SeaChange recorded transaction costs such as legal, accounting, valuation and other professional services of $1.1 million for the nine months ended October 31, 2010. The transaction costs were expensed and recorded in general and administrative expenses in the Consolidated Statement of Operations. During the three and nine month periods ended October 31, 2010, the Company recorded a charge of $105,000 and $334,000, respectively, which is included as interest expense in the Consolidated Statement of Operations for the change in fair value of the acquisition-related costs.

Casa Systems, Inc.

On April 26, 2010, the Company sold its entire 19.8% ownership interest in Casa Systems, Inc. (“Casa”) back to Casa, a Massachusetts development stage company that specializes in video-on-demand products with the telecommunications and television markets, for $34.1 million realizing a pre-tax profit of $25.2 million which was included in the Consolidated Statement of Operations.

6. Goodwill and Intangible Assets

Goodwill

Goodwill allocated to the Company's reportable segments and changes in the carrying amount of goodwill for the first nine months of fiscal 2011 were as follows:

	Goodwill			
	Software	Servers & Storage	Media Services	Total
	(in thousands)			
Balance at January 31, 2010	$ 35,536	$ 754	$ 19,586	$ 55,876
Acquisition of VividLogic	10,025	-	-	10,025
Equity investment goodwill	881	-	-	881
Cumulative translation adjustment	155	-	65	220
Balance at October 31, 2010	$ 46,597	$ 754	$ 19,651	$ 67,002

As of August 1, 2010, the Company performed its annual impairment testing of goodwill associated with its three reporting segments and determined there was no goodwill impairment. Our projections used to evaluate goodwill as of August 1, 2010 have included changes to revenue and operating expense resulting from the restructuring plan that occurred during the third quarter of fiscal 2011. (See note 8)

Intangible Assets

Intangible assets consisted of the following:

		October 31, 2010			January 31, 2010		
	Useful Life	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
			(in thousands)			(in thousands)	
Finite-lived intangible assets:							
Customer contracts	1- 10 years	$ 34,933	$ (13,746)	$ 21,187	$ 28,643	$ (11,984)	$ 16,659
Non-compete agreements	2-3 years	2,793	(919)	1,874	2,487	(290)	2,197
Completed technology	4 - 9 years	12,147	(4,432)	7,715	9,904	(3,250)	6,654
Trademarks and other	5 years	2,402	(1,685)	717	1,391	(1,191)	200
Total finite-lived intangible assets		$ 52,275	$ (20,782)	$ 31,493	$ 42,425	$ (16,715)	$ 25,710
Infinite-lived intangible assets:							
Trade names		$ 200	$ -	$ 200	$ -	$ -	$ -
In-process research and development		558	-	558	554	-	554
Total infinite-lived		$ 758	$ -	$ 758	$ 554	$ -	$ 554

intangible assets						
Total intangible assets	$ 53,033	$ (20,782)	$ 32,251	$ 42,979	$ (16,715)	$ 26,264

Estimated future amortization expenses related to the above intangible assets at October 31, 2010 are as follows:

Fiscal Year	(in thousands)
2011 (for the remaining three months ending January 31, 2011)	$ 1,293
2012	6,178
2013	5,872
2014	4,703
2015 and thereafter	13,447
Total	$ 31,493

7. Commitments and Contingencies

ARRIS Litigation

On July 31, 2009, Arris Corporation (“Arris”) filed a contempt motion in the U.S. District Court for the District of Delaware against SeaChange International relating to U.S. Patent No 5,805,804 (the “804 patent”), a patent owned by Arris. In its motion, Arris is seeking further patent royalties and the enforcement of the permanent injunction entered by the Court on April 6, 2006 against certain SeaChange products. On August 3, 2009, SeaChange filed a complaint seeking a declaratory judgment from the Court that its products do not infringe the ‘804 patent and asserting certain equitable defenses. SeaChange also filed a motion to consolidate the Arris contempt motion with the declaratory judgment action and requested a status conference on SeaChange’s declaratory judgment action. On August 25, 2009, Arris filed 1) an answer to SeaChange’s complaint that included a counterclaim of patent infringement under the ‘804 patent; and 2) a motion to stay the declaratory judgment action until the resolution of the contempt motion. On June 4, 2010, the Court entered an order granting Arris’ motion to stay the declaratory judgment action pending resolution of the contempt proceeding and denied SeaChange’s motion to consolidate and request for status conference. The parties have responded to written discovery and conducted depositions and a hearing has been set for March 1, 2011 on Arris’ contempt motion. SeaChange believes that Arris’ contempt motion is without merit, and that SeaChange products do not infringe the remaining claims under the ‘804 patent.

Indemnification and Warranties

SeaChange provides indemnification, to the extent permitted by law, to its officers, directors, employees and agents for liabilities arising from certain events or occurrences while the officer, director, employee, or agent is or was serving at SeaChange’s request in such capacity. With respect to acquisitions, SeaChange provides indemnification to or assumes indemnification obligations for the current and former directors, officers and employees of the acquired companies in accordance with the acquired companies’ bylaws and charter. As a matter of practice, SeaChange has maintained directors' and officers’ liability insurance including coverage for directors and officers of acquired companies.

SeaChange enters into agreements in the ordinary course of business with customers, resellers, distributors, integrators and suppliers. Most of these agreements require SeaChange to defend and/or indemnify the other party against intellectual property infringement claims brought by a third party with respect to SeaChange’s products. From time to time, SeaChange also indemnifies customers and business partners for damages, losses and liabilities they may suffer or incur relating to personal injury, personal property damage, product liability, and environmental claims relating to the use of SeaChange’s products and services or resulting from the acts or omissions of SeaChange, its employees, authorized agents or subcontractors. For example, SeaChange has received requests from several of its customers for indemnification of patent litigation claims asserted by Acacia Media Technologies, USA Video Technology Corporation, Multimedia Patent Trust, Microsoft Corporation and VTran Media Technologies. Management performed an analysis of these requests, evaluating whether any potential losses were probable and estimable.

SeaChange warrants that its products, including software products, will substantially perform in accordance with its standard published specifications in effect at the time of delivery. Most warranties have at least a one year duration that generally commence upon installation. In addition, SeaChange provides maintenance support to customers and therefore allocates a portion of the product purchase price to the initial warranty period and recognizes revenue on a straight line basis over that warranty period related to both the warranty obligation and the maintenance support agreement. When SeaChange receives revenue for extended warranties beyond the standard duration, it is deferred and recognized on a straight line basis over the contract period. Related costs are expensed as incurred.

In the ordinary course of business, SeaChange provides minimum purchase guarantees to certain of its vendors to ensure continuity of supply against the market demand. Although some of these guarantees provide penalties for cancellations and/or modifications to the purchase commitments as the market demand decreases, most of the guarantees do not. Therefore, as the market demand decreases, SeaChange re-evaluates the accounting implications of guarantees and determines what charges, if any, should be recorded.

With respect to its agreements covering product, business or entity divestitures and acquisitions, SeaChange provides certain representations and warranties and agrees to indemnify and hold such purchasers harmless against breaches of such representations, warranties and covenants. With respect to its acquisitions, SeaChange may, from time to time, assume the liability for certain events or occurrences that took place prior to the date of acquisition.

SeaChange provides such guarantees and indemnification obligations after considering the economics of the transaction and other factors including, but not limited to, the liquidity and credit risk of the other party in the transaction. SeaChange believes that the likelihood is remote that any such arrangement could have a material adverse effect on its financial position, results of operation or liquidity. SeaChange records liabilities, as disclosed above, for such guarantees based on the Company’s best estimate of probable losses which considers amounts recoverable under any recourse provisions.

8. Restructuring

During the three months ended October 31, 2010, the Company continued actions to lower its cost structure as it strives to improve its financial performance. The three months ended October 31, 2010 included restructuring charges to its income statement totaling $1.1 million for severance costs related to the termination of 34 employees and a charge for the disposal of fixed assets totaling $1.3 million as a direct result of the restructuring plan. For the nine months ended October 31, 2010, the Company has incurred $6.9 million of restructuring charges. The Company continues to review its Servers and Storage business and may incur additional restructuring costs over the next two quarters to align the costs structure more closely with the forecasted future revenue.

The severance accrual amounts reported as a component of accrued liabilities on the Balance Sheet as of October 31, 2010 were as follows:

(in thousands)		Severance
Accrual balance as of July 31, 2010	$	494
Amount charged to expense		1,152
Severance costs paid		(300)
Accrual balance as of October 31, 2010	$	1,346

9. Treasury Stock

On May 26, 2010, SeaChange's Board of Directors authorized the repurchase of up to $20.0 million of its common stock, par value $.01 per share, through a share repurchase program. As authorized by the program, shares may be purchased in the open market or through privately negotiated transactions in a manner consistent with applicable securities laws and regulations, including pursuant to a Rule 10b5-1 plan maintained by the Company. This share repurchase program does not obligate the Company to acquire any specific number of shares and may be suspended or discontinued at any time. All repurchases are expected to be funded from the Company's current cash and investment balances. The timing and amount of the shares to be repurchased will be based on market conditions and other factors, including price, corporate and regulatory requirements and alternative investment opportunities. The repurchase program terminates on January 31, 2012. There were no stock repurchases during the three months ended October 31, 2010. During the nine months ended October 31, 2010, the Company repurchased approximately 178,000 shares at a cost of $1.4 million. During the third quarter ended October 31, 2010, the Company retired 1,288,356 shares of treasury stock.

10. Segment Information

The Company is managed and operated as three segments, Software, Servers and Storage, and Media Services. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company's Advertising, VOD, Middleware and Broadcast software, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing, and amortization of intangibles. The Software segment includes the results of eventIS from the date of the acquisition on September 1, 2009 and the results of VividLogic from the date of acquisition on February 1, 2010.
- Servers and Storage segment includes product revenues from the VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.

- Media Services segment includes the operations of ODG, including Mobix Interactive, activities which include content acquisition and preparation services for television and wireless service providers and related operating expenses.

Under this reporting structure, the Company further determined that there are significant functions, and therefore costs, that are considered corporate expenses and are not allocated to the reportable segments for the purposes of assessing performance and making operating decisions. These unallocated costs include general and administrative expenses, other than direct general and administrative expenses related to Media Services and Software, other income (expense), net, taxes and equity losses in earnings of affiliates, which are managed separately at the corporate level.

The basis of the assumptions for all such revenues, costs and expenses includes significant judgments and estimations. There are no inter-segment revenues for the periods shown below. The Company does not separately track all assets by operating segments nor are the segments evaluated under this criterion. The following summarizes the revenues, gross profit, operating expenses and income from operations by reportable segment:

	Three Months Ended October 31, 2010	Three Months Ended October 31, 2009	Nine Months Ended October 31, 2010	Nine Months Ended October 31, 2009
	(in thousands)		(in thousands)	
Software				
Revenue:				
Products	$ 15,543	$ 19,167	$ 51,712	$ 49,876
Services	19,293	16,578	58,789	46,547
Total revenue	34,836	35,745	110,501	96,423
Gross profit	18,940	22,416	59,902	58,354
Operating expenses:				
Research and development	9,074	10,437	28,934	29,233
Selling and marketing	4,395	4,868	13,241	12,550
General and administrative	421	173	935	173
Amortization of intangibles	733	635	2,300	1,404
Restructuring	344	-	878	-
	14,967	16,113	46,288	43,360
Income from operations	$ 3,973	$ 6,303	$ 13,614	$ 14,994
Servers and Storage				
Revenue:				
Products	$ 2,835	$ 8,182	$ 13,281	$ 26,441
Services	3,358	4,179	9,973	11,804
Total revenue	6,193	12,361	23,254	38,245
Gross profit	3,089	4,238	11,147	16,392
Operating expenses:				
Research and development	2,497	2,916	8,417	8,200
Selling and marketing	1,331	2,199	5,074	7,032
Restructuring	2,090	-	5,155	-
	5,918	5,115	18,646	15,232
(Loss) income from operations	$ (2,829)	$ (877)	$ (7,499)	$ 1,160
Media Services				
Service revenue	$ 8,106	$ 5,184	$ 21,605	$ 14,005
Gross profit	1,213	903	4,431	1,543
Operating expenses:				
General and administrative	1,408	824	3,114	2,247
Amortization of intangibles	73	(64)	213	440
	1,481	760	3,327	2,687
(Loss) income from operations	$ (268)	$ 143	$ 1,104	$ (1,144)
Unallocated Corporate				
Operating expenses:				
General and administrative	$ 4,283	$ 4,989	$ 14,039	$ 13,616
Restructuring	$ -	$ -	$ 912	$ -
Total unallocated corporate expenses	$ 4,283	$ 4,989	$ 14,951	$ 13,616
Consolidated (loss) income from operations	$ (3,407)	$ 580	$ (7,732)	$ 1,394

The following table summarizes revenues by geographic locations:

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	Three Months Ended October 31,				Nine Months Ended October 31,			
	2010		2009		2010		2009	
	Amount	%	Amount	%	Amount	%	Amount	%
	(in thousands, except percentages)				(in thousands, except percentages)			
Revenues by customers' geographic locations:								
North America	$ 27,323	55%	$ 37,701	71%	$ 90,045	58%	$ 103,664	70%
Europe and Middle East	16,176	33%	11,881	22%	46,864	30%	30,060	20%
Latin America	1,392	3%	2,322	4%	7,430	5%	8,985	6%
Asia Pacific and other international locations	4,244	9%	1,386	3%	11,021	7%	5,964	4%
Total	$ 49,135		$ 53,290		$ 155,360		$ 148,673	

The following summarizes revenues by significant customer where such revenue exceeded 10% of total revenues for the indicated period:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2010	2009	2010	2009
Customer A	18%	38%	24%	28%
Customer B	12%	11%	12%	10%
Customer C	11%	11%	*	*
Customer D	*	*	*	11%

* Denotes a percentage less than 10%

At October 31, 2010, three different customers accounted for approximately 21%, 16% and 11%, respectively, of the accounts receivable and unbilled receivables balances, and at January 31, 2010, the same three customers accounted for 23%, 16% and 11%, respectively, of SeaChange’s accounts receivable and unbilled receivables balances.

11. Income Taxes

For the three months ended October 31, 2010, the Company recorded an income tax provision of $1.9 million on losses before tax of $3.2 million due to the lower forecasted profit before tax for fiscal 2011, resulting in the reduction of previously recorded tax benefits in the second quarter of fiscal 2011 hence changing the effective rate during the third quarter of fiscal 2011 from the previously projected 68% effective rate to 11% effective rate for fiscal 2011. In addition, the Company recognized $300,000 of tax benefits resulting from the expiration of the statute of limitations for uncertain tax positions.

For the nine months ended October 31, 2010, the Company recorded an income tax benefit of $1.7 million on income before tax of $17.2 million resulting in an effective tax benefit rate of 10%. The income tax benefit was primarily due to a reduction of a portion of the valuation allowance against the Company’s deferred tax assets due to the Company having met the “more likely than not” realization criteria on its U.S. deferred tax assets resulting from the gain related to the Company’s equity investment in Casa Systems, Inc and the benefit of the reduction in deferred tax assets associated with the deferred tax liabilities from the acquisition of VividLogic. Previously, the Company maintained a full valuation allowance and will continue to monitor available information in determining whether there is sufficient evidence to consider releasing some or all of the remaining valuation allowance. In addition, the Company recognized $300,000 of tax benefits resulting from the expiration of the statute of limitations for uncertain tax positions. The statute of limitations varies by the various jurisdictions in which we operate. In any given year, statute of limitations in certain jurisdictions may lapse without examination and any uncertain tax position taken in these years will result in reduction of the liability for unrecognized tax benefits for that year. These tax benefits were offset by the tax expense resulting from the gain on the sale of Casa Systems, Inc. and the tax expense resulting from our operations in foreign tax jurisdictions. The Company estimates its annual effective tax rate for the year and applies that rate to the year to date profit before tax to determine the quarterly and year to date tax expense or benefit. Should the Company determine any portion of the valuation allowance is no longer required, a tax benefit would be recorded in the financial period of the change in determination.

The effective income tax rate is based upon the estimated income for the year, the composition of the income in different countries and adjustments, if any, in the applicable quarterly periods for the potential tax consequences, benefits, resolution of tax audits or other tax contingencies. Our income tax provision or benefit consists of federal, foreign, and state income taxes.

In conjunction with the purchase price allocation for the acquisition of VividLogic, we recorded a liability for uncertain tax position in the amount of $1.2 million. Tax years 2006 to 2009 of VividLogic are currently open for examination. An indemnification asset held in escrow of $1.2 million has also been recorded, which represents the selling shareholders' obligation to indemnify the Company for uncertain tax positions taken by the former shareholders of VividLogic.

12. Comprehensive Income

The components of comprehensive income consisted of the following:

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2010	2009	2010	2009
	(in thousands)		(in thousands)	
Net income (loss)	$ (5,215)	$ 657	$ 18,615	$ 1,279
Other comprehensive income:				
Foreign currency translation adjustment	3,269	1,257	60	5,714
Unrealized (loss) gain on marketable securities, net of tax	(14)	4	(30)	(104)
Other comprehensive income, net of tax	3,255	1,261	30	5,610
Comprehensive income (loss)	$ (1,960)	$ 1,918	$ 18,645	$ 6,889

13. Earnings Per Share

Earnings per share present both "basic" earnings per share and "diluted" earnings per share. Basic earnings per share are computed by dividing earnings 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 common stock, such as stock options and restricted stock units and warrants, calculated using the treasury stock method.

For the three months ended October 31, 2010 and 2009, there were 2,905,000 and 3,270,000 of common stock equivalents, respectively, which were anti-dilutive based on the Company's stock price being lower than the option exercise price. The number of options that were anti-dilutive at October 31, 2010 includes 514,000 shares, whose dilutive effect was not included in the calculation as a result of the Company's net loss for the quarter.

For the nine months ended October 31, 2010 and 2009, there were 2,646,000 and 3,463,000 of common stock equivalents, respectively, which were anti-dilutive based on the Company's stock price being lower than the option exercise price.

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

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2010	2009	2010	2009
	(in thousands)		(in thousands)	
Weighted average shares used in calculating earnings per share—Basic	31,496	30,871	31,409	30,838
Dilutive common stock equivalents	-	788	520	569
Weighted average shares used in calculating earnings per share—Diluted	31,496	31,659	31,929	31,407

14. Related Party

ReiJane Huai, who resigned as a director of SeaChange effective as of November 11, 2010, was until September 29, 2010 the Chairman and CEO of FalconStor Software Inc., from whom the Company purchases products used in the manufacture of SeaChange products. There were no product purchases from FalconStor Software for the three and nine months ended October 31, 2010, and the Company had no liability to FalconStor Software as of October 31, 2010.

On September 1, 2009, SeaChange completed its acquisition of eventIS from a holding company in which Erwin van Dommelen, elected President of SeaChange Software in March 2010, has a 31.5% interest. On closing the transaction, SeaChange made cash payments to the holding company totaling $37.0 million and issued $1.1 million of restricted shares. SeaChange is obligated to make additional fixed payments to the holding company of deferred purchase price under the eventIS share purchase agreement, each such payment to be in an aggregate amount of $2.8 million with $1.7 million payable in cash and $1.1 million payable by the issuance of restricted shares of SeaChange common stock, which will vest in equal installments over three years starting on the first anniversary date of the purchase agreement for three years. At the option of the former shareholder of eventIS, up to forty percent of each payment otherwise to be made in restricted stock may be payable in cash on the vesting dates of the restricted shares. On September 1, 2010, the Company paid $1.8 million and issued 75,000 shares (approximate value $615,000) of restricted stock that will vest annually over three years. The remaining $410,000 will be paid out in equal installments on September 1, 2011, 2012, and 2013. Under the earnout provisions of the eventIS share purchase agreement, if certain performance goals are met over each of the three periods ending January 31, 2011, 2012, and 2013, SeaChange will be obligated to make additional cash payments to the holding company.

15. Recently Issued Accounting Standard Updates

Recent Accounting Guidance Not Yet Effective

Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

In July 2010, the Financial Accounting Standards Board (FASB) issued guidance requiring improved disclosures about the credit quality of a company's financing receivables and their associated credit reserves. The amendments in the update require more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. The objective of enhancing these disclosures is to improve financial statement users' understanding of the nature of an entity's credit risk associated with its financing receivables and the entity's assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The amendments in the update are effective for the first interim or annual reporting period ending on or after December 15, 2010. The Company expects the amended guidance to impact its disclosures, but to otherwise not have a material effect on its consolidated results of operations or financial position.

Revenue Recognition for Arrangements with Multiple Deliverables

In September 2009, the FASB amended the guidance for revenue recognition in multiple-element arrangements. It has been amended to remove from the scope of industry specific revenue accounting guidance for software and software related transactions, tangible products containing software components and non-software components that function together to deliver the product’s essential functionality. The guidance now requires an entity to provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated, and also requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables for these products if a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence of selling price. The guidance also eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method for these products. The accounting changes summarized are effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. The Company is currently assessing the impact of these amendments on its accounting and reporting systems and processes; however, at this time the Company is unable to quantify the impact of their adoption on its financial statements or determine the timing and method of its adoption.

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

The following information should be read in conjunction with the unaudited consolidated financial information and the notes thereto included in this Quarterly Report on Form 10-Q. In addition to historical information, the following discussion and other parts of this Quarterly Report contain forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995, that involve risks and uncertainties. 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 Annual Report on Form 10-K and Form 10-K/A for our fiscal year ended January 31, 2010 and elsewhere in this Quarterly Report. These factors may cause our actual results to differ materially from any forward-looking statement.

Overview

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

On September 1, 2009, the Company acquired the entire share capital of eventIS Group B.V. (“eventIS”). Based in Eindhoven, the Netherlands, eventIS provides video on demand and linear broadcast software and related services to cable television and telecommunications companies primarily in Europe. The results of eventIS’s operations have been included in the consolidated financial statements since the acquisition date. The Company acquired eventIS, among other reasons, to expand its video on demand solutions into the European market.

On February 1, 2010, the Company completed its acquisition of all the outstanding capital stock of VividLogic, Inc. (“VividLogic”). VividLogic, based in Fremont, California, provides in-home infrastructure software for high definition televisions, home gateways, and set-top boxes to cable television service providers, set-top box manufacturers and consumer electronics (CE) suppliers. The results of VividLogic’s operations have been included in the consolidated financial statements since the acquisition date. The Company acquired VividLogic to expand its in-home solutions.

On April 26, 2010, the Company sold its entire 19.8% ownership interest in Casa Systems, Inc. (“Casa”) back to Casa, a development stage company that specializes in video-on-demand products with the telecommunications and television markets, for $34.1 million realizing a pre-tax profit of $25.2 million which is included in the Consolidated Statement of Operations for the applicable period.

The Company is managed and operated as three segments, Software, Servers and Storage, and Media Services. A description of the three reporting segments is as follows:

- Software segment includes product revenues from the Company’s Advertising, VOD, Middleware and Broadcast software, related services such as professional services, installation, training, project management, product maintenance, technical support and software development for those software products, and operating expenses relating to the Software segment such as research and development, selling and marketing, and amortization of intangibles. The Software segment includes the results of eventIS from the date of the acquisition on September 1, 2009 and the results of VividLogic from the date of acquisition on February 1, 2010.
- Servers and Storage segment includes product revenues from the VOD and Broadcast server product lines and related services such as professional services, installation, training, project management, product maintenance, and technical support for those products and operating expenses relating to the Servers and Storage segment, such as research and development and selling and marketing.
- Media Services segment includes the operations of ODG, including Mobix Interactive, activities which include content acquisition and preparation services for television and wireless service providers and related operating expenses.

The Company determined there are significant functions, and therefore costs, considered corporate expenses that are not allocated to the reportable segments for the purposes of assessing performance and making operating decisions. These unallocated costs include general and administrative expenses, other than direct general and administrative expenses related to the Software and Media Services segments, other income (expense), net, taxes and equity losses in earnings of affiliates, which are managed separately at the corporate level.

The basis of the assumptions for all such revenues, costs and expenses includes significant judgments and estimations. There are no inter-segment revenues for the periods shown below. The Company does not separately track all assets by operating segments nor are the segments evaluated under this criterion.

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

- the customer’s receipt of authorized signatures on their purchase orders;

- the budgetary approvals within the customer's company for capital purchases; and
- the ability to process the purchase order within the customer's organization in a timely manner.

Factors that may impact the shipment of customer orders include:

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

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

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

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

- market acceptance of the products and services offered by our customers and increased subscriber usage and demand for these products and services;

- selection by our customers of our products and services versus the products and services being offered by our competitors;

- our ability to introduce new products to the market in a timely manner and to meet the demands of the market for new products and product enhancements;

- our ability to maintain gross margins from the sale of our products and services at a level that will provide us with cash to fund our operations given the pricing pressures within the market and the costs of materials to manufacture our products;

- our ability to control operating costs given the fluctuations that we have experienced with revenues from quarter to quarter; and

- our ability to successfully integrate businesses acquired by us, including eventIS, Mobix Interactive, and VividLogic.

Three Months Ended October 31, 2010 Compared to the Three Months Ended October 31, 2009

The following table sets forth statement of operations data for the three months ended October 31, 2010 and 2009.

	Three Months Ended October 31, 2010	2009
	(in thousands)	
Revenues:		
Products	$ 18,378	$ 27,349
Services	30,757	25,941
	49,135	53,290
Costs and expenses:		
Cost of product revenues	7,299	10,046
Cost of services revenues	18,595	15,687
Research and development	11,570	13,353
Selling and marketing	5,726	7,067
General and administrative	6,112	5,986
Amortization of intangibles	805	571
Restructuring	2,435	-
(Loss) income from operations	(3,407)	580
Other income, net	173	455
(Loss) income before income taxes and equity loss in earnings of affiliates	(3,234)	1,035
Income tax provision	1,942	105
Equity loss in earnings of affiliates, net of tax	(39)	(273)
Net (loss) income	$ (5,215)	$ 657

Revenues

The following table summarizes information about the Company’s reportable segment revenues for the three months ended October 31, 2010 and 2009.

	Three Months Ended October 31, 2010	2009	%
	(in thousands, except for percentage data)		
Software revenues:			
Products	$ 15,543	$ 19,167	(19)%
Services	19,293	16,578	16%
Total Software revenues	34,836	35,745	(3)%
Servers and Storage revenues:			
Products	2,835	8,182	(65)%
Services	3,358	4,179	(20)%
Total Servers and Storage revenues	6,193	12,361	(50)%
Media Services:			

Services		8,106		5,184	56%
Total consolidated revenue:					
Products		18,378		27,349	(33)%
Services		30,757		25,941	19%
Total consolidated revenues	$	49,135	$	53,290	(8)%

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Product Revenues. Product revenues decreased 33% to $18.4 million in the three months ended October 31, 2010 from $27.3 million in the three months ended October 31, 2009. Product revenues from the Software segment accounted for 85% and 70% of the total product revenue for the three months ended October 31, 2010 and 2009, respectively. The Servers and Storage segment accounted for 15% and 30% of total product revenues in the three months ended October 31, 2010 and 2009, respectively. The decrease in Product revenues was due to a decrease in VOD server and software license shipments to North American and Latin American service providers and the return of approximately $1.9 million of VOD servers from a customer due to a warranty claim that resulted in the reduction of previously recorded revenue. This decrease was partially offset by higher Advertising software and VividLogic product revenues and the inclusion this year of eventIS for a full quarter of revenues compared to the prior year's third quarter which included two months of revenues.

Services Revenues. Services revenues increased 19% year over year to $30.8 million in the three months ended October 31, 2010 from $25.9 million in the three months ended October 31, 2009. For the three months ended October 31, 2010 and 2009, services revenues for the Software segment accounted for 63% and 64%, respectively, of the total services revenue. Servers and Storage services revenue accounted for 11% and 16% of total services revenue and Media Services revenue accounted for 26% and 20% of total services revenues in the three months ended October 31, 2010 and 2009, respectively. The increase in Service revenues compared to the three months ended October 31, 2009 was due to increased revenues from Media Services resulting from recent contract wins with customers from Dubai and France, and the inclusion of a full quarter of services revenues from our recent acquisitions of eventIS and VividLogic.

For the three months ended October 31, 2010, three customers accounted for more than 41% of our total revenues, and three customers accounted for more than 60% of our total revenues for the three months ended October 31, 2009. Revenue from each of these customers was included in revenue from the Software and the Servers and Storage segments. We believe that a significant amount of our revenues will continue to be derived from a limited number of customers.

International sales accounted for approximately 50% and 31% of total revenues in the three months ended October 31, 2010 and 2009, respectively. With the acquisition of eventIS, headquartered in the Netherlands, we expect that international products and services revenues will be a significant portion of our business in the future.

Software Revenues. Revenues from our Software segment for the three months ended October 31, 2010 decreased $1.0 million, or a 3% decrease compared to the three months ended October 31, 2009. The 19% decrease in the software products revenues was due to lower VOD software licensing revenue from North American customers. This decrease was partially offset by higher Advertising licensing revenues and the inclusion of eventIS and VividLogic product revenues for a full quarter in this year's third quarter compared to last year.

The $2.7 million or 16% increase in services revenue compared to the three months ended October 31, 2009 was due to higher VOD technical support revenues year over year and service revenues from the recent acquisitions of eventIS and VividLogic.

Servers and Storage Revenues. Revenues from the Servers and Storage segment for the three months ended October 31, 2010 decreased $6.2 million or 50% compared to the three months ended October 31, 2009. The decrease in product revenues in the three months ended October 31, 2010 of $5.3 million compared to the same quarter in the previous year was primarily due to decreased shipments of VOD servers to North American and Latin American customers. In addition, this year's third quarter included the return of VOD servers due to a warranty claim from a customer, which resulted in the reduction of previously recorded VOD server revenue of approximately $1.9 million.

The 20% decrease in service revenues compared to the three months ended October 31, 2009 was due to lower VOD server installation revenues resulting from a decrease in VOD server shipments year over year and lower Broadcast technical support revenues.

Media Services. Revenues from Media Services increased by approximately $2.9 million or 56% to $8.1 million in the three months ended October 31, 2010 compared to the three months ended October 31, 2009. The increase in revenue was due primarily to recent contract wins in Dubai and France and increased content processing revenues from a customer in Greece.

Product Gross Profit. Costs of product revenues consist primarily of the cost of purchased material components and subassemblies, labor and overhead relating to the final assembly and testing of complete systems and related expenses. The gross profit percentage for products was 60% and 63% for the three months ended October 31, 2010 and 2009, respectively. The decrease was primarily due to lower VOD and Advertising software margins that was partially offset by significantly higher VOD server margins.

Services Gross Profit. Cost of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support, software development, and project management provided by us and costs associated with providing video content services. The gross profit percentage for services remained constant at 40% for the three months ended October 31, 2010 compared to the same quarter in the previous year was primarily due to higher VOD technical support margins and the inclusion of higher margin eventIS service revenues offset by lower Media Services segment margins resulting from higher headcount costs to support increased revenues.

Software Revenues Gross Profit. Software segment gross margin of 54% for the three months ended October 31, 2010 was nine percentage points lower compared to the three months ended October 31, 2009. The decrease in software gross margins was primarily due to the lower Advertising and VOD software subscription margins that were partially offset by higher middleware margins.

Servers and Storage Gross Profit. Servers and Storage segment gross margin of 50% in the three months ended October 31, 2010 was 16 points higher than in the three months ended October 31, 2009 due to the third quarter of last year including higher shipments of lower margin VOD servers to a North American customer that was partially offset by the reduction in gross margin related to the return of product by a customer during this year’s third quarter.

Media Services Gross Profit. Media Services segment gross margin of 15% for the three months ended October 31, 2010 was three percentage points lower than the gross margin for the three months ended October 31, 2009 due to higher headcount-related costs to support recent contract wins in France and Dubai.

Research and Development. Research and development expenses consist primarily of the compensation of development personnel, depreciation of development and test equipment and an allocation of related facilities expenses. Research and development expenses decreased to $11.6 million, or 24% of total revenues, in the three months ended October 31, 2010, from $13.4 million, or 25% of total revenues, in the three months ended October 31, 2009. The decrease year over year is primarily due to lower Servers and Storage and Software domestic headcount-related costs partially offset by increased Philippine engineering costs and the inclusion of eventIS and VividLogic.

Selling and Marketing. Selling and marketing expenses consist primarily of compensation expenses, including sales commissions, travel expenses and certain promotional expenses. Selling and marketing expenses decreased from $7.1 million, or 13% of total revenues, in the three months ended October 31, 2009, to $5.7 million, or 12% of total revenues, in the three months ended October 31, 2010. The decrease compared to the three months ended October 31, 2009 was primarily due to lower commission expenses resulting from lower product revenues year over year and lower marketing communication expenses.

General and Administrative. General and administrative expenses consist primarily of the compensation of executive, finance, human resource and administrative personnel, legal and accounting services and an allocation of related facilities expenses. In the three months ended October 31, 2010, general and administrative expenses increased to $6.1 million, or 12% of total revenues, from $6.0 million, or 11% of total revenues, in the three months ended October 31, 2009. In comparison to the three months ended October 31, 2009, the increase in general and administrative expense related to the inclusion of eventIS and VividLogic and higher legal fees partially offset by lower corporate headcount-related expenses.

Amortization of intangible assets. Amortization expense consists of the amortization of acquired intangible assets which are operating expenses and not considered costs of revenues. In the three months ended October 31, 2010 and 2009, amortization expense was $805,000 and $571,000, respectively. Additional amortization expense of $466,000 and $446,000 for the three months ended October 31, 2010 and 2009, respectively, related to acquired technology that was charged to cost of sales, with the increase in the three months ended October 31, 2010 being due to amortization expense of the intangible assets related to the recent acquisitions of eventIS and VividLogic.

Restructuring. During the third quarter of fiscal 2011, the Company continued actions to lower its cost structure as it strives to improve its financial performance. For the three months ended October 31, 2010, restructuring charges to the Company’s income statement totaling $1.1 million related to severance costs for the termination of 34 employees primarily in research and development areas in the Servers and Storage segment and the disposal of fixed assets totaling $1.3 million as a direct result of the restructuring plan. The Company continues to review its Server and

Storage business and may incur additional restructuring costs in the next one to two quarters to align the cost structure of this business unit more closely with forecasted future revenue.

Other (expense) income, net. Other (expense) income, net was $173,000 of income in the three months ended October 31, 2010, compared to $455,000 of income in the three months ended October 31, 2009. The $173,000 of income for the three months ended October 31, 2010 was comprised of $75,000 of interest income, $239,000 of foreign exchange gains offset by $137,000 of interest expense due to the change of the fair value of contingent consideration. The $455,000 of income for the three months ended October 31, 2009, was comprised of $172,000 of interest income, and $278,000 of translation gain.

Equity Loss in Earnings of Affiliates. Equity loss in earnings of affiliates was $39,000 and $273,000 in the three months ended October 31, 2010 and 2009, respectively. For the three months ended October 31, 2010, $181,000 of equity loss was recognized from On Demand Deutschland, net of $142,000 in accreted gains related to customer contracts and content licensing agreements and a capital distribution related to reimbursement of previously incurred costs. For the three months ended October 31, 2009, the equity loss related to On Demand Deutschland was $420,000 net of $147,000 in accreted gains related to customer contracts and content licensing agreements and a capital distribution related to reimbursement of previously incurred costs.

Income Tax Provision. For the three months ended October 31, 2010, the Company recorded an income tax provision of $1.9 million on losses before tax of $3.2 million due to the lower forecasted profit before tax for fiscal 2011, resulting in the reduction of previously recorded tax benefits in the second quarter of fiscal 2011 hence changing the effective rate during the third quarter of fiscal 2011 from the previously projected 68% effective rate to 11% effective rate for fiscal 2011. The Company estimates its annual effective tax rate for the year and applies that rate to the year to date profit before tax to determine the quarterly and year to date tax expense or benefit. Previously, the Company maintained a full U.S tax valuation allowance and will continue to monitor available information in determining whether there is sufficient evidence to consider releasing some or all of the remaining valuation allowance. In addition, the Company recognized $300,000 of tax benefits resulting from the expiration of the statute of limitations for uncertain tax positions. The statute of limitations varies by the various jurisdictions in which we operate. In any given year, statute of limitations in certain jurisdictions may lapse without examination and any uncertain tax position taken in these years will result in reduction of the liability for unrecognized tax benefits for that year. Should the Company determine any portion of the valuation allowance is no longer required, a tax benefit would be recorded in the financial period of the change in determination.

For the three months ended October 31, 2009, we recorded an income tax provision of $105,000 on income before taxes of $1.0 million resulting in an effective tax rate of 10%. The difference in the fiscal 2010 periods between our effective tax rate and the federal statutory rate of 35% was primarily due to the differential in foreign tax rates and the utilization of foreign tax credits.

The effective income tax rate is based upon the estimated income for the year, the composition of the income in different countries and adjustments, if any, in the applicable quarterly periods for the potential tax consequences, benefits, resolution of tax audits or other tax contingencies.

In conjunction with the purchase price allocation for the acquisition of VividLogic, we recorded a liability in the amount of $1.2 million for an uncertain California state tax position. Tax years 2006 to 2009 of VividLogic are currently open for examination. An indemnification asset held in escrow of $1.2 million represents the selling shareholders' obligation to indemnify the Company for uncertain tax positions taken by VividLogic prior to our purchase of it.

Non-GAAP Measures. As part of our ongoing review of financial information related to our business, we regularly use non-GAAP measures, in particular, adjusted non-GAAP earnings per share, as we believe they provide a meaningful insight into our business and trends. We also believe that these adjusted non-GAAP measures provide readers of our financial statements with useful information and insight with respect to the results of our business. However, the presentation of adjusted non-GAAP information is not intended to be considered in isolation or as a substitute for results prepared in accordance with GAAP. Below are tables for the three months ended October 31, 2010 and 2009, respectively:

	Three Months Ended October 31, 2010			Three Months Ended October 31, 2009		
	GAAP	Adjustment	Non-GAAP	GAAP	Adjustment	Non-GAAP
	(in thousands except share data)			(in thousands except share data)		
Revenues	$ 49,135	$ 785	$ 49,920	$ 53,290	$ 731	$ 54,021
Operating expenses	26,648		26,648	26,977		26,977
Stock-based compensation	-	413	413	-	870	870
Amortization of intangible assets	-	1,271	1,271	-	1,016	1,016
Restructuring	-	2,435	2,435		-	
Acquisition related costs	-	105	105	-	430	430
	26,648	4,224	22,424	26,977	2,316	24,661
(Loss) income from operations	(3,407)	5,009	1,602	580	3,047	3,627
Income from sale of investment in affiliate	-	-	-	-		
Income tax (provision) benefit impact	(1,942)	1,667	(275)	(105)	(309)	(414)
Net (loss) income	$ (5,215)	$ 6,676	$ 1,461	$ 657	$ 2,738	$ 3,395
Diluted (loss) income per share	$ (0.17)	$ 0.22	$ 0.05	$ 0.02	$ 0.09	$ 0.11
Diluted weighted average common shares outstanding	31,496	31,496	31,496	31,659	31,659	31,659

In managing and reviewing our business performance, we exclude a number of items required by GAAP. Management believes that excluding these items, mentioned below, is useful in understanding trends and managing our operations. We believe it is useful for investors to understand the effects of these items on our total operating expenses. Our non-GAAP financial measures include adjustments based on the following items, as well as the related income tax effects and adjustments to the valuation allowance.

Deferred software revenue: Business combination accounting rules require us to account for the fair value of customer contracts assumed in connection with our acquisitions. Because customer contracts may take up to 18 months to complete, our GAAP revenues subsequent to these acquisitions do not reflect the full amount of software revenues on assumed customer contracts that would have otherwise been recorded by eventIS Group B.V. and VividLogic, Inc. We believe this adjustment is useful to investors as a measure of the ongoing performance of our business because we have historically experienced high renewal rates on similar customer contracts, although we cannot be certain that customers will renew these contracts.

Stock-based compensation expenses: We have excluded the effect of stock-based compensation and stock-based payroll expenses from our non-GAAP operating expenses and net income measures. Although stock-based compensation is a key incentive offered to our employees, we continue to evaluate our business performance excluding stock-based compensation expenses. Stock-based compensation expenses will recur in future periods.

	Three Months Ended			
	October 31, 2010		October 31, 2009	
	(in thousands)			
Cost of revenues	$	27	$	168
Research and development		108		244
Selling and marketing		72		135
General and administrative		206		323
Total stock-based compensation	$	413	$	870

Amortization of intangible assets: We have excluded the effect of amortization of intangible assets from our non-GAAP operating expenses and net income measures. Amortization of intangibles is inconsistent in amount and frequency and is significantly affected by the timing and size of our acquisitions.

	Three Months Ended			
	October 31, 2010		October 31, 2009	
	(in thousands)			
Cost of revenues	$	466	$	445
Operating expenses		805		571
Total amortization of intangibles	$	1,271	$	1,016

Restructuring: We incurred charges due to the restructuring of our business including severance charges, write down of inventory to net realizable value, and the disposal of fixed assets resulting from the restructuring, which we generally would not have otherwise incurred in the periods presented as part of our continuing operations.

Acquisition related and other expenses: We incurred significant expenses in connection with our acquisitions of eventIS Group B.V. and VividLogic, Inc. and also incurred certain other operating expenses, which we generally would not have otherwise incurred in the periods presented as a part of our continuing operations. Acquisition related and other expenses consist of transaction costs, costs for transitional employees, other acquired employee related costs, integration related professional services and the change of fair value related to contingent considerations.

Income from sale of investment in affiliate: We generated income due to the sale of our investment in Casa Systems, Inc. We excluded the income generated by this investment due to its non-recurring nature.

Income tax benefit (provision) impact: The non-GAAP income tax adjustment reflects the effective tax rate for the year in which the non-GAAP adjustment occurs and excludes any changes in the tax valuation allowance arising from the gain on the sale of the equity investment in Casa Systems, Inc.

Nine Months Ended October 31, 2010 Compared to the Nine Months Ended October 31, 2009

The following table sets forth statement of operations data for the nine months ended October 31, 2010 and 2009.

	Nine Months Ended October 31,	
	2010	2009
	(in thousands)	
Revenues:		
Products	$ 64,993	$ 76,317
Services	90,367	72,356
Total Revenues	155,360	148,673
Costs and expenses:		
Cost of product revenues	26,082	27,804
Cost of services revenues	53,799	44,580
Research and development	37,351	37,433
Selling and marketing	18,315	19,582
General and administrative	18,089	16,036
Amortization of intangibles	2,512	1,844
Restructuring	6,944	-
(Loss) income from operations	(7,732)	1,394
Gain on sale of investment in affiliate	25,188	-
Other (expense) income, net	(257)	739
Income before income taxes and equity loss in earnings of affiliates	17,199	2,133
Income tax (benefit) provision	(1,700)	337
Equity loss in earnings of affiliates, net of tax	(284)	(517)
Net income	$ 18,615	$ 1,279

Revenues

The following table summarizes information about the Company's reportable segment revenues for the nine months ended October 31, 2010 and 2009.

	Nine Months Ended October 31,		
	2010	2009	%
	(in thousands, except for percentage data)		
Software revenues:			
Products	$ 51,712	$ 49,876	4%
Services	58,789	46,547	26%
Total Software revenues	$ 110,501	$ 96,423	15%
Servers and Storage revenues:			
Products	$ 13,281	$ 26,441	(50)%
Services	9,973	11,804	(16)%
Total Servers and Storage revenues	$ 23,254	$ 38,245	(39)%

Media Services:					
Services	$	21,605	$	14,005	54%
Total consolidated revenue:					