SeaChange

SeaChange International, Inc.

Fourth Quarter and Fiscal Year 2020 Conference Call Script

Monday, April 6, 2020 at 5 p.m. PT

OPERATOR

Good afternoon and welcome to SeaChange's fiscal fourth quarter and full year 2020 earnings call for the period ended January 31, 2020.

Joining me for today's call is the company's Chief Executive Officer Yossi Aloni, Chief Commercial Officer Chad Hassler and Chief Financial Officer Michael Prinn.

After the market close today, SeaChange issued its financial results for the fiscal fourth quarter and full year 2020 in a press release, a copy of which is available in the investors section of the company's website at investors.seachange.com. To accompany today's call, the company has made available its prepared remarks along with a supplemental slide deck, both of which are posted in the investors section of SeaChange's website. Management encourages you to download the slide deck if you haven't done so already.

Before we begin today's call, I'd like everyone to please take note of the Safe Harbor paragraph that is included at the end of today's press release. This paragraph emphasizes the major uncertainties and risks inherent in the forward-looking statements that management will be making today. As we have indicated, forward-looking statements are based on management's current expectations, and are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. These risks and uncertainties are also outlined in the company's SEC filings, including its annual report on Form 10-K and quarterly reports on Form 10-Q. Any forward-looking statements should be considered in light of these factors.

Additionally, this presentation contains certain "non-GAAP financial measures" as that term is defined by the SEC in Regulation G. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP. Accordingly, SeaChange has provided a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures in the company's earnings release issued today.

I would like to remind everyone that this call is being recorded and will be made available for replay via a link available in the investor relations section of SeaChange's website.

Now, I would like to turn the call over to SeaChange's CEO, Mr. Yossi Aloni. Sir, please proceed.

YOSSI ALONI – CEO

Thanks, operator and good afternoon, everyone.

We are pleased to announce that the transformation of our company which began in late Q1 is completed. Today, SeaChange is a new company. Over the past nine months we upgraded our board of directors, have a new executive team, new sales and marketing organization, and a stronger and more efficient R&D organization.

In 2020, we launched the Framework go-to-market strategy, integrating all the excellent SeaChange standalone products into a single software solution with value-based engagement. The initial results are just great, during the last nine months of fiscal 2020, we won more projects than SeaChange won over the past seven years. These wins enabled us to deliver profit and growth albeit a cliff in our legacy revenues.

Overall, fiscal 2020 was a positive year for SeaChange:

- We achieved total revenue of $67.2 million, of this amount Framework engagements are 55% of our total revenue.
- We improved our total gross margins to 65%. In the second half of fiscal 2020 where most of our revenues came from Framework engagements our gross margin was over 70%.
- We generated $4.8 million in non-GAAP operating income.
- We realized more than $12 million in annualized cost savings and this is just the beginning.
- We consolidated our R&D operations to a single location, increasing our efficiency and enabling additional meaningful savings for fiscal 2021.

- We cleaned up all our legacy customer commitments, many of which generated negative ROI, this enables additional savings for fiscal 2021.
- As we exited Q4, SeaChange is a profitable, growing, lean and efficient company, and well positioned to benefit from the COVID-19 impact on the media segment.

As for the current operating environment with COVID-19, roadmap and customer support: no impact, our CTO took all the needed actions in a timely manner. We maintain both our high-quality customer support and roadmap development pace.

Customer engagements: we and our customers are working from home; therefore, this is slowing some of our engagements. We continue to push forward, and we expect to continue to close business.

As for the opportunity: with the Framework being the only solution that can help reduce our customer video delivery operating expense by up to 50%. We expect to see a significant boost to our business within very few months.

TV providers are facing two challenges these days: an increase in operating expenses and declining revenues. Growing demand for video increases the provider's expenses. For example, many TV providers are paying more for CDN, others are increasing network support and making immediate network investments to enable servicing the growing demand.

In addition, while the TV providers operating expense is increasing, advertising revenues and video ARPU are going down. The increasing operating expenses with declining revenues as we enter a recession is a perfect storm for the TV providers.

Our Framework is the best tool in the industry to addresses these challenges. On the cost side using our value-based engagement we reduce our customers' operating expenses to a point where their total cost of ownership to use the Framework is almost zero. We try to make it impossible for the customer to say no, while protecting our target margins. In many cases, our customers reduced their video delivery operating expenses by 50%.

On the revenue side, the Framework enables the TV providers to offer web-like advertising for both live and on demand TV, which enables them to protect and increase some of their advertising revenues. No other vendor in the industry offer a zero cost to own solution or make this claim. This amazing combination will enable us to scale up our business. We believe that within a very few months fiscal

2021 will be a great year for SeaChange.

Before I discuss our outlook and the strategic initiatives for fiscal 2021, I'll turn over to our CCO Chad to provide details on the Framework wins. Afterwards Mike our CFO will walk you through our financial performance. Chad?

CHAD HASSLER – CCO

Thanks, Yossi, and good afternoon everyone. It's great to speak with you again today.

We finished the fiscal year with an exceptionally strong win rate by securing 11 significant Framework deals in Q4, which was up approximately 30% over the prior quarter. The 11 Framework wins in the quarter brought the total number of wins for the year to 26, which exceeded our annual target of 20 to 25. And, as Yossi mentioned, we achieved this all in less than a year, a truly impressive feat on its own.

The 26 wins we secured reflects the increasing demand we are seeing across the industry for our versatile, cloud-based or localized video delivery solution. Framework enables content owners, service providers and broadcasters to offer a Netflix-like service for both live channels and video-on-demand, using existing cable networks and/or over-the-top. This helps these organizations stay competitive and generate new revenue streams by offering unique services and content to meet all their customers' viewing needs.

It's not just the sheer number of wins that's noteworthy, it's also the healthy mix of new and existing logos we secured during the year, including significant wins in which we successfully replaced a competing, legacy solution. From the top telecommunications companies in the U.S. to leading regional service providers globally, the common denominator is that these organizations are selecting the Framework to enhance the user experience, significantly reduce operating costs, and more effectively monetize their installed base.

An integral part of our success is thanks to the go-to-market strategy we implemented last April. If you've had the opportunity to hear Yossi or I talk about the strategy in any detail, you'll know that it was inspired by simplicity. We started by introducing the Framework, were we had truly the best components. This includes the best user interface and the best back office, that instead of being sold as standalone components, which is how the company previously sold, we began selling it as a fully integrated solution. Customers were looking for a plug-and-play solution that just worked, not multiple components that they had to assemble to build a solution.

While we've had great success selling Framework following this proven strategy, we're not resting on our laurels and are actively pursuing additional approaches and channels to drive greater adoption and revenue streams for SeaChange. Later this year, we plan to introduce the Framework plugins store, which will be designed help our customers do more with the Framework through both free and premium plugins, providing them with further avenues to monetize their install base. Additionally, the Framework technology enables us to change the way TV ads are sold, which, in turn, will allow our customers to recoup some of the ad revenue the TV industry has lost to the Web over the past decade. In fact, we have several on-going customer engagements and should be able to announce the initial customer deployments in the coming months.

Overall, we're really encouraged by the sales traction we achieved in fiscal 2020. We've entered the new year with a growing list of Framework customers, building recurring revenues through multi-year agreements, industry-leading technology, along with a robust pipeline of new opportunities that is well distributed across our geographic regions. We're confident these factors have positioned well for continued success in fiscal 2021 and beyond.

With that, I'll turn the call over to Mike to walk us through our financial performance for fiscal Q4 and full year 2020. Mike?

MIKE PRINN – CFO

Thanks, Chad, and good afternoon everyone.

Turning to our financial results for the fourth quarter ended January 31, 2020…

We entered the fourth quarter of fiscal 2020 with $22.2 million in total backlog, excluding maintenance and legacy support. We booked new business of $17.4 million during the fourth quarter and ended the quarter with backlog of $21.8 million.

Total revenue increased 14% to $19.3 million from $17.0 million in the same year-ago period. The increase in total revenue was driven by a $13.0 million increase in Framework revenue compared to no

Framework revenue in same year-ago period, offset by a $10.7 million decrease in legacy revenue.

Product revenue increased 69% to $13.2 million, or 69% of total revenue, from $7.8 million, or 46% of revenue, in the same year-ago period. The increase in product revenue was driven by a $12.4 million increase in Framework revenue.

Service revenue decreased 33% to $6.1 million, or 31% of total revenue, from $9.1 million, or 54% of total revenue, in the same year-ago period. The decrease in service revenue was due to lower revenue from both professional services and support revenue from customers related to legacy products. As we mentioned on our Q3 call, these declines are consistent with our expectations as we transitioned legacy customers to new Framework arrangements and transitioned our professional services organization to our customer engineering organization as we completed legacy professional services projects.

Revenue from our international markets was $11.0 million, or 57% of total revenue, which compares to $12.4 million, or 73% of total revenue, in the same year-ago period. The decrease in international revenue was due to a large project for a significant international customer in the fourth quarter of last year.

Revenue in our U.S. market was $8.2 million, or 43% of total revenue, which was up from $4.6 million, or 27% of total revenue, in the same year-ago period. The increase in revenue from the US was due to our Framework offering being introduced in fiscal 2020.

In terms of customer concentration, we had two customers that accounted for 16% and 12% of our total revenue compared to one customer in Q4 of last year that accounted for 42% of our total revenue.

Looking at our margins…

Gross profit increased to $14.0 million, or 73% of total revenue, from $10.9 million, or 64% of total revenue, in the same year-ago period. The increase in gross profit was due to a shift in sales to our Framework product starting in Q2 of fiscal 2020. The 73% gross margin we achieved in the quarter exceeded our annual guidance target of 60% for the fiscal year.

Product gross margin was 87%, compared to 88% in Q4 of last year. Service gross margin was 42%, compared to 43% in Q4 of last year.

Looking at our expenses…

Non-GAAP operating expenses decreased 25% to $9.2 million from $12.3 million in Q4 of last year. The improvement reflects the continued cost savings initiatives related to the reduction of third-party costs and elimination of non-essential internal costs throughout our organization. In Q4, we eliminated all resources related to legacy professional services and support arrangements as we completed the remining legacy projects we had underway.

Our success reducing OPEX enabled us to realize three consecutive quarters of non-GAAP operating income as well as three consecutive quarters of non-GAAP net income.

GAAP income from operations totaled $3.6 million, an improvement from a loss of $19.9 million in the same year-ago period. As a percentage of total revenue, GAAP income from operations for the fourth quarter of fiscal 2020 was 19%, which compares to a negative percentage in the year-ago period.

Non-GAAP income from operations totaled $4.8 million, or $0.13 per diluted share, an improvement from a loss of $1.2 million, or $(0.03) per basic share, in the same year-ago period. As a percentage of total revenue, non-GAAP income from operations was 25% compared to negative 7% in Q4 of last year.

GAAP net loss totaled $43,000, or $(0.00) per basic share, a significant improvement from a loss of $19.6 million, or $(0.55) per basic share, in the same year-ago period.

Non-GAAP net income totaled $1.2 million or $0.03 per diluted share. This was an improvement from a loss of $946,000, or $(0.03) per basic share, in Q4 last year. As a percentage of total revenue, non-GAAP net income was 6% compared to negative 6% in Q4 of last year.

Turning to the balance sheet…

We ended the year with $13.9 million in cash and cash equivalents and marketable securities and had no debt. Our cash position was up $159,000 from the prior quarter, so we were pleased with that progress for the quarter, as in prior quarters and prior years we have had significant cash burn

Deferred revenue at quarter end was $6.2 million, which compares to $7.8 million at the end of the prior quarter and $10.7 million at the end of Q4 last year. The sequential and year-over-year decrease was primarily due to the decrease in legacy revenue and the timing of revenue recognized and renewal of post-warranty maintenance and support agreements during the quarter.

DSOs, excluding unbilled receivables, was 66 days at the end of the fourth quarter of this fiscal year, compared to 88 days in the fourth quarter of last fiscal year.

Unbilled receivables were $23.3 million, which compares to $16.7 million in the prior quarter and $5.4 million in Q4 of last year. The sequential and year-over-year increase was the result of the timing of billings from our Framework deals due to the payment terms on those deals compared to the revenue recognition for the Framework deals.

Now, turning to our fiscal year 2020 results…

Total revenue increased 8% to $67.2 million from $62.4 million in fiscal 2019. The increase in total revenue was driven by a $36.8 million increase in Framework revenue compared to no Framework revenue in fiscal 2019, offset by a 51% decrease in legacy revenue to $30.4 million compared to $62.4 million in fiscal 2019. We fell slightly short of the lower end of our guidance range, primarily because of a few Framework deals that pushed out of the quarter.

Looking at our revenue buckets…

Product revenue increased 93% to $39.9 million, or 59% of total revenue, from $20.7 million, or 33% of total revenue, in fiscal 2019. The increase in product revenue was driven by a $18.3 million increase in Framework revenue.

Service revenue decreased 35% to $27.2 million, or 41% of total revenue, from $41.7 million, or 67% of total revenue, in fiscal 2019. The decrease in service revenue was driven by a $6.1 million decrease in installation and customized development services as a result of our Framework product's out-of-the-box functionality, as well as a $7.0 million decrease in maintenance associated with decommissioned legacy products.

Revenue from our international markets was $35.4 million, or 53% of total revenue, which compares to $38.8 million, or 62% of total revenue, in fiscal 2019.

Revenue in our U.S. market was $31.7 million, or 47% of total revenue, which was up from $23.6 million, or 38% of total revenue, in fiscal 2019.

In terms of customer concentration, we had no customers accounting for more than 10% each of our total revenue in the fiscal year compared to two customers who represented 24% and 11% each in fiscal 2019.

Looking at our margins…

Gross profit increased to $43.5 million, or 65% of total revenue, from $37.3 million, or 60% of total revenue, in fiscal 2019. As I mentioned earlier, the increase in gross profit was due to a new go-to-market strategy of our Framework product starting in Q2 of fiscal 2020. The 65% gross margin we achieved exceeded our annual guidance target of 60% for the fiscal year.

Product gross margin was 85%, compared to 83% in fiscal 2019. The improvement was due to an increase in higher-margin Framework revenue in fiscal 2020.

Service gross margin was 36%, compared to 48% in fiscal 2019. The decline was due to fixed costs related to the decommissioning of our legacy products in fiscal 2020.

Looking at our expenses…

Non-GAAP operating expenses decreased 20% or $9.8 million to $40.0 million from $49.7 million in fiscal 2019. As I mentioned earlier, the improvement reflects the continued cost savings initiatives related to the reduction of third-party costs and elimination of non-essential internal costs throughout the organization.

Turning to our profitability measures…

GAAP loss from operations totaled $3.5 million, a significant improvement from a loss of $35.8 million in fiscal 2019.

Non-GAAP income from operations totaled $3.6 million, or $0.10 per diluted share, an improvement from a loss of $11.7 million, or $(0.33) per basic share, in fiscal 2019. As a percentage of total revenue, non-GAAP income from operations was 5%, which compares to a negative percentage in fiscal 2019.

GAAP net loss for the year totaled $8.9 million, or $(0.24) per basic share, a significant improvement from a loss of $38.0 million, or $(1.06) per basic share, in fiscal 2019. Included in the net loss for fiscal

2020 was a one-time, non-cash charge of $5.4 million related to the loss on the sale of our prior headquarters in Acton.

And finally, non-GAAP net loss improved by $12.0 million to a loss of $1.9 million or $(0.05) per basic share from a loss of $13.9 million or $(0.39) per basic share in fiscal 2019.

Before I hand the call over to Yossi, I wanted to discuss guidance for our fiscal 2021. Prior to the onset of COVID-19, we were prepared to provide guidance representing meaningful revenue growth in fiscal 2021. Based on our pipeline, we believed revenue guidance of $80 million to $90 million for fiscal 2021 with operating metrics consistent with our previous guidance was achievable. We are working to better understand the impact of COVID-19 and will provide our formal fiscal 2021 guidance as COVID's impact on our business becomes clearer.

This completes my financial summary. For a more detailed analysis of our financial results, please refer to today's earnings release as well as our 10-K, which we plan to file by April 15. Yossi?

YOSSI ALONI – CEO

Thanks, Mike.

We started fiscal 2021 with positive momentum and the best pipeline we have ever had. As Mike mentioned, prior to COVID-19, we planned to guide for $80 to $90 million for fiscal 2021. We expect to better understand the short-term COVID-19 impact during the next 90 days. We believe that we have the right cost structure to endure the next few months and later to prevail using our value-based engagement and unique value proposition.

There is one final item I'd like to mention: recently we added a new module to the Framework, which will change the way the TV industry unsold and underutilized advertising inventory is monetized. We are currently working with several customers and will share more in the near future.

With that, let me turn the call over to the operator to begin the Q&A. Operator?

[Q&A]