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, 2004

OR

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

For the transition period from______ to ______

Commission File Number: 0-21393

SEACHANGE INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

124 Acton Street, Maynard, MA 01754
(Address of principal executive offices, including zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 is an accelerated filer (as defined in 12b-2 of the Exchange Act). YES ☒ NO ☐

The number of shares outstanding of the registrant's Common Stock on December 14, 2004 was 28,077,033.

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ITEM I. Financial Statements

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

	October 31, 2004	January 31, 2004
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 103,609	$ 87,597
Restricted cash	1,000	—
Marketable securities	18,066	7,777
Accounts receivable, net of allowance for doubtful accounts of $837 at October 31, 2004 and $1,197 at January 31, 2004	27,728	16,572
Inventories	17,535	19,738
Prepaid expenses and other current assets	3,285	3,640
Total current assets	171,223	135,324
Property and equipment, net	14,389	14,757
Marketable securities	16,420	26,669
Investments in affiliates	3,666	3,809
Intangible assets, net	568	1,293
Goodwill	1,882	253
Other assets	114	151
	$ 208,262	$ 182,256
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of lines of credit and obligations under capital lease	$ 311	$ 399
Accounts payable	10,151	2,367
Income taxes payable	860	1,336
Accrued litigation reserve	7,657	7,604
Other accrued expenses	5,493	7,616
Customer deposits	262	401
Deferred revenue	18,733	16,437
Total current liabilities	43,467	36,160
Long-term portion of lines of credit and obligations under capital lease	—	209
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Convertible preferred stock, 5,000,000 shares authorized, none outstanding	—	—
Common stock, $.01 par value; 100,000,000 shares authorized; 27,722,298 and 27,279,365 shares issued and outstanding at October 31, 2004 and January 31, 2004, respectively	277	273
Additional paid-in capital	172,054	165,410
Accumulated deficit	(7,293)	(19,393)
Accumulated other comprehensive loss	(243)	(403)
Total stockholders' equity	164,795	145,887
	$ 208,262	$ 182,256

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

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

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
	(unaudited)			
Revenues:				
Systems	$ 31,349	$ 29,224	$ 94,969	$ 82,682
Services	11,248	8,933	32,294	26,596
	42,597	38,157	127,263	109,278
Cost of revenues:				
Systems	14,960	17,281	48,763	48,396
Services	6,732	5,542	19,029	16,980
	21,692	22,823	67,792	65,376
Gross profit	20,905	15,334	59,471	43,902
Operating expenses:				
Research and development	7,570	6,646	21,772	19,355
Selling and marketing	4,254	4,180	12,879	12,531
General and administrative	3,383	2,650	8,707	8,355
	15,207	13,476	43,358	40,241
Income from operations	5,698	1,858	16,113	3,661
Interest (expense) income, net	(371)	404	534	1,235
Impairment loss in investments in affiliate	—	—	—	(313)
Income before income taxes and equity income (loss) in earnings of affiliates	5,327	2,262	16,647	4,583
Income tax (benefit) expense	(112)	789	4,404	1,566
Equity income (loss) in earnings of affiliates	110	(9)	(143)	(49)
Net income	$ 5,549	$ 1,464	$ 12,100	$ 2,968
Basic income per share	$ 0.20	$ 0.05	$ 0.44	$ 0.11
Diluted income per share	$ 0.19	$ 0.05	$ 0.42	$ 0.11
Weighted average common shares outstanding:				
Basic	27,652	27,006	27,494	26,892
Diluted	29,097	28,117	28,854	27,669

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

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

	Nine months ended October 31, 2004	Nine months ended October 31, 2003
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 12,100	$ 2,968
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,160	5,561
Amortization of investment premiums	821	—
Equity loss in earnings of affiliates	143	49
Impairment loss on investment in affiliate	—	313
Inventory valuation charge	729	436
Amortization of deferred equity discount	—	3,787
Changes in operating assets and liabilities:		
Accounts receivable	(11,141)	(5,407)
Inventories	321	(4,005)
Prepaid expenses and other assets	131	1,277
Accounts payable	7,746	2,986
Income taxes payable	(605)	269
Accrued expenses	28	1,661
Customer deposits	(139)	(500)
Deferred revenue	2,296	2,810
Net cash provided by operating activities	17,590	12,205
Cash flows from investing activities:		
Purchases of property and equipment	(2,371)	(2,756)
Purchases of marketable securities	(3,541)	(6,910)
Proceeds from sale and maturity of marketable securities	3,048	4,143
Acquisition of business, net of cash acquired	(919)	—
Investment in affiliates	—	(105)
Restricted cash	(1,000)	—
Net cash used in investing activities	(4,783)	(5,628)
Cash flows from financing activities:		
Repayment of borrowings under construction loan	—	(915)
Repayment of obligations under capital lease	(297)	(107)
Proceeds from issuance of common stock	3,502	1,806
Net cash provided by financing activities	3,205	784
Net increase in cash and cash equivalents	16,012	7,361
Cash and cash equivalents, beginning of period	87,597	68,776
Cash and cash equivalents, end of period	$ 103,609	$ 76,137
Supplemental disclosure of noncash activities:		
Transfer of items originally classified as equipment to inventories	$ 156	$ 43
Transfer of items originally classified as inventories to equipment	$ 1,309	$ 1,543

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

SEACHANGE INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of SeaChange International, Inc. and its subsidiaries ("SeaChange" or the "Company"). SeaChange believes that the unaudited condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments), necessary for a fair statement of SeaChange's financial position, results of operations and cash flows at the dates and for the periods indicated. The results of operations for the periods presented are not necessarily indicative of results expected for the full fiscal year or any other future periods. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended January 31, 2004, included in SeaChange's Annual Report on Form 10-K for such fiscal year. The balance sheet at January 31, 2004 was derived from audited financial statements. In the three months ended October 31, 2004, SeaChange recorded a reduction to interest income to properly account for the amortization of market premiums and discounts on acquired marketable securities since December 2002 which reduced net income and accumulated other comprehensive loss by $519,000. SeaChange determined that the impact of the correction was not material to any historical reporting periods.

2. Revenue Recognition

Revenues from sales of systems and software license arrangements that do not require significant modification or customization of the underlying software are recognized when title and risk of loss has passed to the customer, there is evidence of an arrangement, fees are fixed or determinable and collection of the related receivable is probable. Installation, project management and training revenue is deferred and recognized as these services are performed. Revenue from technical support and maintenance is deferred and recognized ratably over the period of the related agreements. Customers are billed for installation, project management, training and maintenance at the time of the product sale. If a portion of the sales price is not due until installation of the system is complete, that portion of the sales price is deferred until installation is complete. Revenue from movie content services is recognized based on the volume of monthly purchases that are made by hotel guests. Revenue from product development contract services, primarily software development to improve integration between the set-top box and the video server, is recognized based on the efforts expended in relation to the overall efforts for the project, as agreements for these services are primarily on a time and material and fixed-price contract terms. Efforts are measured based on the time expected to be incurred. Shipping and handling costs and other out-of-pocket expenses reimbursed by customers are included in revenues and cost of revenues.

SeaChange's transactions frequently involve the sales of systems, software and services under multiple element arrangements. Systems sales always include at least one year of free technical support and maintenance services. Revenue under multiple element arrangements is allocated to all undelivered elements of the sales arrangement based upon the fair value of those elements. The amounts allocated to training, technical support and maintenance are based upon the price charged when these elements are sold separately and unaccompanied by the other elements. The amount allocated to installation and project management revenue is based upon standard hourly billing rates and the estimated time required to complete the service. The amount allocated to the sales of systems and software reflects the residual method basis. 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. Installation and training 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 including software licenses and services where vendor-specific objective evidence of the fair value does not exist to allocate a portion of the fee to the only undelivered elements, where the only undelivered element are technical support and maintenance services, the entire fee under the arrangement is recognized ratably over the period which technical support and maintenance is expected. For transactions in which consideration, including equity instruments, is given to a customer, SeaChange accounts for the value of this consideration as an adjustment to revenue in the Consolidated Statement of Operations (see Note 12).

Certain reclassifications have been made to conform the prior period amounts to the current period presentation. In the fourth quarter of the fiscal year ended January 31, 2004, the Company reclassified reimbursable service expenses to be consistent with EITF 01-14, "Income Statement Characterization of Reimbursements Received for Out of Pocket Expenses Incurred." As a result, amounts billed to customers for reimbursable out-of-pocket expenses of $607,000 for the three months ended October 31, 2003 and $1.5 million for the nine months ended October 31, 2003 have been reclassified from being an offset to cost of services revenue to an addition to services revenue. The amounts reclassified had no effect on current or previously reported income from operations, net income or earnings per share.

3. Stock Compensation

SeaChange accounts for its stock option plans and stock purchase plan under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and related interpretations and provides pro forma footnote disclosures as though the fair value method under SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123"), as

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, An Amendment of SFAS No. 123", was followed. Non-employee stock awards are accounted for in accordance with SFAS 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services". SeaChange's employee stock purchase plan is a non-compensatory plan and its stock option plans are accounted for using the intrinsic value method under the provisions of APB 25. Had compensation for SeaChange's stock based compensation plans been accounted for under the fair value method as proscribed by SFAS No. 123, the amounts reported in the Condensed Consolidated Statements of Operations for the three and nine months ended October 31, 2004 and 2003, would have been:

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
	(in thousands, except per share data)			
Net income, as reported	$ 5,549	$ 1,464	$ 12,100	$ 2,968
Less: Stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	2,260	1,771	5,876	5,938
Pro forma net income (loss)	$ 3,289	$ (307)	$ 6,224	$ (2,970)
Basic income (loss) per share				
As reported	$ 0.20	$ 0.05	$ 0.44	$ 0.11
Pro forma	$ 0.12	$ (0.01)	$ 0.23	$ (0.11)
Diluted income (loss) per share				
As reported	$ 0.19	$ 0.05	$ 0.42	$ 0.11
Pro forma	$ 0.11	$ (0.01)	$ 0.22	$ (0.11)

The fair value of each option granted was estimated on the date of grant assuming a weighted average volatility factor of 100% for the three and nine months ended October 31, 2003 and October 31, 2004. Additional weighted average assumptions used for grants during the three and nine months ended October 31, 2003 and October 31, 2004, included: dividend yield of 0.0% for all periods; risk-free interest rates of 2.0% for options granted during the three and nine months ended October 31, 2003; 2.5% for options granted during the three and nine months ended October 31, 2004; and an expected option term of 7.5 years for all periods.

Because additional option grants are expected to be made each period and options vest over several periods, the above pro forma disclosures are not representative of pro forma effects on reported net income (loss) for future periods.

4. Earnings Per Share

Earnings per share is presented in accordance with SFAS No. 128, "Earnings Per Share", ("SFAS 128") which requires the presentation of "basic" earnings per share and "diluted" earnings per share. Basic earnings per share is 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 warrants, calculated using the treasury stock method.

For the three and nine months ended October 31, 2004, 1,904,000 and 2,261,000, respectively, of common shares issuable upon the exercise of stock options have been excluded from the diluted income per share computation as the exercise prices of these options were above the market price of the common stock during the period indicated. For the three and nine months ended October 31, 2003, 2,954,000 and 3,112,000, respectively, of common shares issuable upon the exercise of stock options have been excluded from the diluted income per share computation as the exercise prices of these options were above the market price of the common stock during the period indicated.

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

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
	(in thousands)			
Weighted average shares used in calculating earnings per share—Basic	27,652	27,006	27,494	26,892
Dilutive common stock options	1,289	1,087	1,213	769
Common stock warrants	156	24	147	8
Weighted average shares used in calculating earnings per share—Diluted	29,097	28,117	28,854	27,669

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Inventories

Inventories consist of the following:

	October 31, 2004	January 31, 2004
	(in thousands)	
Components and assemblies	$ 12,985	$ 13,994
Finished products	4,550	5,744
	$ 17,535	$ 19,738

6. Comprehensive Income

SeaChange's comprehensive income was as follows:

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
	(in thousands)			
Net income	$ 5,549	$ 1,464	$ 12,100	$ 2,968
Other comprehensive income (expense), net of tax:				
Foreign currency translation adjustment, net of tax of $25, $23, $28, and $46 respectively	(48)	42	(51)	(4)
Unrealized gain (loss) on marketable securities, net of tax of $237, $34, $91 and $109, respectively	459	(63)	148	(196)
Other comprehensive income (loss)	411	(21)	97	(200)
Comprehensive income	$ 5,960	$ 1,443	$ 12,197	$ 2,768

7. Income Taxes

During the nine months ended October 31, 2004, SeaChange recorded income tax expense of $4.4 million. Included in the income tax expense was a $1.9 million benefit recorded for the implementation of a tax law change relating to the tax treatment of deferred revenues which resulted in the realization of a deferred tax asset and a corresponding valuation allowance release as SeaChange began to follow the same method for both book and tax purposes for recognizing revenue for maintenance service contracts. SeaChange had an effective income tax rate of 38% for the nine months ended October 31, 2004 before recording the adjustment discussed above. During the nine months ended October 31, 2003, SeaChange recorded income tax expense of $1.6 million, at an annual effective income tax rate of 34%. For the nine months ended October 31, 2003, the effective tax rate was favorably impacted by the utilization of the Company's remaining federal net operating loss carryforwards. As of October 31, 2004, SeaChange continued to record a full valuation allowance against its net deferred tax assets due to the uncertainty of their realization. SeaChange will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If the Company determines that it can continue to generate sufficient U.S. pre-tax income, some portion of the valuation allowance would be reversed and a corresponding increase in net income would be recognized.

8. Segment Information

SeaChange has three reportable segments: broadband systems, broadcast systems and services. The broadband systems segment develops, markets and sells products to digitally manage, store and distribute digital video for cable system operators and telecommunications companies. The broadcast systems segment develops, markets and sells products for the storage, archival, on-air

SEACHANGE INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

playback of advertising and other video programming for the broadcast television industry. The services segment provides installation, training, product maintenance and technical support for all of the above systems and movie content, which is distributed by the broadband product segment. SeaChange does not measure the assets allocated to the segments, other than the intangible assets and goodwill in connection with the acquisition of ZQ Interactive, Ltd. (see Note 9). SeaChange measures profitability of the segments based on their respective gross profits. There were no inter-segment sales or transfers. Long-lived assets are principally located in the United States. The following summarizes the revenues and cost of revenues by reportable segment:

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
	(in thousands)			
Revenues				
Broadband	$ 26,959	$ 27,190	$ 83,996	$ 73,770
Broadcast	4,390	2,035	10,973	8,912
Services	11,248	8,932	32,294	26,596
Total	$ 42,597	$ 38,157	$ 127,263	$ 109,278
Costs of revenues				
Broadband	$ 12,362	$ 16,053	$ 41,580	$ 42,513
Broadcast	2,598	1,228	7,183	5,883
Services	6,732	5,542	19,029	16,980
Total	$ 21,692	$ 22,823	$ 67,792	$ 65,376
Gross profit				
Broadband	$ 14,597	$ 11,137	$ 42,416	$ 31,257
Broadcast	1,792	807	3,790	3,029
Services	4,516	3,390	13,265	9,616
Total	$ 20,905	$ 15,334	$ 59,471	$ 43,902

The following summarizes revenues by geographic locations:

Revenues				
United States of America	$ 32,600	$ 34,601	$ 104,203	$ 95,880
Canada and South America	778	323	5,493	3,079
Europe	5,154	1,444	10,200	4,120
Asia Pacific and rest of world	4,065	1,789	7,367	6,199
Total	$ 42,597	$ 38,157	$ 127,263	$ 109,278

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

	Three months ended		Nine months ended	
	October 31, 2004	October 31, 2003	October 31, 2004	October 31, 2003
Customer A	49%	55%	55%	52%
Customer B	—	11%	—	—

International sales accounted for approximately 23% and 9% of total revenues in the three-month periods ended October 31, 2004 and October 31, 2003, respectively. International sales accounted for approximately 18% and 12% in the nine-month periods ended October 31, 2004 and October 31, 2003, respectively. For the three and nine month periods ended October 31, 2004 and 2003, substantially all sales of the Company's systems were made in United States dollars. Therefore, SeaChange has not experienced any material impact from fluctuations in foreign currency exchange rates on our results of operations or financial position. If this practice changes in the future, the Company will reevaluate its foreign currency exchange rate risk.

SEACHANGE INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

At October 31, 2004, one customer accounted for 55% of the accounts receivable and at January 31, 2004 the same customer accounted for 22% of the accounts receivable.

9. Acquisition

On May 17, 2004, SeaChange acquired all of the outstanding stock of ZQ Interactive, Ltd., a company incorporated in the British Virgin Islands with its principal office in Shanghai, China, for $2.0 million in cash. According to the terms of the purchase agreement, $1.0 million was paid to the sellers at the signing of the purchase agreement and the remaining $1.0 million will be paid to the sellers in two equal annual installments of $500,000 on the first and second anniversary dates of the signing of the purchase agreement. The acquisition was accounted for under the purchase method of accounting. Accordingly, the financial position and results of operations of ZQ Interactive have been consolidated subsequent to the acquisition date. SeaChange allocated $56,000 of the purchase price to the acquired tangible net assets and liabilities including accounts receivable, prepaid expenses and accounts payable. In addition, $520,000 of the purchase price was allocated to the acquired intellectual property. The Company determined the value of the intellectual property based on the net present value of the expected cash flows over the expected life of the intellectual property of five years. The intellectual property intangible asset will be amortized over a five year period on an accelerated basis, reflecting the expected period that the assets will be consumed. The remaining purchase price of $1.6 million including related acquisition costs was determined to be goodwill and will be periodically reviewed in accordance with Statement of Financial Accounting Standards 142, “Goodwill and Other Intangible Assets”. The acquired assets are part of the broadband segment. Pro forma results of operations are not presented as the amounts are not material to the Company’s condensed consolidated financial statements.

10. Goodwill and Intangible Assets

At October 31, 2004, the Company had goodwill of $1.9 million which included $1.6 million of goodwill acquired as part of the ZQ Interactive acquisition in the second quarter of fiscal 2005 (see Note 9). Goodwill is reported as part of the broadband reporting segment.

The Company’s intangible assets consist of patent costs and intellectual property, which are part of the broadband reporting segment. At October 31, 2004, the gross carrying value of these intangible assets was $6.2 million and the accumulated amortization was $5.6 million. At January 31, 2004, the gross carrying value of these intangible assets was $5.7 million and the accumulated amortization was $4.4 million**.** SeaChange’s intangible assets are amortized on both a straight-line and accelerated basis over a period of up to 5 years, reflecting the expected period that the assets will be consumed. Amortization expense for intangible assets was $396,000 and $400,000 for the three months ended October 31, 2004 and 2003, respectively. Amortization expense for intangible assets was $1.2 million for both nine month periods ended October 31, 2004 and 2003, and is estimated to be approximately $1.3 million in fiscal 2005, $235,000 in fiscal 2006, $175,000 in fiscal 2007, $50,000 in fiscal 2008 and $20,000 in fiscal 2009.

11. Commitments and Contingencies

Litigation Regarding SeaChange Patent No. 5,862,312.

On June 13, 2000, SeaChange filed in the United States District Court for the District of Delaware a lawsuit against one of SeaChange’s competitors, nCube Corp., whereby SeaChange alleged that nCube’s MediaCube-4 product infringed a patent held by SeaChange (Patent No. 5,862,312) (“`312”) relating to SeaChange’s MediaCluster technology. In instituting the claim, SeaChange sought both a permanent injunction and damages in an unspecified amount. nCube made a counterclaim against SeaChange that SeaChange’s patent was invalid and that nCube’s MediaCube-4 product did not infringe SeaChange’s patent. On September 6, 2000, nCube conceded that, based on a claim construction ruling issued by the district court in August 2000, nCube’s MediaCube-4 product infringed SeaChange’s patent. On September 25, 2000, a jury upheld the validity of SeaChange’s patent. On March 28, 2002, the district court denied nCube’s motion for a new trial and on September 30, 2002, the district court denied nCube’s motions for judgment as a matter of law. The District Court’s September 30, 2002 order provided no explanation of the court’s reasoning, but indicated that a memorandum opinion would subsequently be issued.

On October 29, 2002, nCube filed a notice of appeal of the district court’s September 30, 2002 orders, and also filed a motion with the United States Court of Appeals for the Federal Circuit seeking to stay the appeal pending issuances of the district court’s memorandum opinion. On January 29, 2003, the Federal Circuit Court of Appeals issued an order staying nCube’s appeal pending issuance of a memorandum opinion by the district court. On November 3, 2003, the Federal Circuit Court of Appeals issued an order dismissing nCube’s appeal for lack of jurisdiction, as a final judgment had not yet been entered in the district court case. Any damages and injunctive relief against nCube will not be awarded until after appeal.

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On April 7, 2004, the District Court issued its Memorandum Opinion which sets forth its reasoning for the September 30, 2002 order. On April 29, 2004, the District Court entered a judgment denying nCube's claim that the '312 patent is invalid. On May 5, 2004, nCube filed a notice of appeal purporting to appeal from the District Court's April 29, 2004 judgment and that appeal is now pending.

On March 26, 2002, nCube Corp. filed a complaint against SeaChange in the United States District Court for the District of Delaware seeking a declaratory judgment that its redesigned MediaCube-4 product does not infringe U.S. Patent No. 5,862,312 held by SeaChange. The complaint also alleges that nCube has been damaged by a certain statement made by SeaChange's Chief Executive Officer during a public conference call to discuss SeaChange's earnings on March 5, 2002. nCube is seeking a public retraction of the statement and damages in an unspecified amount. On April 15, 2002, SeaChange moved to dismiss all claims on the grounds that the patent-related issues are currently pending before the Court in the lawsuit previously filed by SeaChange, and the district court lacks jurisdiction over the remaining claims. On June 25, 2002, the district court stayed that action pending resolution of the appeal in the previously filed lawsuit.

Litigation Regarding nCube Patent No. 5,805,804

On January 8, 2001, nCube Corp. filed a complaint against SeaChange in the United States District Court for the District of Delaware alleging that SeaChange's use of SeaChange's MediaCluster, MediaExpress and Media Server technology each infringe Patent No. 5,805,804 held by nCube ("`804"). In instituting the claim, nCube sought both an injunction and monetary damages. On May 29, 2002, the jury rendered a verdict that SeaChange infringed the nCube `804 patent. The jury determined a reasonable royalty rate of 7% on sales of allegedly infringing video-on-demand products. The jury also determined that damages through January 31, 2002 amounted to approximately $2.0 million and that SeaChange's infringement was willful. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," ("SFAS No. 5") SeaChange recorded certain charges to reflect this unfavorable jury verdict against SeaChange in the first quarter of fiscal 2003. The charges recorded totaled $14.4 million and included provisions for estimated damages of $2.8 million and treble damages of $5.6 million related to the shipments of the accused video-on-demand ("VOD") systems through April 30, 2002, legal fees of $3.6 million incurred by SeaChange in defense of this patent, including $1.5 million of deferred legal costs included in other assets as of January 31, 2002, and estimated nCube legal fees of $2.0 million, and accrued interest on total damages of $418,000.

In response to certain post-trial motions filed by SeaChange and nCube in 2002, the district court issued on March 31, 2003 two orders in the '804 infringement case and on April 7, 2004 issued the related memorandum opinion explaining the scope of and basis for the orders. The first order ruled on the post-trial motions filed by nCube and SeaChange. The district court denied SeaChange's motion for judgment as a matter of law with regard to literal infringement and validity. However, the court granted SeaChange's motion for judgment as a matter of law with regard to infringement under the doctrine of equivalents, finding that this was not sufficiently established during trial. The district court denied SeaChange's motion for a new trial and awarded nCube enhanced damages of two times the jury award ($4.1 million) and two-thirds of its attorney's fees ($1.8 million). The district court also awarded nCube pre-judgment interest ($62,000) and post-judgment interest, ordering that nCube submit to the court an updated post-judgment interest calculation within twenty (20) days of receipt of the April 7, 2004 memorandum. As detailed below, nCube submitted this updated post-judgment interest calculation on April 27, 2004. The court also denied nCube's motion for a permanent injunction and an accounting, as the parties intend to appeal both this case and the litigation regarding the '312 patent detailed above, and the court having granted SeaChange's motion for judgment as a matter of law with regard to infringement under the doctrine of equivalents. Additionally, the court ruled that it would consider the supplemental declaration of one of SeaChange's witnesses for the limited purpose of establishing SeaChange's conduct during litigation, but would disregard the substantive content of the declaration. The second order issued by the court on March 31, 2003 denied a number of outstanding pre-trial motions as moot.

On April 8, 2003, nCube submitted to the district court a post-judgment calculation of damages which applied the 7% royalty rate to the sales of the allegedly infringing video-on-demand products during the months of February, March, April and May of 2002 and which included post-judgment interest through April 8, 2003. nCube's submission calculated the base amount of actual damages to be $2.8 million, resulting in a revised amount of enhanced damages of $5.6 million. nCube's submission also sought post-judgment interest of $34,000.

On April 10, 2003, nCube filed a notice of appeal from the district court orders issued March 31, 2003.

On April 28, 2003, SeaChange filed a notice of appeal, appealing from the judgment and from other adverse rulings by the district court. SeaChange also filed a motion with the Federal Circuit Court of Appeals seeking to stay nCube's appeal pending the issuance of a written opinion by the district court explaining its March 31, 2003 orders. On May 29, 2003, the Court of Appeals allowed SeaChange's motion and ordered the appeals stayed pending the issuance of a memorandum opinion by the district court, which was issued on April 7, 2004. Accordingly, the stay in the appeals has been lifted and the appeal is now pending.

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Based on the court order issued on March 31, 2003 and the subsequent court filing by nCube on April 8, 2003, SeaChange adjusted its accrued litigation reserve in the fourth quarter of fiscal 2003 by reducing the estimated damages by $2.8 million, the estimated nCube legal costs by $160,000 and the pre-judgment and post-judgment interest charges by $600,000. The legal fees incurred through May 29, 2002 of $3.6 million includes the write-off of $1.5 million of SeaChange's deferred legal fees included in other assets as of January 31, 2002, which was expensed in the first quarter of fiscal 2003 as well as SeaChange's fees of $2.1 million incurred related to pre-verdict legal services.

The following is a summary of the accrued litigation reserve through October 31, 2004:

Estimated damages on the accused VOD shipments through April 30, 2002	$ 2,787,000
Estimated treble damages on the accused VOD shipments through April 30, 2002	5,574,000
Estimated legal fees (including write-off of capitalized legal costs and nCube legal fees)	5,621,000
Accrued interest on estimated damages and treble damages through April 30, 2002	418,000
Total charges recorded as of April 30, 2002	14,400,000
Additional accrued interest on estimated damages through January 31, 2004	362,000
Adjustment to litigation reserve based on March 31, 2003 court order and April 8, 2003 court filing	(3,537,000)
Legal expenses paid through January 31, 2004	(3,621,000)
Accrued litigation reserve as of January 31, 2004	7,604,000
Additional accrued interest on estimated damages through October 31, 2004	53,000
Accrued litigation reserve as of October 31, 2004	$ 7,657,000

This reserve reflects SeaChange's best estimate of SeaChange's exposure based on information currently available. However, SeaChange believes that any liability ultimately incurred after pursuing all legal options will not likely exceed the accrued litigation reserve as of October 31, 2004, except for on-going legal fees associated with the dispute and additional interest on the awarded damages, which will be charged to operations. Other than the payment of SeaChange's legal fees, any payment of the other recorded charges will only occur in the event that the jury verdict is upheld in appeal. SeaChange has appealed the district court's judgment to the United States Court of Appeals for the Federal Circuit. Any injunctive relief against SeaChange will not be determined until after appeal. In the event that the court issues an injunction prohibiting SeaChange from selling the accused video-on-demand products, SeaChange believes that such injunction would have a minimal impact on SeaChange's ability to ship products and meet customer demands because SeaChange has implemented a revised version of the software which SeaChange believes does not infringe the nCube `804 patent.

On April 7, 2004, the District Court issued a Memorandum Opinion explaining its reasoning for the March 31, 2003 order. The District Court also issued an order on April 7, 2004 modifying the March 31, 2003 order providing nCube with 20 days to update its post-judgment interest calculation. On April 27, 2004, nCube submitted an updated post-judgment interest calculation of $131,174 as of April 26, 2004.

As discussed above, the appeals with respect to the '312 patent and the '804 patent are now pending.

In addition nCube has asserted that SeaChange infringes several other patents and that it may take legal action in the future. SeaChange believes that SeaChange does not infringe any valid claim in these other patents.

We are aware that on October 20, 2004, nCube announced that C-COR had entered into an agreement with it to acquire the business of nCube, with an anticipated closing date in the second quarter of C-COR's fiscal year 2005. Information relating to the structure of the transaction has not yet been publicly announced by the parties, so the impact of the transaction on this litigation is not yet known.

Securities Class Action Litigation

From October 30, 2002 to January 13, 2003, six purported securities class action lawsuits, all alleging nearly identical claims, were filed in the United States District Court for the District of Massachusetts against SeaChange, Morgan Stanley & Co. Incorporated, Thomas Weisel Partners LLC, RBC Dain Rauscher, Inc., William C. Styslinger, III, William Fiedler, Martin R. Hoffmann, Thomas F. Olson and Carmine Vona. On April 3, 2003, the Court consolidated these complaints into one action captioned: *In re SeaChange International, Inc., et al. Securities Litigation*, Civil Action No. 02-12116-DPW. On May 16, 2003, the plaintiffs filed a consolidated and amended class action complaint (the "Complaint"). In the Complaint, the plaintiffs allege that the defendants violated Sections 11 and/or 12(2) of the Securities Act of 1933 (the "Securities Act"), and in the case of the individual defendants Section 15 of the Securities Act, in connection with the stock offering that SeaChange completed on January 31, 2002. The Complaint seeks damages in an unspecified amount, together with interest thereon, recissory damages, reimbursement of costs and expenses, and further relief that the court may determine to be appropriate. SeaChange believes that the allegations in the Complaint are without merit. On July 18, 2003, SeaChange and the individual defendants filed a motion to dismiss all claims in their entirety, with prejudice. The lead plaintiff's opposition to the motion to dismiss was filed on September 12, 2003, and the defendants' reply memorandum was filed on October 8, 2003. A hearing on the motion to dismiss took place on January 16, 2004. On February 6, 2004, Judge Woodlock of the United States District Court for the District of Massachusetts issued a memorandum granting the motion to dismiss all claims asserted against the Company and the individual defendants, and an order of dismissal was entered by the court on February 9, 2004. On February 19, 2004, the lead plaintiff filed a notice of appeal to the United States Court of Appeals for the First Circuit from the memorandum and order granting the motion to dismiss all claims in their entirety.

General

SeaChange cannot be certain of the outcome of the foregoing current or potential litigation, but SeaChange plans to vigorously defend itself against allegations made against SeaChange and oppose allegations that may be brought against SeaChange in the future. Accordingly, SeaChange is unable to determine the ultimate impact of this litigation on SeaChange's business, financial condition and results of operations or cash flows.

Guarantees and Indemnification Obligations

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 commencing from installation. In addition, upon the sale of its systems, SeaChange provides maintenance support to all customers and therefore allocates a portion of the systems 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. For maintenance support agreements that extend beyond the standard warranty term, revenue is deferred and recognized on a straight line basis over the contract period. Any related costs are expensed as incurred. At October 31, 2004 and January 31, 2004, SeaChange had deferred revenue related to maintenance support agreements of $15.6 million and $14.6 million, respectively.

12. Comcast Equity Investment and Video-on-Demand Purchase Agreements

In the fourth quarter of fiscal year 2001, SeaChange entered into a video-on-demand purchase agreement with Comcast Cable Communications of Pennsylvania, Inc. ("Comcast") to provide SeaChange's interactive television video servers and related services. Under the terms of the video-on-demand purchase agreement, Comcast committed to purchase SeaChange equipment capable of serving a minimum of one million cable subscribers by approximately December 2002. In addition, Comcast could earn up to an additional 450,000 incentive common stock purchase warrants through December 2003 based on the number of cable subscribers in excess of one million served by SeaChange's equipment which was purchased by Comcast. In connection with the execution of this commercial agreement, SeaChange entered into a common stock and warrant purchase agreement, dated as of February 28, 2001, with Comcast SC Investment, Inc. ("Comcast SC"), whereby Comcast SC agreed to purchase an aggregate of 756,144 shares of SeaChange's common stock for $10.0 million and Comcast SC received a warrant to purchase 100,000 shares of SeaChange's common stock with an exercise price of $13.225 per share. Under conditions of the arrangement, the number of common shares purchased and the number of common stock purchase warrants and related exercise price were subject to adjustment. In accordance with the agreement, an additional 25,000 common stock purchase warrants were issued as the registration statement had not been declared effective on or before March 31, 2001. On June 13, 2001, the effective date of the registration statement, SeaChange issued an additional 14,667 common stock purchase warrants in accordance with the agreement.

SeaChange determined the intrinsic value of $586,000 related to the 756,144 shares of common stock purchased on February 28, 2001 and measured the fair value of $1.1 million related to the 100,000 common stock purchase warrants as of the closing date. These amounts were recorded as contra-equity. On April 30, 2001, SeaChange recorded an additional contra-equity amount of $325,000 for the fair value of the additional 25,000 common stock purchase warrants of SeaChange common stock issued on March 31, 2001, and on June 13, 2001 recorded an additional contra equity amount of $335,000 representing the incremental fair value of the 14,667 common stock purchase warrants of SeaChange common stock issued on that date. The total contra-equity amount of $2.4 million was amortized as an offset to gross revenue in proportion to the revenue recognized from the sale of equipment with respect to the first one million subscribers Comcast has committed to under the video-on-demand purchase agreement.

During the three months ended July 31, 2003 and April 30, 2003, Comcast earned an additional 109,142 and 92,113, respectively, of incentive common stock purchase warrants based on the number of cable subscribers in excess of the first one million subscribers. The estimated fair value of the common stock purchase warrants was based on the average closing market price of SeaChange's common stock for the last fifteen trading days in each of those periods. SeaChange recorded $1,012,000 and $575,000 as an offset to gross product revenue during the three months ended July 31, 2003 and April 30, 2003, respectively, representing the estimated fair value of the additional incentive common stock purchase warrants and the revaluation of incentive common stock purchase warrants earned by Comcast in prior quarterly periods but not issued as of those dates.

As of December 31, 2003, Comcast had earned the remaining incentive common stock purchase warrants available under the video-on-demand purchase agreement. The estimated fair value of the common stock purchase warrants was based on the average closing market price of SeaChange's common stock for the last fifteen trading days ended on each of the determination dates of December 31, 2002, June 30, 2003 and December 31, 2003, the final determination date of the agreement. In October 2004, SeaChange issued Comcast the remaining 433,878 incentive common stock purchase warrants. The original estimate of the value of the warrants was based on management's determination that Comcast earned the incentive common stock warrants when SeaChange's VOD equipment was delivered to Comcast and SeaChange recorded the revenue. SeaChange agreed to revise the number of incentive common stock purchase warrants to be issued at each of the determination dates defined above when SeaChange reached a final agreement with Comcast on when the warrants were earned. As a result of the adjustment, SeaChange determined that the estimated fair market value of the incentive common stock purchase warrants was lower than the amount that it had been previously recorded, which resulted in a $1.1 million reduction in the accrual estimate with an offsetting increase in product revenues in the accompanying income statement for the period.

13. Investments in Affiliates

Visible World. In the fourth quarter of fiscal year 2002, SeaChange entered into a Joint Development and Marketing Agreement with Visible World. The purpose of the partnership is to integrate the advertising insertion product offerings that SeaChange offers with the software technologies of Visible World, which would enable advertisers an end-to-end solution for providing target advertising to their customers. Commencing on November 29, 2002, the agreement is terminable on 90-days notice given by either party. In conjunction with the arrangement, Visible World issued SeaChange a fully vested warrant to purchase one million shares of Series B Preferred Stock at an exercise price of $0.01 per share. The warrant expires at the earliest of a) the consummation of a qualified public offering, as defined in the agreement, by Visible World, b) the sale of Visible World, as defined in the warrant agreement and c) 10 years. Because the issuance of the warrant to SeaChange under the terms of the agreement is in exchange for services to be provided by SeaChange, the warrant is accounted for under the guidance of EITF 00-08, "Accounting by a Grantee for an Equity Instrument to be Received in Conjunction with Providing Goods or Services." Management determined the fair value of the warrant as of the date of the grant based on available financial information using the Black-Scholes valuation model. The assumptions used in this valuation included: a fair value of Visible World stock of $0.50 per share, a weighted average volatility factor of 100%, a dividend yield of 0.0%, a risk-free interest rate of 4.22%, and an expected warrant term of 5 years. SeaChange recorded the value of the warrant of $493,000 as a long-term investment included in investments in affiliates with an offsetting amount included in deferred revenue. SeaChange is recognizing the deferred revenue over the expected term of the services ending in the fourth quarter of fiscal year 2007.

In August 2003, Visible World completed the first phase of a private financing in which it raised $4.6 million in exchange for preferred stock. As a result of the financing, SeaChange determined that the fair value of the warrant had declined and recorded a $313,000 charge related to the other than temporary loss on the investment. In connection with this financing, SeaChange's warrant to purchase one million shares of Series B preferred stock of Visible World was amended to be exercisable for one million shares of common stock of Visible World; and SeaChange exercised the warrant to purchase the one million shares of Visible World common stock. SeaChange subsequently exchanged 95,517 shares of Visible World common stock for 1,192,311 shares of Series A-1 Preferred Stock. In addition, as part of Visible World's private financing, SeaChange invested $96,000 for an additional 1,192,311 shares of Series A-1 Preferred Stock. In January 2004, SeaChange and Visible World signed a revised Marketing Agreement in which SeaChange agreed to receive warrants to purchase 2.8 million shares of preferred stock of Visible World in lieu of future royalties that would have been earned by SeaChange relating to revenue earned by Visible World in accordance with an agreement between Visible World and Comcast Cable Corporation. The warrants will vest over the five year term of the agreement between Visible World and Comcast. SeaChange estimated the fair value of these warrants to be $223,000 and included the amount in investments in affiliates with an offsetting amount included in deferred revenue. SeaChange is recognizing the deferred revenue over the five year term of the agreement. As of October 31, 2004, SeaChange owned less than 5% of the common and preferred stock of Visible World and is accounting for this investment under the cost method of accounting.

On Demand Group. In the third quarter of fiscal year 2003, SeaChange entered into a Subscription and Shareholders Agreement (the "Subscription Agreement") with The ON Demand Group Limited ("ODG"), a company incorporated in England and Wales that provides consulting and management services in Europe. Pursuant to the Subscription Agreement, the Company invested 1.5 million U.K. pounds Sterling (approximately $2.4 million) in exchange for 600,000 ordinary shares of ODG representing approximately 23% of the total outstanding capital stock of ODG as of October 29, 2002. As part of the Subscription Agreement, SeaChange committed to purchase additional ordinary shares and preference shares of ODG from ODG and certain of its existing shareholders under certain conditions, including that ODG had entered into certain agreements including a Carriage Agreement and Shareholders Agreement with a European cable operator and that the agreements were in a form and substance satisfactory to SeaChange. ODG never entered into all of the required agreements before the Subscription Agreement was amended in October 2003 to eliminate the subscription obligation and SeaChange at no time had an obligation to purchase such additional shares. In connection with ODG's plan to develop and deploy a new video-on-demand television management service in the future, SeaChange entered into a Business Development Agreement with ODG for a minimum of five years whereby ODG agreed to exclusively purchase and to market and promote the Company's video-on-demand systems and software worldwide.

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In October 2003, the Subscription Agreement with ODG was amended to remove SeaChange's commitment to purchase additional ordinary and preference shares from ODG and certain of its existing shareholders. As part of the amended Subscription Agreement, SeaChange committed to loan ODG up to 5.5 million U.K. pounds Sterling (approximately $10.5 million) payable in tranches of 500,000 U.K. pounds Sterling or multiples thereof. ODG's ability to draw-down the loan is subject to certain milestones and draw-down conditions, including the deployment of new video-on-demand television management service, no material adverse change in ODG's business, and ODG's business having performed to within 95% of its operating costs and cash flows as set forth in its business plan. Any outstanding loan amounts would mature five years from the date of the first draw-down and interest is payable quarterly at the rate of 8.1% per annum. No amounts are outstanding as of October 31, 2004.

In December 2003, SeaChange purchased 117,647 common shares of ODG from its principal owners for 400,000 U.K. pounds Sterling (approximately $692,000) increasing SeaChange's ownership percentage to 28% as of that date. SeaChange accounts for this investment under the equity method of accounting.

In July 2004, the Business Development Agreement with ODG was amended to include a referral fee based upon a percentage of gross revenues, if any, that may be generated by SeaChange through the term of the agreement. SeaChange has determined that this additional activity is not significant and did not require reconsideration as to whether ODG is a variable interest entity.

14. New Accounting Pronouncements

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46") and, in December 2003, issued a revision to that interpretation ("FIN No. 46R"). FIN No. 46R replaces FIN No. 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary is required to consolidate the financial position and results of the VIE. SeaChange evaluated its relationships with equity method investments and determined that the adoption of FIN 46R in the quarter ended April 30, 2004 had no impact on the Company's consolidated financial position, results of operations or cash flows.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on EITF No. 03-06, "Participating Securities and Two-Class Method under FASB Statement No. 128, "Earnings Per Share." EITF 03-6 is intended to clarify what is a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of this pronouncement had no impact on the Company's consolidated financial position, results of operations or cash flows.

In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs - an Amendment of ARB No. 43, Chapter 4" ("FAS 151"). FAS 151 amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this Statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of the provisions of FAS 151 is not expected to have a material impact on SeaChange's financial position or results of operations.

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

Factors That May Affect Future Results

Any statements contained in this Form 10-Q that do not describe historical facts may constitute forward-looking statements as that term is defined in the Private Securities Litigation Reform Act of 1995. These statements relate to future events or our future financial performance and are identified by words such as "may," "will," "could," "should," "expect," "plan," "intend," "seek," "anticipate," "believe," "estimate," "potential," or "continue" or other comparable terms or the negative of those terms. Forward-looking statements in this Form 10-Q include certain statements regarding the effect of certain accounting standards on our financial position and results of operations, the effect of certain legal claims against us, projected changes in our revenues, earnings and expenses, exchange rate sensitivity, interest rate sensitivity, liquidity, product introductions and general market conditions. Our actual future results may differ significantly from those stated in any forward-looking statements. Any such forward-looking statements contained herein are based on current expectations, but are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. The factors that could cause actual future results to differ materially from current expectations include the following: the continued growth, development and acceptance of the video-on-demand market; the loss of one of our large customers; the cancellation or deferral of purchases of our products; the length of our sales cycles; a decline in demand or average selling price for our broadband products; our ability to manage our growth; the effectiveness of our disclosure controls and procedures and internal controls over financial reporting; our ability to protect our intellectual property rights and the expenses that may be incurred by us to protect our intellectual property rights; an unfavorable result of current or future litigation, including our current patent litigation with nCube Corp.; content providers limiting the scope of content licensed for use in the video-on-demand market; our ability to introduce new products or enhancements to existing products; our dependence on certain sole source suppliers and third-party manufacturers; our ability to compete in our marketplace; our ability to respond to changing technologies; the risks associated with international sales; the performance of companies in which we have made equity investments, including the ON Demand Group Limited and Visible World; our ability to integrate the operations of acquired subsidiaries; changes in the regulatory environment; our ability to hire and retain highly skilled employees; and increasing social and political turmoil.

Further information on factors that could cause actual results to differ from those anticipated is detailed in various filings made by us from time to time with the Securities and Exchange Commission, including but not limited to, those appearing under the caption "Certain Risk Factors That May Affect Our Business" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 14, 2004 and those appearing under the caption "Factors That May Affect Future Results" in our Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on September 9, 2004. Any forward-looking statements should be considered in light of those factors.

Overview

We are a leading developer, manufacturer, and marketer of systems, known as video-storage servers, that automate the management and distribution of both long-form video streams, such as movies or other feature presentations, and short-form video streams, such as advertisements.

We have three reportable segments: broadband systems, broadcast systems and services. The broadband systems segment includes products, such as our digital advertising and video-on-demand products, that digitally manage, store and distribute digital video for cable system operators and telecommunications companies. The broadcast systems segment includes products for the storage, archival, and on-air playback of advertising and other video programming for the broadcast television industry. Our system revenues are comprised of sales of our broadband and broadcast systems. The service segment is comprised of revenue related to product development contracts, installation, project management, training, product maintenance and technical support for all of the above systems, and delivery of content which is distributed by the broadband systems and software segment.

We have experienced fluctuations in our systems revenues from quarter to quarter due to the timing of 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: (1) the customer's obtaining authorized signatures on their purchase orders, (2) budgetary approvals within the customer's company for capital purchases and (3) 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: (1) the availability of material to produce the product, (2) the time required to produce and test the system before delivery and (3) 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 systems sold and services provided, pricing, costs of materials used in our products, concentration of customers and the expansion of our operations during the fiscal year. We price our systems and services based upon our costs as well as in consideration of the prices of competitive products and services in the marketplace. The costs of our systems primarily consist of the costs of components and subassemblies that have generally declined over time. As a result of the growth of our business, our operating expenses have fluctuated in the areas of research and development, selling and marketing, customer service and support and administration and are expected to increase as our revenues increase. Despite the limited economic recovery, we expect that our cable and broadcast customers may still have limited capital spending budgets as we believe they are dependent on advertising revenues to fund their capital equipment purchases.

Accordingly, we expect our financial results to vary from quarter to quarter and our historical financial results are not necessarily indicative of future performance.

Our ability to continue to generate revenues within the markets in which our systems are sold and net income is dependent on several factors which include: (1) market acceptance of the systems and services offered by our customers and increased subscriber usage and demand for these systems and services; (2) selection by our customers of our systems and services versus the systems and services being offered by our competitors; (3) our ability to introduce new systems to the market in a timely manner and to meet the demands of the market for new systems and systems enhancements; (4) our ability to maintain gross margins from the sale of our systems 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; and (5) our ability to control operating costs given the fluctuations that we have experienced with revenues from quarter to quarter.

In the nine months ended October 31, 2004, our total revenues grew 17% to $127.3 million from the same period in 2003 compared to 7% growth to $109.3 million in the nine months ended October 31, 2003 compared to the same period in fiscal 2002. The growth in revenues is primarily attributed to our broadband segment, in which video-on-demand systems revenues rose 28% to $74.2 million in the nine months ended October 31, 2004 over the same period in fiscal 2003 and 25% to $57.9 million in the nine months ended October 31, 2003 compared to the same period in the previous fiscal year. This significant growth in systems revenues reflects the expanding deployment of residential video-on-demand systems by cable operators throughout the United States of America and the start of deployments in Europe and Asia. We expect video-on-demand systems revenues will increase in fiscal 2005 as compared to fiscal 2004, depending upon their continued acceptance in key regional domestic markets and their initial deployment throughout Asia and Europe during the fourth quarter of fiscal 2005. Services revenues also continued to grow, by 21% to $32.3 million in the nine months ended October 31, 2004 over the same period in fiscal 2003 and 12% in the nine months ended October 31, 2003 compared to the same period in the previous year. This sustained growth is primarily attributed to providing technical support and maintenance services to customers with an ever expanding base of equipment installed at their sites.

Our advertising systems revenues, which are included in our broadband segment, decreased 38% to $9.8 million in the nine months ended October 31, 2004 from the same period in 2003 which compares to a decrease of 4% in the nine months ended October 31, 2003 over the same period in the previous year. We believe the decrease in advertising systems revenues reflects a decline in demand for analog advertisement systems from cable operators as cable operators migrate from an analog to a digital network environment. We expect sales of advertising systems to be lower in fiscal 2005 as compared to fiscal 2004. Our broadcast systems revenue increased 23% to $11.0 million in the nine months ended October 31, 2004 from the same period in fiscal 2003 which compares to a decrease of 41% in the nine months ended October 31, 2003 over the same period in the previous year. We expect sales of broadcast systems to remain relatively flat in fiscal 2005 as compared to fiscal 2004.

Gross profits increased 7 percentage points to 47% in the nine months ended October 31, 2004 over the same period in 2003 in comparison to a 3 percentage point increase in the nine months ended October 31, 2003 over the same period in the previous year. Higher sales volume and lower manufacturing and material costs per unit primarily contributed to this favorable performance, even though competitive pressures resulted in lower average selling prices per unit in fiscal 2005. In addition, gross margins were favorably impacted by the $1.1 million adjustment to product revenue recorded related to the final agreement with Comcast (See Note 12 to Financial Statements) in connection with the issuance of incentive common stock warrants. We believe these competitive pressures will continue and our ability to maintain gross margins will be dependent upon maintaining current levels of revenues and achieving technological advances that will further reduce material costs of sales.

Our revenue growth and improving gross margin resulted in net income of $12.1 million or $0.42 per diluted share in the nine months ended October 31, 2004 as compared to net income of $3.0 million or $0.11 per diluted share in the same period in 2003. This improvement in operating results enabled us to generate $17.6 million of cash from operations during the nine months ended October 31, 2004 in comparison to $12.2 million in the nine months ended October 31, 2003.

Acquisition

In May 2004, we acquired all of the outstanding stock of ZQ Interactive, Ltd., a company incorporated in the British Virgin Islands with its principal office in Shanghai, China, for $2.0 million in cash. Accordingly, the financial position and results of operations of ZQ Interactive have been consolidated subsequent to the acquisition date; the impact of this consolidation has not been material to our condensed consolidated financial statements for the periods presented. For discussion of the accounting treatment of the transaction, see Note 9 of the accompanying financial statements.

Summary of Critical Accounting Policies; Significant Judgments and Estimates

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

A summary of those accounting policies that we believe are most critical to fully understand and evaluate our financial results is set forth in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 14, 2004.

Accounting for Acquisitions

We have completed business acquisitions which have resulted in goodwill and other intangible asset balances. Our business strategy contemplates that we may continue to pursue additional acquisitions in the future. Our accounting for acquisitions involves judgments and estimates primarily, but not limited to: the fair value of certain forms of consideration, of acquired intangible assets, which involve projections of future revenues and cash flows, of other acquired assets and assumed liabilities, including potential contingencies, and the useful lives of intangible assets of acquisitions. Changes in assumptions and estimates related to acquisitions could have a material impact on our financial position or results of operations.

Accounting for Income Taxes

We record income taxes using the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards. We evaluate the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. We are required to establish a valuation allowance if the likelihood of realization of the deferred tax assets is reduced based on an evaluation of objective verifiable evidence. Significant management judgment is required in determining our income tax expense (benefit), our deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets. In fiscal 2003, we established a valuation allowance against our deferred tax assets due to indications that they may not be fully realized. The amount of the deferred tax asset considered realizable is subject to change based on future events, including generating sufficient pre-tax income in future periods. Through October 31, 2004, we continue to record a full valuation allowance against our net deferred tax assets due to the uncertainty of their realization. In light of our ability to generate pre-tax income during the last five quarters, we assessed the need for the valuation allowance as of October 31, 2004 based on all available evidence. However, due to the uncertainties related to our ability to continue to generate pre-tax income for fiscal 2006 and thereafter, we concluded that the valuation allowance would not be reversed as of October 31, 2004. We will continue to evaluate new information that will become available to us that will provide us with evidence to conclude on whether or not the valuation reserve should be reversed. This information will include: capital spending plans from U.S. cable operators for calendar 2005 for both advertising and VOD systems, specific capital spending plans from our largest customer for VOD in calendar 2005, price per stream information for expected VOD purchases which has continued to decline over the past two fiscal years, capital spending plans from potentially significant customers in Europe and Asia that will be a large portion of our expected total revenues in fiscal 2006 and the finalization of our fiscal 2006 operating plan which will be impacted by these factors and by our continued requirement to invest in new product development and customer support services of our products world-wide.

Three Months Ended October 31, 2004 Compared to the Three Months Ended October 31, 2003

Revenues

Systems Revenues. Our systems revenues consist of sales of our broadband products and software licenses and broadcast products. Systems revenues increased 7% from $29.2 million in the three months ended October 31, 2003 to $31.3 million in the three months ended October 31, 2004. Revenues from the broadband segment, which accounted for 86% and 93% of total systems revenues in the three months ended October 31, 2003 and October 31, 2004, respectively, decreased from $27.2 million in the three months ended October 31, 2003 to $27.0 million in the three months ended October 31, 2004. Video-on-demand systems revenues increased to $23.8 million for the three months ended October 31, 2004 as compared to $22.5 million for the three months ended October 31, 2003. Revenues from video-on-demand systems for the three months ended October 31, 2004 were increased by $1.1 million for the adjustment recorded in connection with the final agreement with Comcast (See Note 12 to Financial Statements) in connection with the incentive common stock purchase warrants. Revenues from video-on-demand systems for the three months ended October 31, 2003 were reduced by the amortization of $2.2 million related to the deferred equity discount associated with the Comcast equity investment. Advertising system revenues were $3.2 million for the three months ended October 31, 2004 as compared to $4.7 million for the three months ended October 31, 2003. The increase in broadband revenues is primarily attributable to the increased deployment of residential video-on-demand systems in the United States by cable operators and the start of deployments in Europe and Asia, offset in part by a decline in the number of expansion systems purchased by United States cable system operators for advertising insertion. Broadcast system segment revenues were $2.0 million in the three months ended October 31, 2003 compared to $4.4 million in the three months ended October 31, 2004. The 116% increase in broadcast revenues for the three months ended October 31, 2004 was primarily attributable to capital purchases by broadcast companies in Asia. We expect future revenue growth, if any, to come principally from our video-on-demand and broadcast system products as cable and telecommunications companies are expected to continue to offer new applications for their customers and the market for digital video servers within the broadcast industry is expected to continue to expand.

Services Revenues. Our services revenues consist of fees for installation, training, project management, product maintenance, technical support services, product development contracts and movie content fees. Our services revenues increased 26% to $11.2 million in the three months ended October 31, 2004 from $8.9 million in the three months ended October 31, 2003. This increase in services revenues primarily resulted from the annual renewals of technical support and maintenance service contracts, price increases on certain technical support and maintenance services, increased product development services revenues and the impact of a growing installed base of systems. Revenues from our wholly-owned subsidiary, Digital Video Arts, were $200,000 in the three months ended October 31, 2003 and $1.0 million in the three months ended October 31, 2004. Revenues from services are expected to continue to grow as the installed base of our products increases and revenues from Digital Video Arts continue to grow due to additional development contracts and new service offerings.

For the three months ended October 31, 2003 and October 31, 2004, one customer accounted for more than 10% of our total revenues. This customer accounted for 55% of total revenues in the three months ended October 31, 2003 and 49% of total revenues in the three months ended October 31, 2004. Another customer accounted for 11% of total revenues in the three months ended October 31, 2003 and less than 10% of total revenues in the three months ended October 31, 2004. Revenue from these customers was primarily in the broadband segment. We believe that a significant amount of our revenues will continue to be derived from a limited number of customers which could result in fluctuations in our quarterly revenues.

International sales accounted for approximately 9% and 23% of total revenues in the three months ended October 31, 2003 and October 31, 2004, respectively. No individual country except the U.S. accounted for more than 10% of total revenue. We expect that international sales will continue to become a significant portion of our business in the future and expect to obtain several new video-on-demand orders in Europe and Asia during the fourth quarter of fiscal 2005. As of October 31, 2004, substantially all sales of our products were made in United States dollars. Therefore, we have not experienced, nor do we expect to experience in the near term, any material impact from fluctuations in foreign currency exchange rates on revenues.

Systems Gross Profit. Costs of systems revenues consist primarily of the cost of purchased components and subassemblies, labor and overhead relating to the final assembly and testing of complete systems and related expenses. Costs of systems revenues decreased 13% to $15.0 million in the three months ended October 31, 2004 as compared to $17.3 million in the three months ended October 31, 2003. In the three months ended October 31, 2004, the decrease in the costs of systems revenues primarily reflects higher systems revenues within the video-on-demand products offset by lower material costs on video-on-demand products and higher prices on certain international broadcast sales. Our ability to maintain or improve our current gross profit as a percentage of systems revenues will be impacted by competitive price pressures which have resulted in lower average selling prices in fiscal 2005. Systems gross profit as a percentage of systems revenues was 41% and 52% in the three months ended October 31, 2003 and October 31, 2004, respectively. Gross profit for the broadband segment increased from 41% of revenues for the three months ended October 31, 2003 to 54% of revenues for the three months ended October 31, 2004. The increase in broadband gross profit percentages is primarily due to higher revenues and lower material costs on certain components due to technological advances and the adjustment related to the issuance of the incentive common stock purchase warrants to Comcast (See Note 12 to Financial Statements). Gross profit for the broadcast segment increased from 40% to 41% for the three months ended October 31, 2003 and 2004, respectively. The increase in the broadcast gross profit percentage is primarily due to higher revenues and higher sales prices on certain international revenues.

Services Gross Profit. Costs of services revenues consist primarily of labor, materials and overhead relating to the installation, training, product maintenance and technical support services provided by us and costs associated with providing movie content services. Costs of services revenues increased 21% from $5.5 million in the three months ended October 31, 2003 to $6.7 million in the three months ended October 31, 2004 due primarily to the hiring of additional personnel to support the growing installed base of customers throughout the world. Services gross profit as a percentage of services revenue was 38% in the three months ended October 31, 2003 and 40% in the three months ended October 31, 2004. The increase in services gross profit was primarily a result of higher revenues on a relatively fixed cost structure. We expect that we will continue to experience fluctuations in gross profit percentage in the future due to the timing of revenues from product development and technical support and other services to support the growing installed base of systems and the timing of costs associated with our ongoing investment required to continue to expand our service organization to support our installed base of systems and our new products.

Research and Development. Research and development expenses consist primarily of the compensation of development personnel, depreciation of development and test equipment and an allocation of related facilities expenses. Research and development expenses increased 14% from $6.6 million, or 17% of revenues, in the three months ended October 31, 2003 to $7.6 million, or 18% of total revenues, in the three months ended October 31, 2004 due primarily to the hiring of additional development engineers to support new product initiatives**.** We expect that research and development expenses will increase slightly in the fourth quarter of fiscal 2005 and will increase 5% to 10% in fiscal year 2005 compared to our results in fiscal year 2004 as we continue our development of new products and enhancements.

Selling and Marketing. Selling and marketing expenses consist primarily of compensation expenses, including sales commissions, travel expenses and certain promotional expenses. Selling and marketing expenses increased slightly from $4.2 million, or 11% of revenues, in the three months ended October 31, 2003 to $4.3 million, or 10% of total revenues, in the three months ended October 31, 2004.

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. General and administrative expenses increased 28% from $2.7 million, or 7% of revenues, in the three months ended October 31, 2003 to $3.4 million, or 8% of total revenues in the three months ended October 31, 2004 due to higher accounting and consulting costs associated with the compliance with Sarbanes-Oxley legislation and higher legal costs related to the nCube litigation.

Interest Income (Expense), net. Interest income, net was $404,000 in the three months ended October 31, 2003 and interest expense, net was $371,000 in the three months ended October 31, 2004. For the three months ended October 31, 2004, we recorded a $800,000 reduction to interest income ($519,000 after taxes) to properly account for the amortization of market premiums and discounts on acquired marketable securities since December 2002. Management determined that the impact of the correction was not material to any historical reporting period.

Equity income (loss) in earnings of affiliates. Equity loss in earnings of affiliates was $9,000 in the three months ended October 31, 2003 in comparison to equity income in earnings of affiliates of $110,000 in the three months ended October 31, 2004. The equity loss and income in earnings of affiliates consists of our proportionate ownership share of the income (loss) of the On Demand Group Limited ("ODG") under the equity method of accounting.

Income Tax Expense (Benefit). Our effective tax rate was 35% and a negative 2% for the three months ended October 31, 2003 and 2004, respectively. Included in the income tax expense was a $1.9 million benefit recorded for the implementation of a tax law change relating to the tax treatment of deferred revenues which resulted in the realization of a deferred tax asset and a corresponding valuation allowance release as SeaChange began to follow the same method for both book and tax purposes for recognizing revenue for maintenance service contracts. SeaChange had an effective income tax rate of 34% for the three months ended October 31, 2004 before recording the adjustment discussed above. For the three months ended October 31, 2003, the effective tax rate was favorably impacted by the utilization of the Company's remaining federal net operating loss carryforwards. As of October 31, 2004, we continued to record a full valuation allowance against our net deferred tax assets due to the uncertainty of their realization as a result of cumulative historical pre-tax losses. We will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If we determine that we can continue to generate sufficient U.S. pre-tax income, some portion of the valuation allowance would be reversed and a corresponding increase in net income would be recognized

Nine Months Ended October 31, 2004 Compared to the Nine Months Ended October 31, 2003

Revenues

Systems Revenues. Systems revenues increased 15% from $82.7 million in the nine months ended October 31, 2003 to $95.0 million in the nine months ended October 31, 2004. Revenues from the broadband segment, which accounted for 89% and 88% of total systems revenues in the nine months ended October 31, 2003 and October 31, 2004, respectively, increased from $73.8 million in the nine months ended October 31, 2003 to $84.0 million in the nine months ended October 31, 2004. Video-on-demand systems revenues increased to $74.2 million for the nine months ended October 31, 2004 as compared to $57.9 million for the nine months ended October 31, 2003. Revenues from video-on-demand systems for the nine months ended October 31, 2004 were increased by $1.1 million for the adjustment recorded for the final agreement with Comcast in connection with the issuance of the incentive common stock purchase warrants to Comcast (See Note 12 to Financial Statements). Revenues from video-on-demand systems for the nine months ended October 31, 2003 were reduced by the amortization of $3.8 million related to the deferred equity discount associated with the Comcast equity investment. Advertising system revenues were $9.8 million for the nine months ended October 31, 2004 as compared to $15.9 million for the nine months ended October 31, 2003. The increase in broadband revenues is primarily attributable to the increased deployment of residential video-on-demand systems in the United States by cable operators and the start of deployments in Europe and Asia, offset in part by a decline in the number of expansion systems purchased by United States cable system operators for advertising insertion. Broadcast system segment revenues were $8.9 million in the nine months ended October 31, 2003 compared to $11.0 million in the nine months ended October 31, 2004. The 23% increase in broadcast revenues for the nine months ended October 31, 2004 was primarily attributable to an increased capital expenditures by broadcast companies in Asia. We expect future revenue growth for the fourth quarter of fiscal 2005, if any, to come principally from our video-on-demand and broadcast system products as cable and telecommunications companies continue to offer new applications for their customers and the market for digital video servers within the broadcast industry continues to expand.

Services Revenues. Our services revenues increased 21% to $32.3 million in the nine months ended October 31, 2004 from $26.6 million in the nine months ended October 31, 2003. This increase in services revenues primarily resulted from the annual renewals of technical support and maintenance service contracts, price increases on certain technical support and maintenance services and the impact of a growing installed base of systems. Revenues from our wholly-owned subsidiary, Digital Video Arts, were $1.1 million in the nine months ended October 31, 2003 and $2.4 million in the nine months ended October 31, 2004. Revenues from services are expected to remain relatively flat in the fourth quarter of fiscal 2005.

For the nine months ended October 31, 2003 and October 31, 2004, one customer accounted for more than 10% of our total revenues. This customer accounted for 52% of total revenues in the nine months ended October 31, 2003 and 55% of total revenues in the nine months ended October 31, 2004. Revenue from this customer was primarily in the broadband segment. We believe that a significant amount of our revenues will continue to be derived from a limited number of customers which could result in fluctuations in our quarterly revenues.

International sales accounted for approximately 12% and 18% of total revenues in the nine months ended October 31, 2003 and October 31, 2004, respectively. No individual country except the U.S. accounted for more than 10% of total revenue. We expect that international sales will continue to become more of a significant portion of our business in the future and expect to obtain several new video-on-demand orders in Europe and Asia during fiscal year 2005. As of October 31, 2004, substantially all sales of our products were made in United States dollars. Therefore, we have not experienced, nor do we expect to experience in the near term, any material impact from fluctuations in foreign currency exchange rates on our revenues.

Systems Gross Profit. Costs of systems revenues increased to $48.8 million in the nine months ended October 31, 2004 as compared to $48.4 million in the nine months ended October 31, 2003. In the nine months ended October 31, 2004, the increase in the costs of systems revenues primarily reflects higher systems revenues and lower material costs within the video-on-demand products. Our ability to maintain or improve our current gross profit as a percentage of systems revenues is impacted by competitive price pressures which have resulted in lower average selling prices in fiscal 2005. Systems gross profit as a percentage of systems revenues was 41% and 49% in the nine months ended October 31, 2003 and October 31, 2004, respectively. Gross profit for the broadband segment increased from 42% of revenues for the nine months ended October 31, 2003 to 51% of revenues for the nine months ended October 31, 2004. The increase in broadband gross profit percentages is primarily due to higher revenues and lower material costs on certain components due to technological advances and the adjustment related to the issuance of the incentive common stock purchase warrants to Comcast (See Note 12 to Financial Statements). Gross profit for the broadcast segment increased from 34% to 35% for the nine months ended October 31, 2003 and 2004, respectively. The increase in the broadcast gross profit percentage is primarily due to higher revenues and higher sales prices on certain international revenues.

Services Gross Profit. Costs of services revenues increased 12% from $17.0 million in the nine months ended October 31, 2003 to $19.0 million in the nine months ended October 31, 2004. Services gross profit as a percentage of services revenue was 36% in the nine months ended October 31, 2003 and 41% in the nine months ended October 31, 2004. The increase in services gross profit was primarily a result of higher revenues on a relatively fixed cost structure. We expect that we will continue to experience fluctuations in gross profit percentage in the future due to the timing of revenues from product development services and technical support and other services to support the growing installed base of systems and the timing of costs associated with our ongoing investment required to continue to expand our service organization to support our installed base of systems and our new products.

Research and Development. Research and development expenses increased 13% from $19.4 million, or 18% of total revenues, in the nine months ended October 31, 2003 to $21.8 million, or 17% of total revenues, in the nine months ended October 31, 2004 due primarily to the hiring of additional development engineers for new product initiatives and costs required for set-top box integration testing. We expect that research and development expenses will increase 5% to 10% in fiscal 2005 as we continue our development of new products and enhancements.

Selling and Marketing. Selling and marketing expenses increased 3% from $12.5 million, or 11% of total revenues, in the nine months ended October 31, 2003 to $12.9 million, or 10% of revenues, in the nine months ended October 31, 2004 primarily reflecting higher commissions on a higher revenue base.

General and Administrative. General and administrative expenses increased 4% from $8.4 million, or 8% of total revenues, in the nine months ended October 31, 2003 to $8.7 million, or 7% of total revenues in the nine months ended October 31, 2004 as a result of higher accounting and consulting costs related to the compliance with the Sarbanes-Oxley legislation.

Interest Income (Expense), net. Interest income, net was $1.2 million in the three months ended October 31, 2003 and $534,000 in the three months ended October 31, 2004. For the three months ended October 31, 2004, we recorded a $800,000 reduction to interest income ($519,000 after taxes) to properly account for the amortization of market premiums and discounts on acquired marketable securities since December 2002. Management determined that the impact of the correction was not material to any historical reporting period.

Impairment loss on investments in affiliates. We recorded a charge of $313,000 in the nine months ended October 31, 2003 related to the other-than-temporary loss on our investment in Visible World.

Equity loss in earnings of affiliates. Equity loss in earnings of affiliates was $49,000 and $143,000 in the nine months ended October 31, 2003 and 2004, respectively. The equity loss in earnings of affiliates consists of our proportionate ownership share of the loss of the ON Demand Group Limited ("ODG") under the equity method of accounting.

Income Tax Expense. Our annual effective tax rate was 35% and 26% for the nine months ended October 31, 2003 and 2004, respectively. Included in the income tax expense for the nine months ended October 31, 2004 was a $1.9 million benefit recorded for the implementation of a tax law change relating to the tax treatment of deferred revenues which resulted in the realization of a deferred tax asset and a corresponding valuation allowance release as SeaChange began to follow the same method for both book and tax purposes for recognizing revenue for maintenance service contracts. SeaChange had an effective income tax rate of 38% for the nine months ended October 31, 2004 before recording the adjustment discussed above. For the nine months ended October 31, 2003, the effective tax rate was favorably impacted by the utilization of the Company's remaining federal net operating loss carryforwards. As of October 31, 2004, we continued to record a full valuation allowance against our net deferred tax assets due to the uncertainty of their realization as a result of cumulative historical pre-tax losses. We will continue to assess the need for the valuation allowance at each balance sheet date based on all available evidence. If we determine that we can continue to generate sufficient U.S. pre-tax income, some portion of the valuation allowance would be reversed and a corresponding increase in net income would be recognized.

Off-Balance Sheet Arrangements

We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital or incurring debt, other than our equity investment in ODG (see Liquidity and Capital Resources). Our arrangements with ODG, which is not consolidated into our financial statements, is not currently likely to have a material affect on our liquidity or the availability of our capital resources.

Liquidity and Capital Resources

We have financed our operations and capital expenditures primarily with the proceeds from sales of our common stock and cash flows generated from operations. Cash and cash equivalents increased $16.0 million from $87.6 million at January 31, 2004 to $103.6 million at October 31, 2004 largely due to cash provided by operating activities. Working capital, excluding long-term marketable securities, increased from $99.2 million at January 31, 2004 to $127.8 million at October 31, 2004.

Net cash provided by operating activities was $17.6 million for the nine months ended October 31, 2004 compared to $12.2 million for the nine months ended October 31, 2003. The net cash provided by operating activities for the nine months ended October 31, 2004 was the result of the net income of $12.1 million adjusted for non-cash expenses including depreciation and amortization of $5.2 million and the changes in certain operating assets and liabilities. The significant changes in operating assets and liabilities that provided cash from operations included increases in accounts payable of $7.7 million due to the timing of payments for inventory purchased in October and deferred revenue of $2.3 million. These items that generated cash from operations were offset by an increase in accounts receivable of $11.1 million, due primarily to the receipt of customer orders late in the fiscal quarter. It is typical for us to experience fluctuations in our monthly operating results primarily due to the timing of receiving customer orders and the related shipment of these customer orders. As a result of these monthly fluctuations, we may experience significant increases or decreases in our inventories as a result of the timing of the procurement of components for anticipated orders for both our product segments, increases or decrease in our accounts payable balance primarily due to the timing of payments for materials purchased for prior month shipments, increases or decreases in our accounts receivable balances as a result of the timing of receiving customer orders during the period and of customer payments.

Net cash used in investing activities was $4.8 million and $5.6 million for the nine months ended October 31, 2004 and October 31, 2003, respectively. Investment activity for the nine months ended October 31, 2004 consisted primarily of capital expenditures of $2.4 million, an acquisition of a business of $900,000, net of cash acquired and purchases of marketable securities of $3.5 million offset in part by the sale of marketable securities of $3.0 million and an increase in restricted cash of $1.0 million.

Net cash provided by financing activities was $3.2 million for the nine months ended October 31, 2004 and $784,000 for the nine months ended October 31, 2003. In the nine months ended October 31, 2004, the cash provided by financing activities included $3.5 million in proceeds from the issuance of common stock in connection with stock option exercises and the employee stock purchase plan, partially offset by the repayment of obligations under capital leases of approximately $297,000.

In December 2003, we renewed our revolving line of credit with a bank for a two year period and increased the committed amount from $10.0 million to $15.0 million. Loans made under this revolving line of credit bear interest at a rate per annum equal to the bank's prime rate, which was 4.75% on October 31, 2004. Borrowings under this line of credit are collateralized by substantially all of our assets. The loan agreement requires that we provide the bank with certain periodic financial reports and comply with certain financial ratios including a minimum level of earnings before interest, taxes and depreciation and amortization on a trailing twelve month basis, when amounts are outstanding under the loan agreement. As of October 31, 2004, we were in compliance with the financial covenants. There are currently no amounts outstanding under the revolving line of credit.

In the third quarter of fiscal year 2003, we entered into a Subscription and Shareholders Agreement (the "Subscription Agreement") with The On Demand Group Limited ("ODG"), a company incorporated in England and Wales that provides video-on-demand consulting and management services in Europe. Pursuant to the Subscription Agreement, we invested 1.5 million U.K. pounds Sterling (approximately $2.4 million) in exchange for 600,000 ordinary shares of ODG representing approximately 23% of the total outstanding capital stock of ODG as of October 29, 2002. As part of the Subscription Agreement, we committed to purchase additional ordinary shares and preference shares of ODG from ODG and certain of its existing shareholders under certain conditions, including that ODG had entered into certain agreements including a Carriage Agreement and Shareholders Agreement with a European cable operator and that the agreements were in a form and substance satisfactory to us. ODG never entered into all of the required agreements before the Subscription Agreement was amended in October 2003 to eliminate the subscription obligation and we at no time had an obligation to purchase such additional shares. In connection with ODG's plan to develop and deploy a new video-on-demand television management service in the future, we entered into a Business Development Agreement with ODG for a minimum of five years whereby ODG agreed to exclusively purchase and to market and promote our video-on-demand systems and software worldwide.

In October 2003, the Subscription Agreement with ODG was amended to remove our commitment to purchase additional ordinary and preference shares from ODG and certain of its existing shareholders. As part of the amended Subscription Agreement, we committed to loan ODG up to 5.5 million U.K. pounds Sterling (approximately $10.5 million) payable in tranches of 500,000 U.K. pounds Sterling or multiples thereof. ODG's ability to draw-down the loan is subject to certain milestones and draw-down conditions, including the deployment of new video-on-demand television management services, no material adverse change in ODG's business, and ODG's business having performed to within 95% of its operating costs and cash flows as set forth in its business plan. Any outstanding loan amount would mature five years from the date of the first draw-down and interest is payable quarterly at the rate of 8.1% per annum. No amounts are outstanding as of October 31, 2004.

In December 2003, we purchased 117,647 common shares of ODG from its principal owners for 400,000 U.K. pounds Sterling (approximately $692,000).

In July 2004, the Business Development Agreement with ODG was amended to include a referral fee based upon a percentage of gross revenues, if any, that may be generated by us through the term of the agreement. We have determined that this additional activity is not significant and did not require reconsideration as to whether ODG is a variable interest entity.

We had no material capital expenditure commitments as of October 31, 2004. There were no significant changes in commitments as presented in the Form 10-K filed on April 14, 2004.

We believe that existing cash, cash equivalents and marketable securities together with available borrowings under the revolving line of credit are adequate to satisfy our working capital and capital expenditure requirements and other contractual obligations for at least the next twelve months.

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.

Recent Accounting Pronouncements

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46") and, in December 2003, issued a revision to that interpretation ("FIN No. 46R"). FIN No. 46R replaces FIN No. 46 and addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. A variable interest entity (VIE) is defined as an entity in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The primary beneficiary is required to consolidate the financial position and results of the VIE. We evaluated our relationships with equity method investments and determined that the adoption of FIN 46R in the quarter ended April 30, 2004 had no impact on our consolidated financial position, results of operations or cash flows.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on EITF No. 03-06, "Participating Securities and Two-Class Method under FASB Statement No. 128, "Earnings Per Share." EITF 03-6 is intended to clarify what is a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. ETIF 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of this pronouncement had no impact on our consolidated financial position, results of operations or cash flows.

In November 2004, the FASB issued FASB Statement No. 151, "Inventory Costs - an Amendment of ARB No. 43, Chapter 4" ("FAS 151"). FAS 151 amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this Statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of the provisions of FAS 151 is not expected to have a material impact on our financial position or results of operations.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

We face exposure to financial market risks, including adverse movements in foreign currency exchange rates and changes in interest rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results. Our primary exposure while minimal to date has been related to local currency revenue and operating expenses in Europe and Asia. Historically, we have not hedged specific currency exposures as gains and losses on foreign currency transactions have not been material to date. At October 31, 2004, we had no outstanding amounts related to variable rate U.S. dollar denominated debt. As there were no amounts outstanding as of October 31, 2004 related to variable rate debt, there was no interest rate exposure. The carrying amounts reflected in the consolidated balance sheet of cash and cash equivalents, trade receivables, and trade payables approximates fair value at October 31, 2004 due to the short maturities of these instruments. We maintain investment portfolio holdings of various issuers, types, and maturities. Our cash and marketable securities include cash equivalents, which we consider to be investments purchased with original maturities of three months or less. Given the short maturities and investment grade quality of the portfolio holdings at October 31, 2004, a sharp rise in interest rates should not have a material adverse impact on the fair value of our investment portfolio. At October 31, 2004, we had $18.1 million in short-term marketable securities and $16.4 million in long-term marketable securities. The major portion of these securities have fixed interest rates and are not subject to risk arising from interest rate variability.

ITEM 4. Controls and Procedures

We evaluated the effectiveness of our disclosure controls and procedures, as defined in Securities Exchange Act of 1934, as amended (the “Exchange Act”) Rule 13a-15(e), as of the end of the period covered by this quarterly report on Form 10-Q. William C. Styslinger, III, our Chief Executive Officer, and William L. Fiedler, our Chief Financial Officer, reviewed and participated in this evaluation. Based upon that evaluation, Messrs. Styslinger and Fiedler concluded that our disclosure controls and procedures were effective as of the end of the period covered by the report and as of the date of the evaluation.

As a result of the evaluation completed by us, and in which Messrs. Styslinger and Fiedler participated, we have concluded that there were no changes during the fiscal quarter ended October 31, 2004 in our internal controls over financial reporting, which have affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

See Note 11 of Notes to Condensed Consolidated Financial Statements.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

As disclosed in our Current Report of Form 8-K filed November 23, 2004, on November 17, 2004, Comcast Cable SC Investment, Inc. (“Comcast Cable SC”) exercised warrants to purchase an aggregate of 185,381 shares of our common stock. Comcast Cable SC used the net issuance provision of the warrants being exercised, meaning that Comcast Cable SC surrendered to us the right to purchase under the warrants being exercised shares of common stock with an in-the-money value equal to the exercise price of the warrants with respect to the 185,381 shares of our common stock purchased by Comcast Cable SC.

Additionally, Comcast SC Investment, Inc. (“Comcast SC”) has since purchased 139,667 shares of our common stock by exercising warrants held by Comcast SC, using the net issuance provision thereof, meaning that Comcast SC surrendered to us the right to purchase under the warrants being exercised shares of common stock with an in-the-money value equal to the exercise price of the warrants with respect to the 139,667 shares of our common stock purchased by Comcast SC. The issuance of 100,000 of these shares was covered by a previously filed registration statement and the issuance of the balance of these shares was exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) as the issuance did not involve a public offering or general solicitation and Comcast SC is an accredited investor, as defined pursuant to Rule 501(a) thereof.

The aggregate number of shares of common stock deemed repurchased by us in connection with the exercise of these warrants is specified in the table below.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
November 1, 2004 to November 30, 2004	204,059	$18.55	0	N/A

ITEM 6. Exhibits

31.1 Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

31.2 Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

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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 15, 2004

SEACHANGE INTERNATIONAL, INC.

by: /s/ William L. Fiedler

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

Index to Exhibits

No.	Description
31.1	Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification Pursuant to Rule 13a-14(a) of the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

Exhibit 31.1

CERTIFICATION

I, William C. Styslinger, III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SeaChange International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986.]
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 15, 2004

/s/ William C. Styslinger, III

William C. Styslinger, III
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, William L. Fiedler, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SeaChange International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986.]
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 15, 2004

/s/ William L. Fiedler

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

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of SeaChange International, Inc. (the “Company”) on Form 10-Q for the period ending October, 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, William C. Styslinger, III, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William C. Styslinger, III

Name: William C. Styslinger, III
Title: President and Chief Executive Officer

Date: December 15, 2004

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of SeaChange International, Inc. (the "Company") on Form 10-Q for the period ending October 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William L. Fiedler, Chief Financial Officer, Senior Vice President, Finance and Administration, Treasurer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ William L. Fiedler

Name: William L. Fiedler
Title: Chief Financial Officer, Senior Vice President, Finance and Administration, Treasurer and Secretary

Date: December 15, 2004