

QUANTUM CORP /DE/  
Form 10-Q  
August 07, 2006

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

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

For the quarterly period ended June 30, 2006

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 1-13449

**QUANTUM CORPORATION**

Incorporated Pursuant to the Laws of the State of Delaware

IRS Employer Identification Number 94-2665054

1650 Technology Drive, Suite 700, San Jose, California 95110

(408) 944-4000

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act).

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

As of the close of business on August 1, 2006, approximately 188.9 million shares of Quantum Corporation's common stock were issued and outstanding.

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**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**QUANTUM CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

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(In thousands, except per-share data)  
(Unaudited)

	Three Months Ended	
	June 30, 2006	June 27, 2005
Product revenue	\$ 159,044	\$ 176,094
Royalty revenue	27,551	30,543
<b>Total revenue</b>	<b>186,595</b>	<b>206,637</b>
Cost of revenue	134,570	149,195
Gross margin	52,025	57,442
Operating expenses:		
Research and development	24,083	29,182
Sales and marketing	20,960	21,808
General and administrative	10,261	10,789
Restructuring charges (reversals)	83	(78)
	<b>55,387</b>	<b>61,701</b>
Loss from operations	(3,362)	(4,259)
Interest income and other, net	1,963	2,174
Interest expense	(2,162)	(2,791)
Loss before income taxes	(3,561)	(4,876)
Income tax provision	15	601
<b>Net loss</b>	<b>\$ (3,576)</b>	<b>\$ (5,477)</b>
Net loss per share		
Basic	\$ (0.02)	\$ (0.03)
Diluted	\$ (0.02)	\$ (0.03)
Weighted average common and common equivalent shares		
Basic	188,198	182,868
Diluted	188,198	182,868

See accompanying notes to Condensed Consolidated Financial Statements.

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	June 30, 2006 (Unaudited)	March 31, 2006 (1)
	<hr/>	<hr/>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 70,985	\$ 123,298
Short-term investments	141,173	99,975
Accounts receivable, net of allowance for doubtful accounts of \$7,778 and \$7,843, respectively	118,958	114,020
Inventories	87,651	88,963
Service inventories	63,528	57,316
Deferred income taxes	7,425	7,422
Other current assets	35,739	30,869
	<hr/>	<hr/>
Total current assets	525,459	521,863
Long-term assets:		
Property and equipment, less accumulated depreciation	34,925	38,748
Purchased technology, less accumulated amortization	36,625	41,237
Other intangible assets, less accumulated amortization	7,647	8,572
Goodwill	47,178	47,178
Other long-term assets	7,553	5,746
	<hr/>	<hr/>
Total long-term assets	133,928	141,481
	<hr/>	<hr/>
	\$ 659,387	\$ 663,344
	<hr/>	<hr/>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 69,344	\$ 67,306
Accrued warranty	30,242	32,422
Accrued restructuring charges	5,916	13,019
Other accrued liabilities	104,477	102,531
	<hr/>	<hr/>
Total current liabilities	209,979	215,278
Long-term liabilities:		
Deferred income taxes	6,961	6,995
Convertible subordinated debt	160,000	160,000
	<hr/>	<hr/>
Total long-term liabilities	166,961	166,995
Commitments and contingencies		
Stockholders' equity:		
Common stock	276,654	274,579
Accumulated other comprehensive income	5,747	2,870
Retained earnings	46	3,622
	<hr/>	<hr/>
Stockholders' equity	282,447	281,071

\$	659,387	\$	663,344
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(1) Derived from the March 31, 2006 audited Consolidated Financial Statements included in the Annual Report on Form 10-K of Quantum Corporation for fiscal year 2006, as filed with the Securities and Exchange Commission on June 12, 2006.

See accompanying notes to Condensed Consolidated Financial Statements.

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**QUANTUM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)  
(Unaudited)

	Three Months Ended	
	June 30, 2006	June 27, 2005
Cash flows from operating activities:		
Net loss	\$ (3,576)	\$ (5,477)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	10,365	11,151
Gain on Ireland facility closure	(476)	-
Deferred income taxes	(37)	11
Share-based compensation	1,778	137
Changes in assets and liabilities:		
Accounts receivable	(4,938)	9,014
Inventories	1,312	(3,126)
Service inventories	(6,212)	1,305
Accounts payable	2,038	(4,639)
Income taxes payable	(624)	(710)
Accrued warranty	(2,180)	(75)
Accrued restructuring	(7,103)	(3,608)
Other assets and liabilities	(2,590)	3,901
Net cash provided by (used in) operating activities	(12,243)	7,884
Cash flows from investing activities:		
Purchases of short-term investments	(287,473)	(601,200)
Proceeds from sale of short-term investments	246,275	495,575
Purchases of property and equipment	(5,169)	(5,867)
Proceeds from the sale of Ireland facility	6,000	-
Payments made in connection with business acquisitions	-	(14,329)
Net cash used in investing activities	(40,367)	(125,821)
Cash flows from financing activities:		
Proceeds from issuance (repurchases) of common stock, net	297	(22)

Net cash provided by (used in) financing activities	297	(22)
Net decrease in cash and cash equivalents	(52,313)	(117,959)
Cash and cash equivalents at beginning of period	123,298	225,136
Cash and cash equivalents at end of period	\$ 70,985	\$ 107,177
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 150	\$ 347
Income taxes, net of refunds	\$ 634	\$ (319)
Value of common stock tendered in satisfaction of employees' income taxes on vesting of employee stock options	\$ 5	\$ 72

See accompanying notes to Condensed Consolidated Financial Statements.

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**QUANTUM CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**Note 1: Description of Business**

Quantum Corporation (“Quantum”, the “Company”, “us” or “we”) (NYSE:DSS), founded in 1980, a global leader in storage, delivers highly reliable backup, recovery and archive solutions that meet demanding requirements for data integrity and availability with superior price/performance and comprehensive service and support. Quantum offers customers of all sizes a range of solutions, from leading tape drive and media technologies, autoloaders, and libraries to disk-based backup systems.

**Note 2: Share-based Compensation Expense**

Effective April 1, 2006, the Company adopted the provisions of SFAS No. 123 (revised 2004) *Share-Based Payment* (“SFAS No. 123R”). SFAS No. 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method and requires the use of an option pricing model for estimating fair value. Accordingly, share-based compensation is measured at the grant date, based on the fair value of the award. The exercise price of options is equal to the market price of Quantum common stock on the date of grant. The company previously accounted for awards granted under its equity incentive plans under the intrinsic value method prescribed by Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations, and provided the required pro forma disclosures prescribed by SFAS No. 123, “Accounting for Stock-Based Compensation,” as amended. Accordingly, prior to the adoption of SFAS No. 123R only share-based compensation related to the issuance of restricted stock awards were recognized in the statements of operations, since they were issued at a discount.

The Company employed the modified prospective method of adoption for SFAS No. 123R, under which the compensation cost recognized by the Company beginning in fiscal year 2007 includes (a) compensation cost for all equity incentive awards granted prior to, but not yet vested as of April 1, 2006, based on the grant-date fair value

estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all equity incentive awards granted, modified or settled subsequent to April 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. The Company uses the ratable attribution method to recognize share-based compensation costs over the service period of the award.

Quantum has Stock Option Plans (the "Plans") that provide for the issuance of stock options, stock appreciation rights, stock purchase rights, restricted stock awards, and long-term performance awards (collectively referred to as "options") to employees, consultants, officers and affiliates of Quantum. Beginning in the first quarter of fiscal year 2007, Quantum also began issuing restricted stock units to existing employees with a purchase price of \$0.00. Quantum will continue granting stock options to newly hired employees. Stock options granted to newly hired employees during the three months ended June 30, 2006 and June 27, 2005 generally vest 25% on the first anniversary of the vest begin date with the remainder vesting monthly at the rate of 1/48<sup>th</sup> over the following 3 years and have contractual terms of seven years. Stock options granted during the three months ended June 27, 2005 to existing employees generally vest monthly over four years and have contractual terms of seven years. Restricted stock awards and units granted during the three months ended June 30, 2006 and June 27, 2005 generally vest over two to four years. The Company does not have any performance-based awards outstanding as of June 30, 2006.

The Plans have reserved 56.2 million shares of stock for future issuance. As of June 30, 2006, 29.9 million shares of stock were available for grant. Quantum also has an employee stock purchase plan ("purchase plan"), under which employees can purchase stock at 85% of the lesser of the market price at the beginning or the end of the 6-month purchase period.

Share-based compensation recognized in fiscal year 2007 as a result of the adoption of SFAS No. 123R as well as pro forma disclosures according to the original provisions of SFAS No. 123 for periods prior to the adoption of SFAS No. 123R use the Black-Scholes Merton option pricing model for estimating fair value of options granted under the Company's plans and rights to acquire stock granted under the Company's purchase plan.

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The following table summarizes the effects of share-based compensation resulting from the application of SFAS No. 123R to options granted under the Company's plans and rights to acquire stock granted under the Company's purchase plan:

(In thousands, except per-share data)

	Three Months Ended June 30, 2006
Share-based compensation expense included in operations:	
Cost of revenue	\$ 251
Research and development	477
Sales and marketing	340
General and administrative	710
Total share-based compensation expense effect on net income	<u>\$ 1,778</u>
Share-based compensation expense by type of employees awards:	
Stock options	\$ 1,204
Stock purchase plan	359
Restricted stock awards	<u>215</u>

	\$	1,778
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Share-based compensation effects on basic earnings per common share	\$	(0.01)
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Share-based compensation effects on diluted earnings per common share	\$	(0.01)
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The impact to loss before income taxes and net loss are the same since the impact to the tax provision is minimal due to valuation allowances recorded for deferred tax assets on stock option expenses. In accordance with SFAS No. 123R, the Company adjusts share-based compensation on an annual basis for changes to the estimate of expected equity award forfeitures based on actual forfeiture experience. The effect of adjusting the forfeiture rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. The effect of forfeiture adjustments in the first quarter of fiscal year 2007 was insignificant.

The total share-based compensation cost capitalized as part of inventory as of June 30, 2006 was not material. During the first quarter of fiscal year 2007, the tax benefit realized for the tax deduction from option exercises and other awards was zero. As of June 30, 2006, there was \$4.6 million of total unrecognized compensation costs related to stock options granted under the company's plans. The unrecognized compensation cost is expected to be recognized over a weighted average period of 1.34 years. Total intrinsic value of options exercised for the three months ended June 30, 2006 was not material. As of June 30, 2006, there was \$1.5 million of total unrecognized compensation costs related to nonvested restricted stock awards and units granted under the company's plans. The unrecognized compensation cost is expected to be recognized over a weighted average period of 1.48 years. The total fair value of restricted shares vested during the period ended June 30, 2006 was \$0.1 million. The Company settles employee stock option exercises with newly issued common shares.

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*Pro Forma Information Under FAS 123*

Prior to fiscal year 2007, Quantum accounted for its share-based compensation plans using the intrinsic value method prescribed in APB No. 25 and related Interpretations. Only share-based compensation relating to restricted stock awards was reflected in net loss in the three months ended June 27, 2005, as generally all other stock options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. Had compensation cost for the plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of FAS 123, Quantum's net loss and basic and diluted net loss per share would have been changed to the pro forma amounts indicated below:

(In thousands, except per-share data)

	Three Months Ended June 27, 2005	
Reported net loss	\$	(5,477)
Share-based employee compensation determined under the fair value method for all awards, net of tax effects		(1,928)
Pro forma net loss	\$	(7,405)
Reported net loss per share	\$	(0.03)
Net effect per share of option fair value amortization		(0.01)
Basic and diluted pro forma net loss per share	\$	(0.04)



*Determining Fair Value Under FAS 123R*

Quantum estimates the fair value of share-based awards granted using the Black-Scholes-Merton option valuation model. Quantum amortizes the fair value of all awards on a ratable basis over the requisite service periods, which are generally the vesting periods. The expected life of awards granted represents the period of time that they are expected to be outstanding. We determine the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules, exercise patterns and pre-vesting and post-vesting forfeitures. Stock purchases under the purchase plan have an expected life of six months, which is equal to the purchase period. Quantum estimates the volatility of its common stock based on the historical volatility of its own common stock over the most recent period corresponding with the estimated expected life of the award. Quantum based the risk-free interest rate used in the Black-Scholes Merton option valuation model on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term equal to the expected life of the award. Quantum has never paid any cash dividends on its common stock and it does not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes Merton option valuation model. Quantum uses historical data to estimate pre-vesting option forfeitures and records share-based compensation only for those awards that are expected to vest.

The weighted average estimated fair values and the assumptions used in calculating such values for the Plans during each fiscal period are as follows:

	Three Months Ended	
	June 30, 2006	June 27, 2005
Option life (in years)	4.2	3.26
Risk-free interest rate	4.87%	3.73%
Stock price volatility	0.66	0.71
Dividend yield	—	—
Weighted-average grant date fair values	\$ 1.76	\$ 1.15

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Under the purchase plan, rights to purchase shares are only granted during the second and fourth quarter of each fiscal year. The value of rights to purchase shares granted in the fourth quarter of fiscal year 2006 and fiscal year 2005 was estimated at the date of grant. In January 2005, the Stock Purchase Plan was modified from a 2-year look back to a 6 month look back option. The weighted average fair values and the assumptions used in calculating such values during each fiscal period are as follows:

	Three Months Ended	
	March 31, 2006	March 31, 2005
Option life (in years)	0.50	0.53
Risk-free interest rate	4.29%	3.61%
Stock price volatility	0.34	0.73
Dividend yield	—	—
Weighted-average grant date fair values	\$ 0.87	\$ 1.00

A summary of activity relating to Quantum's Plans follows:

	Options (In thousands)	Weighted-Avg. Exercise Price	Weighted-Avg. Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding as of March 31, 2006	27,768	\$ 4.90		
Granted	157	\$ 2.91		
Exercised	(122)	\$ 2.50		
Expired	(1,325)	\$ 7.38		
Canceled	(216)	\$ 2.89		
Outstanding as of June 30, 2006	<u>26,262</u>	\$ 4.80	5.33	\$ 956
Vested and expected to vest at June 30, 2006	<u>25,015</u>	\$ 4.90	5.33	\$ 946
Exercisable as of June 30, 2006	<u>18,823</u>	\$ 5.56	5.06	\$ 878

The following tables summarize information about options outstanding and exercisable as of June 30, 2006:

Range of Exercise Prices	Options Outstanding (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Options Exercisable (In thousands)	Weighted Average Exercise Price
\$ 0.96 - \$ 2.76	6,914	\$ 2.52	5.79	3,149	\$ 2.37
\$ 2.80 - \$ 2.95	5,498	\$ 2.93	4.37	3,255	\$ 2.94
\$ 2.97 - \$ 3.78	6,061	\$ 3.35	6.48	4,771	\$ 3.33
\$ 3.82 - \$ 9.70	5,671	\$ 7.73	4.99	5,531	\$ 7.82
\$ 9.75 - \$ 24.11	2,118	\$ 13.46	3.83	2,117	\$ 13.46
	<u>26,262</u>	\$ 4.80	5.33	<u>18,823</u>	\$ 5.56

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A summary of activity relating to Quantum's restricted stock awards follows:

	Awards (In thousands)	Weighted-Avg. Grant Date Fair Value
Nonvested at March 31, 2006	789	\$ 2.82
Vested	(29)	\$ 2.62
Forfeited	(30)	\$ 2.89

Nonvested at June 30, 2006 730 \$ 2.82

A summary of activity relating to Quantum's restricted stock units follows:

	Units (In thousands)	Weighted-Avg. Period (In years)	Aggregate Intrinsic Value (In thousands)
Nonvested at March 31, 2006	-		
Granted	8		
Nonvested at June 30, 2006	8	3.76	\$ 20
Vested and expected to vest at June 30, 2006	5	3.76	\$ 14
Exercisable as of June 30, 2006	-		\$ -

**Note 3: Basis of Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Quantum and its majority-owned subsidiaries. All material intercompany balances and transactions have been eliminated. The interim financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year. The Condensed Consolidated Balance Sheet as of March 31, 2006 has been derived from the audited financial statements at that date. However, it does not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. The accompanying financial statements should be read in conjunction with the audited financial statements of Quantum for the fiscal year ended March 31, 2006, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on June 12, 2006.

In previous years, the Company reported two data storage business segments: Tape Drive and Storage Systems. Beginning with the first quarter of fiscal year 2007, the Company is reporting one business segment as a result of organizational changes. These changes include the integration of marketing, sales and research and development functions to enhance the product positioning and to lower the cost platforms between the Tape Drive and Storage Systems businesses. As a result of these integration efforts, discrete financial information for each product group is no longer tracked below the gross margin level; management can no longer measure operating performance nor make resource allocation decisions for each product group.

**Note 4: Net Loss Per Share**

The following tables set forth the computation of basic and diluted net loss per share:

(In thousands, except per-share data)

Three Months Ended	
June 30, 2006	June 27, 2005

Net loss	\$ (3,576)	\$ (5,477)
Weighted average shares outstanding used to compute basic and diluted net loss per share	188,198	182,868
Basic and diluted net loss per share	\$ (0.02)	\$ (0.03)

The computations of diluted net loss per share for the periods presented excluded the effect of the following because the effect would have been antidilutive:

- 4.375% convertible subordinated notes issued in July 2003, which are convertible into 36.8 million shares of Quantum common stock (229.885 shares per \$1,000 note) at a conversion price of \$4.35 per share; and
- Options to purchase 26.3 million shares and 33.5 million shares of Quantum common stock that were outstanding at June 30, 2006, and June 27, 2005, respectively.

**Note 5: Restructuring Charges**

In fiscal years 2007 and 2006, Quantum took steps to reduce costs in an effort to return to profitability and rationalize its operations following past acquisitions. The restructuring charges that resulted from these cost reduction efforts relate to the following:

- Outsourcing manufacturing and repair operations;
- Consolidating most of the operations supporting our two business segments; and
- Reducing other general expenses, including consolidating and streamlining operations and administrative functions.

The following tables show the type of activity for the three months ended June 30, 2006 and June 27, 2005.

(In thousands)

	Three Months Ended	
	June 30, 2006	June 27, 2005
<u>By expense type</u>		
Severance and benefits (reversals)	\$ 83	\$ (178)
Facilities	-	100
Total	\$ 83	\$ (78)
<u>By cost reduction actions</u>		
Consolidate the operations supporting our two business segments	\$ 83	\$ (78)

First quarter fiscal year 2007

A \$0.1 million net charge was recorded for severance as part of the continuing effort to streamline the Company's marketing and IT functions.

First quarter fiscal year 2006

A \$0.2 million charge was reversed because estimated severance costs were lower than originally anticipated.

A \$0.1 million charge was recorded for a lease termination fee in Shrewsbury, Massachusetts.

The following two tables show the activity and the estimated timing of future payouts for cost reduction plans (for a complete discussion of Quantum's restructuring charge activity in prior years, refer to Note 6 in Quantum's Annual Report on Form 10-K for the year ended March 31, 2006, as filed with the Securities and Exchange Commission on June 12, 2006):

(In thousands)	Severance and benefits	Facilities	Total
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Balance as of March 31, 2006	\$ 10,046	\$ 2,973	\$ 13,019
Restructuring charges	83	-	83
Cash payments	(6,751)	(435)	(7,186)
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Balance as of June 30, 2006	\$ 3,378	\$ 2,538	\$ 5,916
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Estimated timing of future payouts:			
Fiscal Year 2007	\$ 2,738	\$ 1,446	\$ 4,184
Fiscal Year 2008 to 2013	640	1,092	1,732
	<u>                    </u>	<u>                    </u>	<u>                    </u>
	\$ 3,378	\$ 2,538	\$ 5,916
	<u>                    </u>	<u>                    </u>	<u>                    </u>

The \$5.9 million remaining restructuring charge accrual as of June 30, 2006 is comprised of obligations for severance and vacant facilities. The severance charges will be paid during fiscal years 2007 and 2008. The facilities charges related to vacant facilities in Colorado Springs, Colorado; Boulder, Colorado; and Basingstoke, United Kingdom and will be paid over the respective lease terms, which continue through fiscal year 2013.

#### **Note 6: Goodwill and Intangible Assets**

The following table summarizes goodwill by acquisition as of June 30, 2006 and March 31, 2006:

(In thousands)	Goodwill
	<u>                    </u>
ATL Products, Inc. (acquired October 1998)	\$ 7,711
M4 Data	6,222
Benchmark	33,245
	<u>                    </u>
	\$ 47,178
	<u>                    </u>

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Acquired intangible assets are amortized over their estimated useful lives, which generally range from two years to ten years. In estimating the useful lives of intangible assets, management considered the following factors:

- The cash flow projections used to estimate the useful lives of the intangible assets showed a trend of growth that was expected to continue for an extended period of time;

- The tape automation products, in particular, have long development cycles and have experienced long product life cycles; and
- The ability to leverage core technology into new tape automation products and, therefore, to extend the lives of these technologies.

The following tables provide a summary of the carrying amount of intangible assets that will continue to be amortized:

(In thousands)	As of June 30, 2006			As of March 31, 2006		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Purchased technology	\$ 112,518	\$ (75,893)	\$ 36,625	\$ 112,518	\$ (71,281)	\$ 41,237
Trademarks	22,560	(16,617)	5,943	22,560	(15,865)	6,695
Non-compete agreements	2,516	(2,516)	-	2,516	(2,516)	-
Customer lists	15,672	(13,968)	1,704	15,672	(13,795)	1,877
Assembled workforce	1,582	(1,582)	-	1,582	(1,582)	-
	<u>\$ 154,848</u>	<u>\$ (110,576)</u>	<u>\$ 44,272</u>	<u>\$ 154,848</u>	<u>\$ (105,039)</u>	<u>\$ 49,809</u>

As of June 30, 2006 and March 31, 2006, net goodwill and intangible assets were \$91.5 million and \$97.0 million, respectively, and represented approximately 14% and 15%, respectively, of total assets.

The total amortization expense related to intangible assets is provided in the table below:

(In thousands)	Three Months Ended	
	June 30, 2006	June 27, 2005
Purchased technology	\$ 4,612	\$ 4,225
Trademarks	752	751
Customer lists	173	307
	<u>\$ 5,537</u>	<u>\$ 5,283</u>

The total expected future amortization related to intangible assets is provided in the table below:

(In thousands)	Amortization
Nine months ending March 31, 2007	\$ 12,077
Fiscal year 2008	14,067
Fiscal year 2009	7,929
Fiscal year 2010	4,194
Fiscal year 2011 and thereafter	6,005
Total as of June 30, 2006	<u>\$ 44,272</u>

**Note 7: Inventories and Service Inventories**

Inventories consisted of the following:

(In thousands)

	<u>June 30, 2006</u>	<u>March 31, 2006</u>
Materials and purchased parts	\$ 38,576	\$ 35,061
Work in process	8,044	8,571
Finished goods	41,031	45,331
	<u>\$ 87,651</u>	<u>\$ 88,963</u>

Service inventories consisted of the following:

(In thousands)

	<u>June 30, 2006</u>	<u>March 31, 2006</u>
Component parts	\$ 41,293	\$ 37,255
Finished units	22,235	20,061
	<u>\$ 63,528</u>	<u>\$ 57,316</u>

**Note 8: Accrued Warranty and Indemnifications**

The following table details the quarterly change in the accrued warranty balance:

(In thousands)

	<u>Three Months Ended</u>	
	<u>June 30, 2006</u>	<u>June 27, 2005</u>
Beginning balance	\$ 32,422	\$ 37,738
Additional warranties issued	5,425	6,463
Adjustments for warranties issued in prior fiscal years	-	886
Settlements made in cash	(7,605)	(7,424)
Ending Balance	<u>\$ 30,242</u>	<u>\$ 37,663</u>

Quantum warrants its products against defects for periods ranging from 6 to 48 months. A provision for estimated future costs and estimated returns for credit relating to warranty is recorded when products are shipped and revenue recognized. Quantum's estimate of future costs to satisfy warranty obligations is primarily based on estimates of future failure rates and its estimates of future costs of repair including materials consumed in the repair, and labor and overhead amounts necessary to perform the repair.

The estimates of future product failure rates are based on both historical product failure data and anticipated future failure rates. If future actual failure rates differ from its estimates, Quantum records the impact in subsequent periods. Similarly, the estimates of future costs of repair are based on both historical data and anticipated future costs. If future actual costs to repair were to differ significantly from its estimates, Quantum would record the impact of these unforeseen cost differences in subsequent periods.

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### Indemnifications

Quantum has certain financial guarantees, both express and implied, related to product liability and potential infringement of intellectual property. Other than certain product liabilities recorded as of June 30, 2006, Quantum did not record a liability associated with these guarantees, as Quantum has little or no history of costs associated with such indemnification requirements. Contingent liabilities associated with product liability may be mitigated by insurance coverage that Quantum maintains.

In the normal course of business to facilitate transactions of Quantum's services and products, Quantum indemnifies certain parties with respect to certain matters. Quantum has agreed to hold certain parties harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, Quantum has entered into indemnification agreements with its officers and directors, and its bylaws contain similar indemnification obligations to its agents.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by Quantum under these agreements have not had a material impact on its operating results, financial position, or cash flows.

### **Note 9: Credit Agreements, Short-Term Debt and Convertible Subordinated Debt**

#### Convertible subordinated debt

On July 30, 2003, Quantum issued 4.375% convertible subordinated notes in the aggregate principal amount of \$160 million due in 2010 in a private placement transaction. The notes are unsecured obligations subordinated in right of payment to all of Quantum's existing and future senior indebtedness. The notes mature on August 1, 2010 and are convertible at the option of the holder at any time prior to maturity, unless previously converted, into an aggregate of 36.8 million shares of Quantum common stock at a conversion price of \$4.35 per share. Quantum cannot redeem the notes prior to August 5, 2008. Quantum received net proceeds from the notes of \$155.1 million after deducting commissions and other expenses.

#### Credit line

In December 2002, Quantum entered into a secured senior credit facility with a group of banks, providing Quantum with a \$100 million revolving credit line and a \$50 million synthetic lease that contains the same financial covenants as the revolving credit line. In March 2004, Quantum amended the secured senior credit facility to extend the maturity to March 2006 and adjust several covenant requirements. In January 2005, Quantum amended the revolving credit line and the synthetic lease agreement to reflect the Certance acquisition. The revolving credit line was amended to increase the line from \$100 million to \$145 million and to adjust covenant requirements. The amount Quantum can borrow under the revolving credit facility is limited by the amount of accounts receivable and inventory. In October 2005, Quantum amended and restated the revolving credit line to extend the maturity to October 2008, adjust covenant levels, and adjust the fee structure. In February 2006, Quantum terminated the \$50 million synthetic lease. As of



June 30, 2006, \$2.5 million is committed to standby letters of credit.

Borrowings under the revolving credit line bear interest at either the London interbank offering rate (“LIBOR”) with option periods of one to nine months or a base rate plus a margin determined by a senior debt to earnings ratio as defined in the credit agreement. As of June 30, 2006, there were no borrowings under the revolving credit line. The credit facility is secured by a blanket lien on all of the assets of Quantum and contains certain financial and reporting covenants, which Quantum is required to satisfy as a condition of the credit line. As of June 30, 2006, Quantum was in compliance with all of the covenants.

**Note 10: Income Taxes**

The tax expense recorded for the three months ended June 30, 2006 and June 27, 2005 was \$15,000 and \$0.6 million, respectively. The current quarter's tax provision reflects expenses for foreign income taxes and state taxes of \$0.5 million offset by a benefit related to an expected tax refund of \$0.5 million for losses associated with the closure of Quantum's Ireland facility. The prior year's provision reflects foreign income taxes and state taxes.

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In connection with the disposition of the Company's hard-disk drive business to Maxtor, the Company and Maxtor entered into a Tax Sharing and Indemnity Agreement, dated as of April 2, 2001 (the “Tax Sharing Agreement”) that, among other things, defined each company's responsibility for taxes attributable to periods prior to April 2, 2001. Pursuant to a settlement agreement entered into between the companies dated as of December 23, 2004, Maxtor's remaining tax indemnity liability under section 3(a) of the Tax Sharing Agreement was limited to \$8,760,000. As of June 30, 2006 \$7.3 million remains as the indemnity liability. Quantum believes that this amount is sufficient to cover the remaining potential tax liabilities under this section of the Tax Sharing Agreement.

**Note 11: Litigation**

On August 7, 1998, Quantum was named as one of several defendants in a patent infringement lawsuit filed in the U.S. District Court for the Northern District of Illinois, Eastern Division. The plaintiff, Papst Licensing GmbH (“Papst”), owns numerous United States patents, which Papst alleges are infringed upon by hard disk drive products that were sold by HDD. In October 1999 the case was transferred to a federal district court in New Orleans, Louisiana, where it has been joined with other lawsuits involving Papst for purposes of coordinated discovery under multi-district litigation rules. The other lawsuits have Maxtor, Minebea Limited, and IBM as parties. As part of Quantum's disposition of its hard disk drive business to Maxtor in April 2001, Maxtor assumed the defense of the Papst claims and agreed to indemnify Quantum with respect to litigation relating to this dispute. Maxtor has recently been acquired by Seagate, which has assumed Maxtor's defense and indemnification obligations.

On August 8, 2003, a class action lawsuit was filed against Quantum in the Superior Court of the State of California for the County of San Francisco. Hitachi Maxell, Ltd., Maxell Corporation of America, Fuji Photo Film Co., Ltd., and Fuji Photo Film U.S.A., Inc. are named in the lawsuit as codefendants. The plaintiff, Franz Inc., alleges violation of California antitrust law, violation of California unfair competition law, and unjust enrichment. In November 2005, the parties agreed to settle the litigation for a combination of cash and product contributions. The settlement terms were approved by the Court on July 10, 2006.

**Note 12: Commitments and Contingencies**

Commitments to purchase inventory

Since the third quarter of fiscal year 2003, a number of our tape drive and tape automation products have been manufactured for Quantum by Jabil or other contract manufactures. Under these arrangements, the contract

manufacturer procures inventory to manufacture products based upon a forecast of customer demand provided by Quantum. Quantum is responsible for the financial impact on the contract manufacturer of any reduction or product mix shift in the forecast relative to materials that the contract manufacturer had already purchased under a prior forecast. Such a variance in forecasted demand could require a cash payment for finished goods in excess of current customer demand or for costs of excess or obsolete inventory.

As of June 30, 2006 Quantum issued non-cancelable purchase orders for \$45.7 million to purchase finished goods from its contract manufacturers and had not incurred any significant liability for finished goods in excess of current customer demand or for the costs of excess or obsolete inventory.

**Note 13: Comprehensive Loss**

Total comprehensive loss, net of tax, if any, for the three months ended June 30, 2006 and June 27, 2005, is presented in the following table:

(In thousands)	Three Months Ended	
	June 30, 2006	June 27, 2005
Net loss	\$ (3,576)	\$ (5,477)
Foreign currency translation adjustment	2,877	(102)
Total comprehensive loss	\$ (699)	\$ (5,579)

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**Note 14: Recent Accounting Pronouncements**

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Instruments," which amends SFAS 133 and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. This statement is effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006, and is effective for Quantum beginning in fiscal year 2008. Adoption of this standard is not expected to have a significant impact on its financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation Number 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes," an interpretation of SFAS No. 109, "Accounting for Income Taxes." The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The provisions are effective for the company beginning in fiscal year 2008. The company is currently evaluating the impact this statement will have on its consolidated financial statements.

**Note 15: Pending Acquisition**

On May 2, 2006, Quantum announced that it entered into a definitive Agreement and Plan of Merger (the "Merger Agreement") to acquire Advanced Digital Information Corporation, a Washington corporation ("ADIC"), for approximately \$803 million in cash paid to ADIC shareholders plus \$8 million in direct costs of the acquisition. Pursuant to the terms of the Merger Agreement, each outstanding share of ADIC common stock will be exchanged for cash equal to \$12.25 without interest, with the right to elect, in lieu of cash, 3.461 shares of Quantum common stock.

The stock election is subject to pro-ration such that Quantum will issue no more than approximately 19.95% of the total number of shares of Quantum common stock outstanding immediately prior to the closing of the transaction. In addition, Quantum will assume all of ADIC's outstanding employee stock options according to an option exchange ratio defined in the Merger Agreement. The applicable Hart-Scott-Rodino waiting period expired in July 2006 and certain foreign antitrust approvals were received. Consummation of the merger is subject to customary conditions, including approval of the shareholders of ADIC.

On April 27, 2006, Quantum entered into a commitment letter (the "Commitment Letter") for a \$500 million senior credit facility with Keybank National Association ("KeyBank"). Quantum intends to use the proceeds from the Senior Credit Facility (i) to fund a portion of the proposed merger pursuant to the Merger Agreement, (ii) for working capital, and (iii) for other general corporate purposes.

Certain of the officers and directors of ADIC have entered into a voting agreement with Quantum (the "Voting Agreements"). The Voting Agreements provide that each of the ADIC officers and directors party to such Voting Agreements will vote all shares of capital stock of ADIC over which such person has voting control in favor of the approval of the Merger Agreement and the merger and against approval of any proposal made in opposition to or in competition with the consummation of the merger. The Voting Agreement terminates on the earlier of (i) the date of the merger, (ii) the date that the Merger Agreement has been validly terminated and (iii) May 2, 2007. The acquisition of ADIC is tentatively scheduled to close on August 18, 2006.

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## **Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements in this report usually contain the words "will," "estimate," "anticipate," "expect", "believe" or similar expressions and variations or negatives of these words. All such forward-looking statements including, but not limited to, (1) our expectation that the current installed base of tape drives will result in continued demand for the tape media cartridges, (2) our expectation that media royalties will continue to be a significant source of our DLT® revenues, gross margins, operating income and cash flow, (3) our expectation that we will continue to derive a substantial majority of our revenue from products based on our tape technology, (4) our expectation that we will incur additional future charges for anticipated restructurings, including the amounts of future payments and annualized cost savings resulting therefrom, (5) our intention to pursue product initiatives in order to further improve gross margins, increase operating efficiencies and effectiveness, and reduce operating costs, (6) our belief that strong competition in the tape drive, tape media and tape automation systems markets will result in further price erosion, (7) our belief that we have sufficient resources to cover the remaining tax liability under the Tax Sharing and Indemnity Agreement with Maxtor, (8) our belief that our existing cash and capital resources will be sufficient to meet all currently planned expenditures and sustain our operations for the next 12 months, (9) our expectation that we will return to profitability, (10) our belief that our ultimate liability in any infringement claims made by any third parties against us will not be material to us, (11) our expectation that we will make additional acquisitions in the future, (12) our expectations about the timing and maximum amounts of our future contractual payment obligations, (13) our belief that our total foreign exchange rate exposure is not significant, (14) our expectations regarding timing of our new product introductions, (15) our expectations regarding the benefits of our proposed acquisition of ADIC, including revenue, gross margins, market share and customer benefits and (16) our expectations that we will consummate our acquisition of ADIC in August 2006 are inherently uncertain as they are based on management's expectations and assumptions concerning future events, and they are subject to numerous known and unknown risks and uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. As a result, our actual results may differ materially from the forward-looking statements contained herein. Factors that could cause actual results to differ materially from those described herein include, but are not limited to, (1) the amount of orders received in future periods; (2) our ability to timely ship our products; (3) uncertainty regarding IT spending and the

corresponding uncertainty in the demand for tape drives and tape automation products; (4) our continued receipt of media royalties from media manufacturers at or above historical levels; (5) a continued trend toward centralization of storage; (6) our ability to achieve anticipated pricing, cost and gross margin levels, particularly on tape drives, given lower volumes and continuing price and cost pressures; (7) the successful execution of our strategy to expand our businesses into new directions; (8) our ability to successfully introduce new products; (9) our ability to achieve and capitalize on changes in market demand; (10) acceptance of, and demand for, our products; (11) our ability to maintain supplier relationships; and (12) those factors discussed under “Trends and Uncertainties” elsewhere in this Quarterly Report on Form 10-Q. Our forward-looking statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement.

## **Business Description**

Quantum Corporation (“Quantum”, the “Company”, “us” or “we”) (NYSE:DSS), founded in 1980, a global leader in storage, delivers highly reliable backup, recovery and archive solutions that meet demanding requirements for data integrity and availability with superior price/performance and comprehensive service and support. We offer customers of all sizes a range of solutions, from tape drive and media technologies, autoloaders, and libraries to disk-based backup systems. We are the world’s largest volume supplier of both tape drives and tape automation and have pioneered the development of disk-based systems optimized for backup and recovery.

## **Business Summary**

We design, develop, license, service, and market tape drives, which include both value and performance drives, as well as tape media cartridges. Our value drives, the DLT-V drives, are targeted at the “value” or “price sensitive” segment of the tape drive market. Our performance tape drives, DLT-S drives, are targeted at the “performance sensitive” segment of the tape drive market. Most of our media revenue comes from royalties paid to us by manufacturers who license our tape media cartridge technology. Both DLT® and Super DLT™ products are used to back up large amounts of data stored on network servers. DLT® and Super DLT™ are based on our half-inch Digital Linear Tape (“DLT”) technology that is used in mid-range UNIX and NT system backup and archive applications.

DLT® and Super DLT™ drives store data on DLTtape® and Super DLTtape™ media cartridges, respectively. Historical use of tape drives has shown that drives use many tape media cartridges per year in archival and backup processes. This historical use suggests that the installed base of tape drives will result in continued demand for tape media cartridges. Our tape media cartridges are manufactured and sold by licensed third party manufacturers and, to a lesser extent, directly by us. As a result of the Certance

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Holdings and its subsidiaries (“Certance”) acquisition in January 2005, we acquired tape drive and media products based on the following technologies: Linear Tape Open (“LTO”) Ultrium, Digital Audio Tape (“DAT”)/Digital Data Storage (“DDS”), and Travan. In addition, we acquired Certance’s design and manufacturing capabilities related to recording heads used in tape drives. LTO Ultrium technology solutions provide data protection for midrange through enterprise networks. DAT/DDS products offer data protection for small to midsize business networks. Travan products are designed to reliably and economically protect the data of mobile and home office users.

We receive a royalty on tape media cartridges sold by our licensees. We prefer that a substantial portion of our tape media cartridge sales occur through this license model because this minimizes our operational risks, asset investments and expenses and provides an efficient distribution channel. We believe that the large installed base of tape drives and our licensing of tape media cartridges are of strategic importance to us because they contribute to both our direct sales of tape media cartridges and also provide us with royalty income from our licensing partners. Media royalties have been a significant source of our gross margins, operating results and cash flow, and this trend is expected to continue.

In fiscal years 2004 and 2005 substantially all of our tape drive product manufacturing was outsourced to Jabil Circuit Inc. ("Jabil") in Penang, Malaysia and Mitsumi Electric Co. Ltd. ("Mitsumi") in the Philippines. However, since our acquisition of Certance on January 5, 2005, some of our tape drives and head assemblies are manufactured for Certance products in our facility in Penang, Malaysia and by Panasonic Shikoku Electronics Co., Ltd ("PSEC") in Japan. We are in the process of moving manufacturing away from several of our contract manufacturers to our in-house facility in Penang, Malaysia.

We also design, develop, manufacture, market and sell the broadest portfolio of tape autoloaders and libraries and are one of the pioneers in the disk-based backup market, providing systems that emulate a tape library but are optimized for backup and recovery. Excellent service and support capabilities are key elements of our offerings. Our products serve the entire midrange data storage market from desktop to enterprise-class customers and are used to backup, recover and archive data in networked computing environments. With the Certance acquisition, we expanded our tape automation business by adding Certance's complementary DDS-4, DAT-72 and LTO-3 autoloader products to our product portfolio. Some of our tape automations systems are manufactured in our facilities in Penang, Malaysia, Costa Mesa, California and Colorado Springs, Colorado. All of our disk-based backup systems are built in Costa Mesa, California. Jabil together with Flextronics International, Ltd. ("Flextronics"), Mitsumi, PSEC and Buero- und Datentechnik GmbH & Co. KG ("BDT") manufacture our remaining tape automation systems.

In previous years, the Company reported two data storage business segments: Tape Drive and Storage Systems. Beginning with the first quarter of fiscal year 2007, the Company is reporting one business segment as a result of organizational changes. These changes include the integration of marketing, sales and research and development functions to enhance the product positioning and to lower the cost platforms between the Tape Drive and Storage Systems businesses. As a result of these integration efforts, discrete financial information for each product group is no longer tracked below the gross margin level; management can no longer measure operating performance nor make resource allocation decisions for each product group.

## **CRITICAL ACCOUNTING ESTIMATES AND POLICIES**

Our discussion and analysis of the financial condition and results of operations is based on the accompanying 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 statements requires us to make significant estimates and judgments about future uncertainties that affect reported assets, liabilities, revenues and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. In the event that estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. We believe that the following accounting policies require our most difficult, subjective or complex judgments because of the need to make estimates about the effect of matters that are inherently uncertain. The judgments and uncertainties that affect the application of those policies in particular could result in materially different amounts being reported under different conditions or using different assumptions.

### **Revenue Recognition**

Revenue from sales of products to distributors, VARs, OEMs and end-users is recognized: when passage of title and risk of ownership are transferred to customers; when persuasive evidence of an arrangement exists; when the price to the buyer is fixed or determinable; and when collection is reasonably assured. In the period when the revenue is recognized for either OEMs or distributors, allowances are provided for estimated future price adjustments, such as volume rebates, price protection, and future product returns. Since we have historically been able to reliably estimate the amount of allowances required for future price adjustments and product returns, we recognize revenue, net of projected allowances, upon shipment to our customers.

These allowances are based on the OEMs' and distributors' master agreements, programs in existence at the time the revenue is recognized, historical information, contractual limits and plans regarding price adjustments and product returns. Revenue from distributor arrangements is a significant portion of our total revenue. If we were unable to reliably estimate the amount of future price adjustments and product returns in any specific reporting period, then we would be required to defer recognition of the revenue until the right to future price adjustments and product returns lapsed and we were no longer under any obligation to reduce the price or accept the return of the product.

Quantum licenses certain intellectual property to third party manufacturers under arrangements that are represented by master contracts, allowing these third party manufacturers to manufacture and sell certain of our products. As consideration for licensing the intellectual property, the licensees pay us a per-unit royalty for sales of their products that incorporate the licensed technology. On a periodic basis, the licensees provide us with unit reports that include the quantity of units sold to end users subject to royalties. We recognize revenue based on the unit reports, which are provided to us in a timely fashion. The unit report substantiates that the delivery has occurred. Royalty revenue is measured by multiplying the units sold as reflected in the unit reports by the royalty per unit in accordance with the royalty agreements. Royalty payments are made on a per unit basis at a stipulated per unit amount.

When elements such as hardware and services are contained in a single arrangement, or in related arrangements with the same customer, we allocate revenue to the separate elements based on relative fair value, provided we have fair value for all elements of the arrangement. If in an arrangement we have fair value for undelivered elements but not the delivered element, we defer the fair value of the undelivered elements and the residual revenue is allocated to the delivered elements. Undelivered elements typically include installation and services. If fair value does not exist for undelivered elements, then revenue for the entire arrangement is deferred until all elements have been delivered. Revenue from extended warranty and product service contracts is initially deferred and recognized as revenue ratably over the contract period.

### **Share-Based Compensation**

In the first quarter of fiscal year 2007, Quantum adopted SFAS No. 123 (revised 2004) *Share-Based Payment* ("SFAS No. 123R") using the modified prospective method, and therefore has not restated prior periods' results. Under this method, the Company recognized compensation expense for all share-based awards granted or modified after April 1, 2006 and prior to but not yet vested as of April 1, 2006, in accordance with SFAS No. 123R. Total share-based compensation during the first quarter of fiscal year 2007 was \$1.8 million.

Determining the appropriate fair-value model and calculating the fair value of share-based awards at the date of grant requires judgment. Quantum uses the Black-Scholes option pricing model to estimate the fair value of employee stock options and rights to purchase shares under stock participation plans, consistent with the provisions of SFAS No. 123R. Option pricing models, including the Black-Scholes model, also require the use of input assumptions, including expected volatility, expected life, expected dividend rate, and expected risk-free rate of return. Quantum estimates the volatility of its common stock based on the historical volatility of its own common stock over the most recent period corresponding with the estimated expected life of the award. Quantum estimates expected life of the award based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures. If Quantum determined another method to estimate expected volatility or expected life was more reasonable than its current methods, or if another method for calculating these input assumptions was prescribed by authoritative guidance, the fair value calculated for share-based awards could change significantly. Higher volatility and expected lives result in a proportional increase to share-based compensation determined at the date of grant. The expected dividend rate and expected risk-free rate of return are not as significant to the calculation of fair value.

In addition, SFAS No. 123R requires Quantum to develop an estimate of the number of share-based awards which will be forfeited due to employee turnover. Quarterly changes in the estimated forfeiture rate can have a significant

effect on reported share-based compensation, as the effect of adjusting the rate for all expense amortization after April 1, 2006 is recognized in the period the forfeiture estimate is changed. If the actual forfeiture rate is higher than the estimated forfeiture rate, then an adjustment is made to increase the estimated forfeiture rate, which will result in a decrease to the expense recognized in the financial statements. If the actual forfeiture rate is lower than the estimated forfeiture rate, then an adjustment is made to decrease the estimated forfeiture rate, which will result in an increase to the expense recognized in the financial statements. These adjustments affect Quantum's gross margin, research and development expenses, sales and marketing expenses and, general and administrative expenses. The effect of forfeiture adjustments in the first quarter of fiscal year 2007 was insignificant. The expense Quantum recognizes in future periods could also differ significantly from the current period and/or its forecasts due to adjustments in the assumed forfeiture rates.

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### **Warranty expense and liability**

We generally warrant our products against defects for 6 to 48 months from the date of sale and provide warranty service on tape drives on a return-to-factory basis. Our tape automation systems may carry service agreements available to customers to extend or upgrade the warranty service. We perform services from our Penang, Malaysia facility to support warranty and service obligations for tape drives, automation systems and other storage products. We also provide automation systems warranty service from our facility in Costa Mesa, California. Jabil Global Service provides screen and repair services in Reynosa, Mexico for North America tape drives and in Hungary for EMEA tape drives. In addition, we employ various other third party service providers throughout the world that perform tape drive and automation systems services for us.

We estimate future failure rates based upon both historical product failure data and anticipated future failure rates. Similarly, we estimate future costs of repair based upon both historical data and anticipated future costs. The Company uses a model and exercises considerable judgment in determining the underlying estimates. While our judgment requires an element of subjectivity for all of our products (for example, historical rates of return are not completely indicative of future return rates and we must therefore exercise judgment with respect to future deviations from our historical return rate), our judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of the lack of past experience with those products upon which to base our estimates. We recently introduced a number of new products, of which we are in the early stages of volume shipment and we are experiencing improved quality on our existing products which both influence failure rates. When actual failure rates differ significantly from our estimates, we record the impact of these unforeseen costs or cost reductions in subsequent periods and update our assumptions and forecasting models accordingly. As our new products mature and we continue to experience improved quality on our existing products, we are able to improve our estimates with respect to these products. Therefore, it is reasonably likely that we will have to update our assumptions for failure rates (and, therefore, warranty expense liability) in the future, particularly given that we recently introduced a number of new products of which we are in the early stages of volume shipment.

Similarly, we are in the process of consolidating and outsourcing manufacturing repair sites, which affect the future costs of repair. Our expected costs associated with this outsourcing initiative consist of outsourcing product repairs to third parties, with whom we negotiate on-going outsourcing arrangements, as well as transition costs from in-house repair to outsourcing. If the actual costs were to differ significantly from our estimates, we would record the impact of these unforeseen costs or cost reductions in subsequent periods.

### **Inventory Valuation**

Our inventory is stated at the lower of cost or market, with cost computed on a first-in, first-out basis ("FIFO"). Adjustments to reduce the cost of inventory to its net realizable value, if required, are made for estimated excess, obsolescence, or impaired balances. Factors influencing these adjustments include decline in demand, rapid

technological changes, product life cycle and development plans, component cost trends, product pricing, physical deterioration, and quality issues. Revisions to these adjustments would be required if these factors differ from our estimates.

### **Service Inventories**

We value our service inventories at the lower of cost or market. Service inventories consist of both component parts, which are primarily used to repair defective units, and finished units, which are provided for customer use permanently or on a temporary basis while the defective unit is being repaired. Cost is determined by the FIFO method and includes direct material, direct labor, overhead and other direct costs. Market value for components is replacement cost or the cost of acquiring similar products from our vendors. For finished goods, market value is the estimated selling price less costs to sell and dispose of the inventories. While cost is readily determinable, the estimates of market involve significant estimates and judgments about the future.

We carry service inventories because we generally provide product warranty for 6 to 48 months and earn revenue by providing enhanced warranty and repair service outside this warranty period. We initially record our service inventories at cost and evaluate the difference, if any, between cost and market at the end of each quarter. The determination of the market value of service inventories is dependent on estimates, including the estimated amount of component parts expected to be consumed in the future warranty and out of warranty service, the estimated number of units required to meet future customer needs, the estimated selling prices of the finished units, and the estimated useful lives of finished units.

We record write-downs for the amount that the cost of service inventories exceeds our estimated market value. No adjustment is required when market value exceeds cost.

### **Goodwill and Intangible Assets**

We have a significant amount of goodwill and intangible assets on our balance sheet related to acquisitions. As of June 30, 2006, the net amount of \$91.5 million of goodwill and intangible assets represented 14% of total assets.

As a result of adopting SFAS No. 142 *Goodwill and Other Intangible Assets* on April 1, 2002, we discontinued the amortization of goodwill. Instead, goodwill was reviewed for impairment upon adoption of SFAS No. 142 and is reviewed annually thereafter, or more frequently when indicators of impairment are present.

Intangible assets are carried and reported at acquisition cost, net of accumulated amortization subsequent to acquisition. The acquisition cost is amortized over the estimated useful lives, which generally range from two years to ten years. Intangible assets are reviewed for impairment whenever events or circumstances indicate impairment might exist in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-lived Assets*. Projected undiscounted net cash flows expected to be derived from the use of those assets are compared to the respective net carrying amounts to determine whether any impairment exists. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

The determination of the net carrying value of goodwill and intangible assets and the extent to which, if any, there is impairment are dependent on material estimates and judgments on our part, including the useful life over which the intangible assets are to be amortized, and the estimates of the value of future net cash flows, which are based upon further estimates of future revenues, expenses and operating margins.

### **Restructuring Charges**



In recent periods and over the past several years, we recorded significant restructuring charges related to the realignment and restructuring of our business operations. These charges represented expenses incurred in connection with certain cost reduction programs that we have implemented and consisted of the cost of involuntary termination benefits, separation benefits, stock compensation charges, facilities charges and other costs of exiting activities or geographies.

The charges for severance and exit costs require the use of estimates, primarily related to the number of employees paid severance, the amount of severance and related benefits to be paid, and the cost of exiting facilities, including estimates and assumptions related to future maintenance costs, our ability to secure a sub-tenant, if applicable, and any sublease income to be received in the future.

In the fourth quarter of fiscal year 2003, we became subject to SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of an entity's commitment to an exit plan. The statement further establishes fair value as the objective for initial measurement of the liability and that employee benefit arrangements requiring future service beyond a "minimum retention period" be recognized over the future service period. In the second quarter of fiscal year 2005, severance charges became subject to SFAS No. 112 *Employers' Accounting for Postemployment Benefits* since we currently have a benefit plan with defined termination benefits based on years of service.

## **Income Taxes**

We account for income taxes in accordance with SFAS No. 109 *Accounting for Income Taxes*, which requires that deferred tax assets and liabilities be recognized for the effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized.

We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets.

Significant management judgment is required in determining our deferred tax assets and liabilities and valuation allowances for purposes of assessing our ability to realize any future benefit from our net deferred tax assets. We intend to maintain this valuation allowance until sufficient positive evidence exists to support the reversal of the valuation allowance. Future income tax expense will be reduced to the extent that we have sufficient positive evidence to support a reversal of, or decrease in, our valuation allowance.

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Quantum believes that, based on current applicable tax laws, it has provided adequate amounts and recorded liabilities for probable and estimable tax adjustments that may be proposed by various taxing authorities in the U.S., state, and foreign jurisdictions. These estimated liabilities are recorded on a quarterly basis and estimates are revised based upon new information that was not available at the time of prior estimates. Our estimates have in the past been subject to change and we expect that some of our estimates will be subject to change in the future. While our estimated liabilities are recorded based upon existing tax laws, events may occur in the future that indicate payments of these amounts will be less than estimated, in which event, reversals of these liabilities would create tax benefits that we would recognize in the periods when we determine that the liabilities have been reduced. Conversely, events may occur in the future that indicate that payments of these amounts will be greater than estimated, in which event we would record tax charges and additional liabilities. For example, we may in the future, decide to negotiate with tax authorities regarding our tax liability in a particular jurisdiction, which could result in a different outcome than our

expected liability. In addition, the regulatory audit statute of limitations for a particular jurisdiction may expire without Quantum becoming subject to an audit by that jurisdiction or an audit may occur but result in a smaller tax liability than we had estimated, and we would no longer be required to incur any or all of the liability for that audit, as the case may be.

## RECENT ACCOUNTING PRONOUNCEMENTS

See Note 14 “Recent Accounting Pronouncements” to the Condensed Consolidated Financial Statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on our results of operations and financial condition.

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## RESULTS OF OPERATIONS

(In thousands)

	Three Months Ended					
	June 30, 2006	% of revenue	June 27, 2005	% of revenue	Increase/ (decrease)	% Increase/ (decrease)
Product revenue	\$ 159,044	85.2%	\$ 176,094	85.2%	\$ (17,050)	(9.7%)
Royalty revenue	27,551	14.8%	30,543	14.8%	(2,992)	(9.8%)
Total revenue	186,595	100.0%	206,637	100.0%	(20,042)	(9.7%)
Cost of revenue	134,570	72.1%	149,195	72.2%	(14,625)	(9.8%)
Gross margin	52,025		57,442		(5,417)	(9.4%)
Gross margin rate	27.9%		27.8%		0.1%	
Research and development	24,083	12.9%	29,182	14.1%	(5,099)	(17.5%)
Sales and marketing	20,960	11.2%	21,808	10.6%	(848)	(3.9%)
General and administrative	10,261	5.5%	10,789	5.2%	(528)	(4.9%)
Restructuring charges	83	-	(78)	-	161	206.4%
	55,387	29.7%	61,701	29.9%		
Loss from operations	(3,362)		(4,259)			
Interest income and other, net	1,963	1.1%	2,174	1.1%	(211)	(9.7%)
Interest expense	(2,162)	1.2%	(2,791)	1.4%	(629)	(22.5%)
Loss before income taxes	(3,561)		(4,876)			
Income tax provision	15	-	601	0.3%	(586)	(97.5%)
Net loss	\$ (3,576)		\$ (5,477)		(1,901)	(34.7%)

## Revenue

The decrease in product revenue was substantially driven by lower unit shipments and lower average unit prices across most product lines. This decline was due to shipments of older products reaching maturity such as the VS80, SuperDLT ®320 and ValueLoaders as well as continued intense competition and less demand from our key OEM customers. This decrease was only partially offset by increases in units and average unit prices in latest generation products such as the SuperLoader 3, DLT-V4 and PX500 series.

Tape media royalties decreased in the first quarter of fiscal year 2007 due to lower media unit sales sold through our OEM customers.

## Gross Margin

The decrease in gross margin dollars primarily reflected a decrease in unit sales. As the VS80 and SDLT320 have matured, unit sales have declined and sales of the newer replacement products have not compensated for the decline in sales of mature products. The gross margin rate, however, remained relatively flat due to reduced warranty and repair costs resulting from improved product quality and cost management.

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## Research and Development Expenses

The decrease in research and development expenses in the first quarter of fiscal year 2007 as compared to the first quarter of fiscal year 2006 is due to cost reduction actions, primarily reduced headcount as the Company integrated Certance and to a lesser extent completed product launches.

## Sales and Marketing Expenses

The slight decrease in sales and marketing expenses for the first quarter of fiscal year 2007 as compared to the first quarter of fiscal year 2006 primarily reflected reduced spending on marketing programs and reduced headcount as a result of cost reduction actions.

## General and Administrative Expenses

The slight decrease in general and administrative expenses for the first quarter of fiscal year 2007 as compared to the first quarter of fiscal year 2006 mainly reflected the gain on the sale of the Ireland facility, partially offset by the foreign exchange adjustment resulting from this closure.

## Restructuring Charges

We have taken many actions that have resulted in restructuring charges. These actions include significant restructuring activities relating to the outsourcing of manufacturing and service functions and rationalization of headcount and facilities as a result of various acquisitions. As we continue to integrate the operations of past acquisitions and to monitor and rationalize our infrastructure, we may incur additional charges in the future that are not estimable at this time.

The following two tables show the restructuring charges for the three months ended June 30, 2006 and June 27, 2005, respectively, (for a discussion of our restructuring charge activity in prior years, refer to Note 6 in our Annual Report on Form 10-K for the year ended March 31, 2006, as filed with the Securities and Exchange Commission on June 12, 2006):

(In thousands)

	Three Months Ended	
	June 30, 2006	June 27, 2005
<u>By expense type</u>		
Severance and benefits (reversals)	\$ 83	\$ (178)
Facilities	-	100
Total	\$ 83	\$ (78)
<u>By cost reduction actions</u>		
Consolidate the operations supporting our two business segments	\$ 83	\$ (78)

In the first quarter of fiscal year 2007, a \$0.1 million net charge was recorded for severance as part of the continuing effort to streamline the Company's marketing and IT functions.

In the first quarter of fiscal year 2006, a \$0.2 million charge was reversed because estimated severance costs were lower than originally anticipated and a \$0.1 million charge was recorded for a lease termination fee in Shrewsbury, Massachusetts.

For more information regarding Restructuring Charges, refer to Note 5 "Restructuring Charges" to the Condensed Consolidated Financial Statements.

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### Amortization of Intangible Assets

The following table details intangibles asset amortization expense by classification within our Condensed Consolidated Statements of Operations:

	Three Months Ended		
	June 30, 2006	June 27, 2005	Increase/ (decrease)
Cost of revenue	\$ 4,131	\$ 3,983	\$ 148
Research and development	195	95	100
Sales and marketing	1,065	1,059	6
General and administrative	146	146	-
	\$ 5,537	\$ 5,283	\$ 254

For further information regarding amortization of intangible assets, refer to Note 6 "Goodwill and Intangible Assets" to the Condensed Consolidated Financial Statements.

### Share-based Compensation

Share-based compensation totaled \$1.8 million in the first quarter of fiscal year 2007, compared to \$0.1 million in the first quarter of fiscal year 2006. We adopted the modified prospective method under SFAS No. 123R, effective beginning in the first quarter of fiscal year 2007. Prior to the adoption of SFAS 123R, the Company accounted for its equity incentive plans under the intrinsic value recognition and measurement principles of Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. Accordingly, share-based compensation for the quarter ended June 27, 2005 related only to the issuance of restricted stock awards since they were issued at a discount. As of June 30, 2006, there was \$4.6 million of total unrecognized compensation costs related to stock options granted under the company’s plans. The unrecognized compensation cost is expected to be recognized over a weighted average period of 1.34 years. As of June 30, 2006, there was \$1.5 million of total unrecognized compensation costs related to stock awards and units granted under the company’s plans. The unrecognized compensation cost is expected to be recognized over a weighted average period of 1.48 years. In the first quarter of fiscal year 2007 the Company began issuing restricted stock units to employees.

The following table summarizes the effects of share-based compensation resulting from the application of SFAS No. 123R to options granted under the Company’s plans and rights to acquire stock granted under the Company’s purchase plan:

(In thousands)

	Three Months Ended June 30, 2006
Share-based compensation expense included in operations:	
Cost of revenue	\$ 251
Research and development	477
Sales and marketing	340
General and administrative	710
Total share-based compensation expense effect on net income	<u>\$ 1,778</u>

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### Interest and Other Income, net

The decrease in interest income and other income, net, in the three months ended June 30, 2006 as compared to the corresponding period of the prior year was mainly due to a decrease in interest earned on lower investment balances. The decrease in interest expense in the three months ended June 30, 2006 as compared to the corresponding period of the prior year was mainly due to fewer letters of credit outstanding.

### Income Taxes

We account for income taxes in accordance with SFAS No. 109 *Accounting for Income Taxes*, which requires that deferred tax assets and liabilities be recognized for the effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized.

We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets.

Significant management judgment is required in determining our deferred tax assets and liabilities and valuation allowances for purposes of assessing our ability to realize any future benefit from our net deferred tax assets. We intend to maintain this valuation allowance until sufficient positive evidence exists to support the reversal of the valuation allowance. Future income tax expense will be reduced to the extent that we have sufficient positive evidence to support a reversal of, or decrease in, our valuation allowance.

The current quarter's tax provision reflects expenses for foreign income taxes and state taxes of \$0.5 million offset by a benefit related to an expected tax refund of \$0.5 million for losses associated with the closure of Quantum's Ireland facility. The prior year's provision reflects foreign income taxes and state taxes.

In connection with the disposition of the Company's hard-disk drive business to Maxtor, the Company and Maxtor entered into a Tax Sharing and Indemnity Agreement, dated as of April 2, 2001 (the "Tax Sharing Agreement") that, among other things, defined each company's responsibility for taxes attributable to periods prior to April 2, 2001. Pursuant to a settlement agreement entered into between the companies dated as of December 23, 2004, Maxtor's remaining tax indemnity liability under section 3(a) of the Tax Sharing Agreement was limited to \$8,760,000. As of June 30, 2006 \$7.3 million remains as the indemnity liability. Quantum believes that this amount is sufficient to cover the remaining potential tax liabilities under this section of the Tax Sharing Agreement.

## LIQUIDITY AND CAPITAL RESOURCES

(In thousands)

	As of or for Three Months Ended	
	June 30, 2006	June 27, 2005
Cash and cash equivalents	\$ 70,985	\$ 107,177
Short-term investments	141,173	130,625
Total cash, cash equivalents, and short-term investments	212,158	237,802
Days sales outstanding ("DSO")	58.0	52.9
Inventory turns (Annualized)	6.1	8.7
Net cash provided by (used in) operating activities	\$ (12,243)	\$ 7,884
Net cash used in investing activities	\$ (40,367)	\$ (125,821)
Net cash provided by (used in) financing activities	\$ 297	\$ (22)

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### First Quarter Fiscal Year 2007

Cash used in operating activities during the first quarter of fiscal year 2007 of \$12 million primarily reflected changes in working capital that provided less cash than was used by the loss from operations, adjusted for non-cash items such as depreciation and amortization, deferred income taxes, gain on the closure of the Ireland facility and share-based compensation related to stock incentive plans.

The cash that was used by working capital during the first quarter of fiscal year 2007 was primarily due to an increase in accounts receivable, an increase in service inventories in order to meet the Restriction of Hazardous Substances ("RoHS") compliance requirements for the service parts and inventories in Europe, Middle East and Asia ("EMEA"), and a decrease in accrued restructuring charges from severance payments made during the quarter. The increases in accounts receivable and the DSOs from the first quarter of fiscal year 2006 to the first quarter of fiscal year 2007 is primarily due to a higher percentage of revenue being generated in the last month of the first quarter of fiscal year

2007. Inventory turns declined from 8.7 in the first quarter of fiscal year 2006 to 6.1 in the first quarter of fiscal year 2007 primarily due to the moving of manufacturing operations from contract manufacturers to our in-house Penang, Malaysia facility.

Cash used in investing activities during the first quarter of fiscal year 2007 of \$40 million reflected purchases of short-term investments and purchases of property and equipment. These uses were partially offset by proceeds received from sales of short-term investments and proceeds received from sale of the Ireland facility.

Cash provided by financing activities during the first quarter of fiscal year 2007 of \$0.3 million reflected proceeds received from issuance of common stock upon exercise of stock options held by our employees.

#### First Quarter Fiscal Year 2006

During the first quarter of fiscal year 2006, operating activities generated cash flows of \$8 million. In the first quarter of fiscal year 2006, our \$126 million use of cash for investing activities primarily reflected purchases of short-term investments, payments made in connection with business acquisitions and purchases of property and equipment.

#### *Pending Acquisition*

On May 2, 2006, Quantum announced that it entered into a definitive Agreement and Plan of Merger (the “Merger Agreement”) to acquire Advanced Digital Information Corporation, a Washington corporation (“ADIC”), for approximately \$803 million in cash paid to ADIC shareholders plus \$8 million in direct costs of the acquisition. Pursuant to the terms of the Merger Agreement, each outstanding share of ADIC common stock will be exchanged for cash equal to \$12.25 without interest, with the right to elect, in lieu of cash, 3.461 shares of Quantum common stock. The stock election is subject to pro-ration such that Quantum will issue no more than approximately 19.95% of the total number of shares of Quantum common stock outstanding immediately prior to the closing of the transaction. In addition, Quantum will assume all of ADIC’s outstanding employee stock options according to an option exchange ratio defined in the Merger Agreement. The applicable Hart-Scott-Rodino waiting period expired in July 2006 and certain foreign antitrust approvals were received. Consummation of the merger is subject to customary conditions, including approval of the shareholders of ADIC.

On April 27, 2006, Quantum entered into a commitment letter (the “Commitment Letter”) for a \$500 million senior credit facility with Keybank National Association (“KeyBank”). Quantum intends to use the proceeds from the Senior Credit Facility (i) to fund a portion of the proposed merger pursuant to the Merger Agreement, (ii) for working capital, and (iii) for other general corporate purposes.

Certain of the officers and directors of ADIC have entered into a voting agreement with Quantum (the “Voting Agreements”). The Voting Agreements provide that each of the ADIC officers and directors party to such Voting Agreements will vote all shares of capital stock of ADIC over which such person has voting control in favor of the approval of the Merger Agreement and the merger and against approval of any proposal made in opposition to or in competition with the consummation of the merger. The Voting Agreement terminates on the earlier of (i) the date of the merger, (ii) the date that the Merger Agreement has been validly terminated and (iii) May 2, 2007. The acquisition of ADIC is tentatively scheduled to close on August 18, 2006.

#### *Capital Resources and Financial Condition*

Although we were unprofitable over the last few fiscal years, we made progress in reducing operating costs, and we will continue to focus on improving our operating performance, including increasing revenue, reducing costs, and improving margins in an effort to return to consistent profitability and to generate positive cash flows from operating activities. We believe that our existing cash and capital resources will be sufficient to meet all currently planned expenditures, repayment of debt, contractual

obligations, and sustain operations for at least the next 12 months. This belief is dependent upon our ability to maintain revenue around or above current levels, to maintain or improve gross margins, and to reduce operating expenses in order to provide net income and positive cash flow from operating activities in the future. This belief also assumes we will not be forced to make any significant cash payments or otherwise be impacted by restrictions of available cash associated with our existing letters of credit and our credit facility.

Additionally, on May 2, 2006, we entered into an agreement to acquire ADIC which, if consummated, will be funded through combined cash of both Quantum and ADIC and new debt financing. If this acquisition closes, resulting expenditures from the acquisition will be funded through new financing and anticipated positive cash flow from operations. The cash flow from operations will be a result of our belief that we will be able to manage our assets efficiently and achieve the financial projections and associated synergies that are anticipated if the deal closes.

Should any of the above assumptions prove incorrect, either in combination or individually, it would likely have a material negative effect on our cash balances and capital resources.

Generation of net income and positive cash flow from operating activities in a consistent and sustained manner has historically been an important source of our cash to fund operating needs and, prospectively, will be required for us to fund our business and to meet our current and long-term obligations. We have taken many actions to offset both the negative impact of lower revenue and increased competition in our market segments. We cannot provide assurance that the actions we have taken in the past or any actions we may take in the future will ensure a consistent, sustainable and sufficient level of net income and positive cash flow from operating activities to fund, sustain or grow our businesses. Certain events that are beyond our control, including prevailing economic, competitive, and industry conditions, as well as various legal and other disputes, may prevent us from achieving these required financial objectives. Any inability to achieve consistent and sustainable net income and cash flow profiles could result in:

- (i) Restrictions on our ability to manage or fund our existing operations, which could result in a material and adverse effect on our future results of operations and financial condition.
- (ii) Unwillingness on the part of our bank group partners who provide our credit line to do any of the following:
  - Provide a waiver or amendment for any covenant violations we may experience in future periods, thereby triggering a default under and/or termination of the credit line; or
  - Approve any other amendments of our credit line facility we might seek to obtain in order to improve our business.

Any lack of renewal, or waiver or amendment, if needed, could result in the credit line becoming unavailable to us and any amounts outstanding becoming immediately due and payable. In the case of our secured senior credit facility, this would mean the loss of our remaining standby letters of credit totaling \$2.5 million.

- (iii) Further impairment of our financial flexibility, which could require that we raise additional funding in the capital markets sooner than we otherwise would, and on terms less favorable to us, if available at all.

Any of the above mentioned items, individually or in combination, would have a material and adverse effect on our results of operations, available cash and cash flows, financial condition, access to capital and liquidity.

#### Credit line

In December 2002, we entered into a secured senior credit facility with a group of banks, providing us with a \$100 million revolving credit line and a \$50 million synthetic lease that contains the same financial covenants as the



revolving credit line. In March 2004, we amended the secured senior credit facility to extend the maturity through March 2006 and adjusted several covenant requirements. In January 2005, we amended the revolving credit line and the synthetic lease agreement to reflect the Certance acquisition. The revolving credit line was amended to increase the line from \$100 million to \$145 million and to adjust covenant requirements. The amount we can borrow under the revolving credit facility is limited by the amount of accounts receivable and inventory. In October 2005, Quantum amended and restated the revolving credit line to extend the maturity to October 2008, adjust covenant levels, and adjust the fee structure. In February 2006, we terminated the \$50 million synthetic lease. As of June 30, 2006, \$2.5 million was committed to standby letters of credit.

Borrowings under the revolving credit line bear interest at either the London interbank offering rate ("LIBOR") with option periods of one to nine months or a base rate, plus a margin determined by a senior debt to earnings ratio as defined in the credit agreement. As of June 30, 2006, there were no borrowings under the revolving credit line. The credit facility is secured by a

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blanket lien on all of the assets of Quantum and contains certain financial and reporting covenants, which we are required to satisfy as a condition of the credit line. As of June 30, 2006, we were in compliance with all of the covenants.

### Capital Resources

On July 30, 2003, we issued 4.375% convertible subordinated notes in an aggregate principal amount of \$160 million due in 2010 in a private placement transaction. The notes are unsecured obligations subordinated in right of payment to all of our existing and future senior indebtedness. The notes mature on August 1, 2010 and are convertible at the option of the holders at any time prior to maturity into an aggregate of 36.8 million shares of Quantum common stock at a conversion price of \$4.35 per share. We cannot redeem the notes prior to August 5, 2008. We received net proceeds from the notes of \$155.1 million after deducting commissions and expenses.

As of June 30, 2006, there was approximately \$87.9 million remaining on our authorization to repurchase Quantum common stock. No stock repurchases were made during the fiscal quarter ended June 30, 2006. Our ability to repurchase common stock is restricted under our credit facilities.

The table below summarizes our commitments as of June 30, 2006:

Contractual Obligations	<u>Payments Due by Period</u>				Total
	Less than 1 year	1 – 3 years	3 – 5 years	More than 5 years	
Convertible subordinated debt (1)	\$ 7,000	\$ 14,000	\$ 168,750	\$ -	\$ 189,750
Purchase obligations	45,682	-	-	-	45,682
Operating leases	10,378	21,982	17,208	39,684	89,252
<b>Total contractual cash obligations</b>	<b>\$ 63,060</b>	<b>\$ 35,982</b>	<b>\$ 185,958</b>	<b>\$ 39,684</b>	<b>\$ 324,684</b>

(1) Includes interest payment through August 1, 2010, the maturity date of the convertible subordinated debt.

### Business Outlook

We operate in challenging and competitive markets. Since 2001, our business has experienced declining total revenues and operating losses. Major factors contributing to these trends were increased competition from other computer equipment manufacturers and a continuously challenging operating environment. Both of these factors resulted in generally lower unit prices and unit sales. In recent quarters, we have taken numerous steps aimed at addressing these challenges and eventually returning us to profitability on a consistent basis.

First, we have introduced many new products into the market that we hope will improve both market share and average unit pricing. We will continue to make concerted efforts to increase our branded business, which generally provides higher gross margin rates than OEM sales. Additionally, we continue to derive significant revenue and relatively high gross margins from our media business, which was further strengthened by the Certance acquisition.

Next, we continue to take steps to reduce costs, improve gross margins and rationalize our operations following past acquisitions. Efforts to improve gross margins are focused on lowering product cost structures through the consolidation of the manufacturing into Penang, Malaysia and consolidation of suppliers so that we have fewer, more beneficial relationships with greater volume and scale that will enable us to lower costs. Through improved product quality and cost management, our efforts are also focused on reducing warranty and repair costs on all of our products.

Finally, we have acquired companies with complementary technologies to offset the impact of the long-term financial trends. Most recently, on May 2, 2006, we entered into an agreement to acquire ADIC, which, if consummated, we believe will provide revenue growth and product and customer diversity as well as a stronger platform for back-up, recovery and archive solutions. This will enable us to expand beyond tape with solutions that include software and services, and will provide greater market access for our existing products. We also anticipate that the acquisition would provide greater gross margin improvements through manufacturing synergies and a revenue mix change due to a shift to more end user customer sales and higher sales of branded products. The acquisition of ADIC is tentatively scheduled to close on August 18, 2006.

We will continue to work toward capitalizing on our initiatives. However, there are numerous risks to the successful execution of our business plans. For a discussion of some of the risks and uncertainties that impact our business, see "Risk Factors."

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to a variety of risks, including changes in interest rates and foreign currency fluctuations.

#### Market Interest Rate Risk

Changes in interest rates affect interest income earned on our cash equivalents and short-term investments, and interest expense on short-term and long-term borrowings.

Our cash equivalents and short-term investments consist primarily of auction rate securities and money market funds. The main objective of these investments was safety of principal and liquidity while maximizing return, without significantly increasing risk. A hypothetical 100 basis point parallel decrease in the interest rate curve would have resulted in an approximate \$1.1 million and \$1.5 million annual decrease in interest income in the quarters ended June 30, 2006 and June 27, 2005, respectively.

As of June 30, 2006, our senior credit facilities were comprised of a \$145 million revolving line of credit expiring in October 2008. Borrowings under the revolving credit line bear interest at either the London interbank offering rate ("LIBOR") with option periods of one to nine months or a base rate, plus a margin determined by a senior debt to

Earnings ratio as defined in the credit agreement. Our outstanding convertible subordinated notes in the aggregate principal amount of \$160 million have a fixed interest rate of 4.375% paid semi-annually in February and August, and mature on August 1, 2010 (refer to Note 9 “Credit Agreements, Short-Term Debt and Convertible Subordinated Debt” to the Condensed Consolidated Financial Statements).

We did not enter into derivative transactions related to our cash equivalents or short-term investments nor for our existing or anticipated liabilities during the quarters ended June 30, 2006 and June 27, 2005.

#### Foreign Currency Exchange Rate Risk

As a multinational corporation, we are exposed to changes in foreign exchange rates. These exposures may change over time and could have a material adverse impact on our financial results. During the quarters ended June 30, 2006 and June 27, 2005, we did not utilize foreign currency forward contracts to manage the risk of exchange rate fluctuations because we believed that we had a natural hedge through our worldwide operating structure. We do not anticipate any material effect on our consolidated financial position utilizing our current hedging strategy.

#### **Item 4. Controls and Procedures**

- (a) *Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.
- (b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **PART II - OTHER INFORMATION**

#### **Item 1. Legal proceedings**

The information contained in Note 11 “Litigation” to the Condensed Consolidated Financial Statements is incorporated into this Part II, Item 1 by reference.

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#### **Item 1A. RISK FACTORS**

THE READER SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW, TOGETHER WITH ALL OF THE OTHER INFORMATION INCLUDED IN THIS QUARTERLY REPORT ON FORM 10-Q, BEFORE MAKING AN INVESTMENT DECISION. THE RISKS AND UNCERTAINTIES DESCRIBED BELOW ARE NOT THE ONLY ONES FACING QUANTUM. ADDITIONAL RISKS AND UNCERTAINTIES NOT PRESENTLY KNOWN TO US OR THAT ARE CURRENTLY DEEMED IMMATERIAL MAY ALSO IMPAIR OUR BUSINESS AND OPERATIONS. THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS “FORWARD-LOOKING” STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. PLEASE SEE PAGE 18 OF THIS REPORT FOR ADDITIONAL DISCUSSION OF THESE FORWARD-LOOKING STATEMENTS.

**A large percentage of our sales come from a few customers, and these customers have no minimum or long-term purchase commitments. The loss of, or a significant reduction in demand from, one or more key**

**customers could materially and adversely affect our business, financial condition, and operating results.**

Our sales have been and continue to be concentrated among a few customers. Sales to our top five customers in the first quarter of fiscal year 2007 represented 49% of total revenue. This sales concentration does not include revenues from sales of our media that our licensees sold to our top five customers, for which we earn royalty revenue. Furthermore, customers are not obligated to purchase any minimum product volume and our relationships with our customers are terminable at will.

In the first quarter of fiscal year 2007, approximately 19% and 15% of our revenue was derived from Dell and Hewlett-Packard, respectively. Over the recent years, the revenue contribution from Hewlett-Packard has declined. If this trend continues, or if we experience a significant decline in revenue from Dell, we could be materially and adversely affected. There is additional risk regarding Hewlett-Packard since it markets and manufactures its own LTO and DDS/DAT tape drives and media in competition with our LTO, DDS/DAT, DLTtape® and Super DLTtape™ platforms. To the extent that Hewlett-Packard reduces its purchases of our products in favor of its own, or is successful in gaining share in the market with its tape drive products at the expense of our products, our tape drive and media revenues, operating results and financial condition could be materially and adversely affected.

In addition, many of our tape products are primarily incorporated into larger storage systems or solutions that are marketed and sold to end-users by our large OEM customers. Because of this, we have limited market access to these end-users, limiting our ability to reach and influence their purchasing decisions. These market conditions further our reliance on these large OEM customers. Thus if they were to significantly reduce, cancel or delay their orders with us, our results of operations could be materially adversely affected.

**From time to time we make acquisitions, such as the contemplated acquisition of ADIC. The failure to successfully integrate recent or future acquisitions could harm our business, financial condition, and operating results.**

As a part of our business strategy, we have in the past and expect in the future to make acquisitions, or significant investments in, complementary companies, products or technologies, such as in the contemplated acquisition of ADIC. If we fail to successfully integrate such acquisitions, it could harm our business, financial condition, and operating results. Risks that we may face in our efforts to integrate any recent or future acquisitions include, among others:

- Failure to realize anticipated synergies and benefits from the acquisition;
- Difficulties in assimilating and retaining employees;
- Potential incompatibility of business cultures;
- Diversion of management's attention from ongoing business concerns;
- Coordinating infrastructure operations in a rapid and efficient manner;
- The potential inability to maximize our financial and strategic position through the successful incorporation of acquired technology and rights into our products and services;
- Insufficient revenues to offset increased expenses associated with the acquisition;
- Costs and delays in implementing or integrating common systems and procedures;
- Reduction or loss of customer orders due to the potential for market confusion, hesitation and delay;
- Impairment of existing customer, supplier and strategic relationships of either company;
- Insufficient cash flows from operations to fund the working capital and investment requirements;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;

- The possibility that we may not receive a favorable return on our investment, the original investment may become impaired, and/or we may incur losses from these investments;
- Dissatisfaction or performance problems with the acquired company;
- The assumption of risks of the acquired company that are difficult to quantify, such as litigation;
- The cost associated with the acquisition; and
- Assumption of unknown liabilities or other unanticipated adverse events or circumstances.

Acquisitions present many risks, and we may not realize the financial and strategic goals that were contemplated at the time of any transaction. We cannot provide assurance that we will be able to successfully integrate any business, products, technologies or personnel that we may acquire in the future, and our failure to do so could harm our business, financial condition, and operating results.

**If we draw on our contemplated \$500 million credit facility with Key Bank, we will substantially increase our debt, which could adversely affect our cash flow and prevent us from fulfilling our obligations.**

In the event that we consummate our acquisition of ADIC, we intend to draw down our \$500 million credit facility with Key Bank, which will add a significant amount of indebtedness and interest expense to our obligations under our current indebtedness. Our level of indebtedness presents risks to investors, including the possibility that we may be unable to generate cash sufficient to pay the principal of and interest on our indebtedness when due.

Our substantial debt could have important consequences, such as:

- Making it more difficult or impossible for us to make payments on the notes or any other indebtedness or obligations;
- Requiring us to dedicate a portion of our cash flow from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures and other cash requirements;
- Increasing our vulnerability to adverse economic and industry conditions;
- Limiting our flexibility in planning for, or reacting to, changes and opportunities in, the electronics manufacturing industry, which may place us at a competitive disadvantage; and
- Limiting our ability to incur additional debt on acceptable terms, if at all.

**Our operating results depend on new product introductions, which may not be successful, in which case our business, financial condition, and operating results may be materially and adversely affected.**

To compete effectively, we must continually improve existing products and introduce new ones, such as our recently introduced PX500-Series libraries, the DLT S-4 and GoVault. We have devoted and expect to continue to devote considerable management and financial resources to these efforts. We cannot provide assurance that:

- We will introduce new products in the time frame we are forecasting;
- We will not experience technical, quality, performance-related or other difficulties that could prevent or delay the introduction of, and market acceptance of, new products;
- Our new products will achieve market acceptance and significant market share, or that the markets for these products will continue or grow as we have anticipated;
- Our new products will be successfully or timely qualified with our customers by meeting customer performance and quality specifications because a successful and timely customer qualification must occur before customers will place large product orders; or
- We will achieve high volume production of these new products in a timely manner, if at all.

If we are not successful in timely completion of our new product qualifications and then ramping sales to our key customers, our revenue and results of operations could be adversely impacted. In addition, if the quality of our products is not acceptable to our customers, this could result in customer dissatisfaction, lost revenue, and increased warranty and repair costs.

**Competition has increased, and may increasingly intensify, in the tape drive and tape automation markets as a result of competitors introducing products based on new technology standards, which could materially and adversely affect our business, financial condition, and results of operations.**

We compete with companies that develop, manufacture, market, and sell tape drive and tape automation products. The principal competitors for our tape drive products include Hewlett-Packard, IBM, and Sony. These competitors are aggressively trying to advance and develop new technologies and products to compete against our technologies and products. For instance, LTO

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technology, which was developed by Certance, Hewlett-Packard and IBM, targets the high-capacity data backup market and competes directly with our products based on Super DLTtape™ technology. Hewlett-Packard and IBM thus compete not only with our Super DLTtape™ products but now compete with the LTO product offerings that we acquired through our acquisition of Certance. This competition has resulted in a trend, which is expected to continue, toward lower prices and lower margins earned on our DLTtape® and Super DLTtape™ drives and media. Additionally, over the last two years, our DLT and Super DLTtape™ drives have lost market share to LTO based products, and we cannot provide assurance that our tape technology based products will not continue to lose market share to LTO based products in the future. In addition, the 2003 merger between Hewlett-Packard and Compaq resulted in a larger competitor in the tape drive and tape automation markets with substantially greater resources and a potentially greater market reach with products that compete directly with ours. These factors, and additional factors, such as the possibility of industry consolidation, when combined with the current environment of intense competition, which has resulted in reduced shipments of our tape drive products, could result in a further reduction in our prices, volumes and margins, which could materially and adversely impact our business, financial condition, and results of operations.

Our tape automation products compete with product offerings of ADIC, Overland Data Inc., EMC, and Sun (due to its recent acquisition of StorageTek), which offer tape automation systems incorporating DLTtape® and Super DLTtape™ technology as well as LTO technology. Increased competition has resulted in increased price competition. If this trend continues or worsens, if competition further intensifies, or if industry consolidation occurs, our sales and gross margins could decline, which could materially and adversely affect our business, financial condition and results of operations.

**We have taken considerable steps towards reducing our cost structure and may take further cost reduction actions. The steps we have taken and may take in the future may not reduce our cost structure to a level appropriate in relation to our future sales and therefore, these anticipated cost reductions may be insufficient to bring us back to profitability.**

In the last four years, we have recorded significant restructuring charges and made cash payments in order to reduce our cost of sales and operating expenses to rationalize our operations following past acquisitions and in response to adverse economic, industry and competitive conditions. We may take future steps to further reduce our operating costs. These steps and additional future restructurings in response to rationalization of operations following future acquisitions or to adverse changes in our business and industry may require us to make cash payments that, if large enough, would materially and adversely affect our liquidity. We may be unable to reduce our cost of sales and operating expenses at a rate and to a level consistent with a future potential adverse sales environment, which may adversely affect our business, financial condition, and operating results.

**We derive almost all of our revenue from products incorporating tape technology. If competition from alternative storage technologies continues or increases, our business, financial condition, and operating results would be materially and adversely harmed.**

We derive almost all of our revenue from products that incorporate some form of tape technology and we expect to continue to derive a substantial majority of our revenue from these products for the foreseeable future. As a result, our future operating results depend on the continued market acceptance of products employing tape drive technology. Our tape products, including tape drives and automation systems, compete with other storage technologies, such as hard disk drives. Hard disk drives have experienced a trend toward lower prices while capacity and performance have increased. If products incorporating other technologies gain comparable or superior market acceptance, or their costs decline far more rapidly than tape drive and media costs, the competition resulting from these alternative technologies would increase as customers turn toward those alternative technologies with an acceptable price/performance offering relative to tape drives and automation systems. We are working to address this risk through our own targeted investment in alternative technologies, but if a migration to alternative technologies occurs, and we are not successful in our efforts, our business, financial condition, and operating results would be materially and adversely affected.

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**Our tape media business generates a relatively high gross margin rate, which significantly impacts the total company gross margin rate. If we were to experience a significant decline in the tape media or tape royalty gross margin rate, our business, financial condition, and operating results would be materially and adversely affected.**

Our tape royalty and media gross margin rates and revenues are dependent on many factors, including the following factors:

- The pricing actions of other media suppliers;
- The size of the installed base of tape drives that use our tape cartridges;
- The performance of our strategic licensing partners, which sell our tape media cartridges;
- The relative growth in units of our newer tape drive products, since the associated media cartridges typically sell at higher prices than the media cartridges associated with older tape drive products;
- The relative mix of media purchased directly from us as compared to our licensees;
- The media consumption habits and rates of end users;
- The pattern of tape drive retirements; and
- The level of channel inventories.

Competition from other tape technologies has had a significant negative impact on our income from media as well as on our sales of tape drives. Similarly, competition among media suppliers has periodically resulted in intense, price-based competition for media sales, which also affects media income. If either of these competitive factors continues or intensifies, it would further erode tape drive unit sales, tape drive installed base, media units and media pricing. To the extent that our Quantum branded media revenue and media royalties are dependent upon media pricing and the quantity of media consumed by the installed base of our tape drives, reduced media prices, or a reduced installed tape drive base, would result in further reductions in our Quantum branded media and media royalty revenue and gross margin rates. This would materially and adversely affect our business, financial condition, and results of operations.

**Third party infringement claims could result in substantial liability and significant costs, and, as a result, our business, financial condition, and operating results may be materially and adversely affected.**

From time to time, third parties allege our infringement of and need for a license under their patented or other proprietary technology. While we currently believe the amount of ultimate liability, if any, with respect to any such actions will not materially affect our financial position, results of operations, or liquidity, the ultimate outcome of any litigation is uncertain. Adverse resolution of any third party infringement claim could subject us to substantial liabilities and require us to refrain from manufacturing and selling certain products. In addition, the costs incurred in intellectual property litigation can be substantial, regardless of the outcome. As a result, our business, financial condition, and operating results could be materially and adversely affected.

**A significant portion of our manufacturing and sales operations occurs in foreign locations; we are increasingly exposed to risks associated with conducting our business internationally. Many of our facilities and those of important customers and suppliers are located near known earthquake fault zones or in geographic areas susceptible to other natural disasters, which could disrupt our business and require us to curtail or cease operations.**

We manufacture and sell our products in a number of different markets throughout the world. Following the acquisition of Certance, an increasing number of our products are internally manufactured at a facility in Penang, Malaysia. As a result of our global manufacturing and sales operations, we are subject to a variety of risks that are unique to businesses with international operations of a similar scope, including the following:

- Import and export duties and value-added taxes;
- Import and export regulation changes that could erode our profit margins or restrict our exports;
- Political risks and natural disasters, including earthquakes, especially in emerging or developing economies;
- Potential restrictions on the transfer of funds between countries;
- Inflexible employee contracts in the event of business downturns;
- Adverse movement of foreign currencies against the U.S. dollar (the currency in which our results are reported); and
- The burden and cost of complying with foreign laws.

Any or all of these risks could have a material adverse effect on our business.

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**Our quarterly operating results could fluctuate significantly, and past quarterly operating results should not be used to predict future performance.**

Our quarterly operating results have fluctuated significantly in the past and could fluctuate significantly in the future. As a result, our past quarterly operating results should not be used to predict future performance. Quarterly operating results could be materially and adversely affected by a number of factors, including, but not limited to:

- An inadequate supply of tape media cartridges;
- Reduced demand from our OEM customers;
- Customers canceling, reducing, deferring or rescheduling significant orders as a result of excess inventory levels, weak economic conditions or other factors;
- Declines in network server demand;
- Product ramp cycles;
- Failure to complete shipments in the last month of a quarter during which a substantial portion of our products are typically shipped; or
- Increased competition.

If we fail to meet our projected quarterly results, our business, financial condition, and results of operations may be materially and adversely harmed.

**If we do not successfully manage the changes that we have made and may continue to make to our infrastructure and management, our business could be disrupted, and that could adversely impact our results of operations and financial condition.**

Managing change is an important focus for us. Following the acquisition of Certance, one of our important initiatives involves combining and integrating the information technology (“IT”) infrastructures of the companies, including our enterprise resource planning (“ERP”) systems, and adapting our business processes and software to the requirements of the new organization. We are also managing several significant initiatives involving our operations, including efforts to reduce the number of contract manufacturers and suppliers we use, the outsourcing of our repair capabilities and the



related closing of our facility in Dundalk, Ireland. In addition, we continue to reduce headcount to streamline and consolidate our supporting functions as appropriate following past acquisitions and in response to market or competitive conditions. If we are unable to successfully manage the changes that we implement, and detect and address issues as they arise, it could disrupt our business and adversely impact our results of operations and financial condition.

**If we fail to protect our intellectual property or if others use our proprietary technology without authorization, our competitive position may suffer.**

Our future success and ability to compete depends in part on our proprietary technology. We rely on a combination of copyright, patent, trademark, and trade secrets laws and nondisclosure agreements to establish and protect our proprietary technology. We currently hold 390 United States patents and have 186 United States patent applications pending. However, we cannot provide assurance that patents will be issued with respect to pending or future patent applications that we have filed or plan to file or that our patents will be upheld as valid or will prevent the development of competitive products or that any actions we have taken will adequately protect our intellectual property rights. We generally enter into confidentiality agreements with our employees, consultants, customers, potential customers, and others as required, in which we strictly limit access to, and distribution of, our software, and further limit the disclosure and use of our proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain or use our products or technology. Our competitors may also independently develop technologies that are substantially equivalent or superior to our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States.

**Because we may order components from suppliers in advance of receipt of customer orders for our products which include these components, we could face a material inventory risk.**

Historically, we have relied primarily on third parties to manufacture our products. However, we have begun to manufacture more of our products ourselves and anticipate that we will continue to increase the proportion of our products that we manufacture ourselves. Managing such a build-up of our in-house manufacturing capabilities presents a number of risks that could materially and adversely affect our financial condition. For instance, as part of our component planning, we place orders with or pay certain suppliers for components in advance of receipt of customer orders. We occasionally enter into negotiated orders with vendors early in the manufacturing process of our storage products to ensure that we have sufficient components for our new products to meet anticipated customer demand. Because the design and manufacturing process for these components is complicated, it is possible

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that we could experience a design or manufacturing flaw that could delay or even prevent the production of the components for which we previously committed to pay. We also face the risk of ordering too many components, or conversely, not enough components, since supply orders are generally based on forecasts of customer orders rather than actual customer orders. In addition, in some cases, we make non-cancelable order commitments to our suppliers for work-in-progress, supplier's finished goods, custom sub-assemblies and Quantum-unique raw materials that are necessary to meet our lead times for finished goods. If we cannot change or be released from supply orders, we could incur costs from the purchase of unusable components, either due to a delay in the production of the components or other supplies or as a result of inaccurately predicting supply orders in advance of customer orders. Our business and operating results could be materially and adversely affected as a result of these increased costs.

**A portion of our manufacturing, including service repair, is outsourced to Jabil and other third party contract manufacturers. If we cannot obtain our products and parts from these third parties in a cost effective and timely manner that meets our customers' expectations, this could materially and adversely impact our business, financial condition, and results of operations.**

A number of our tape drive and tape automation products are manufactured for us by Jabil or other contract manufacturers. We face a number of risks as a result of this outsourced manufacturing, including, among others:

- *Sole source of product supply*  
In each case, our contract manufacturer is our sole source of supply for the tape drive and/or tape automation products they manufacture for us. Because we are relying on one supplier, we are at greater risk of experiencing component shortages or other delays in customer deliveries that could result in customer dissatisfaction and lost sales, which could materially damage customer relationships and result in lost revenue.
- *Cost and purchase commitments*  
We may not be able to control the costs we would be required to pay our contract manufacturers for the products they manufacture for us. They procure inventory to build our products based upon a forecast of customer demand that we provide. We would be responsible for the financial impact on the contract manufacturer of any reduction or product mix shift in the forecast relative to materials that they had already purchased under a prior forecast. Such a variance in forecasted demand could require us to pay them for finished goods in excess of current customer demand or for excess or obsolete inventory and generally incur higher costs. As a result, we could experience reduced gross margins and larger operating losses based on these purchase commitments.
- *Quality*  
We will have limited control over the quality of products produced by our contract manufacturers. Therefore, the quality of the products may not be acceptable to our customers and could result in customer dissatisfaction, lost revenue, and increased warranty costs.

Any or all of these risks could have a material adverse effect on our business.

**We do not control licensee pricing or licensee sales of tape media cartridges. To the extent that our royalty revenue is dependent on the prices of cartridges sold by our licensees, should these licensees significantly lower prices on the media products that they sell, such reduced pricing would lower our royalty revenue, which would materially and adversely affect our business, financial condition, and operating results.**

We receive a royalty fee based on sales of our tape media cartridges by Fuji, Maxell, Imation and Sony. Under our license agreements with these companies, each of the licensees determines the pricing and number of units of tape media cartridges that it sells. To the extent that our royalty revenue is based on the prices of cartridges sold by our licensees, our royalty revenue will vary depending on the level of sales and prices set by the licensees. In addition, lower prices set by licensees could require us to lower our prices on direct sales of tape media cartridges, which would reduce our revenue and margins on these products. As a result, lower prices on our tape media cartridges would reduce media revenue, which could materially and adversely affect our business, financial condition, and operating results.

**We have incurred significant losses over the last few years. If we remain unprofitable and are unable to generate positive cash flow from operating activities, our ability to service our debt and fund our other business requirements, as well as obtain additional capital in the future, could be jeopardized, our business could suffer, and our assets could be impaired.**

Our ability to meet our debt service obligations and to fund working capital, capital expenditures, acquisitions, research and development and other general corporate needs will depend upon our future financial performance. Our future financial performance will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. If our losses from operations were to persist at current levels or worsen, we may not have sufficient cash resources to service our debt and maintain access to our credit facilities. We cannot provide assurance that we will generate sufficient cash flow from operations, or that future borrowings or equity financing will be available on commercially reasonable terms or at all, or available

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in an amount sufficient to enable us to pay our debt or fund other liquidity needs. If we are unable to generate sufficient cash flow and/or are unable to service our outstanding debt obligations, we may have to reduce or delay capital expenditures planned for replacements, improvements and expansions, and/or sell assets, thereby affecting our ability to remain competitive and adversely affecting our business.

We must devote substantial resources to new product development, manufacturing, and sales and marketing activities to be competitive in our markets. Historically, cash flow from operating activities has provided us with a significant portion of the cash and liquidity that we have required in order to invest in product development, manufacturing, and sales activities. Until or unless we return to consistent, profitable generally accepted accounting principles ("GAAP") operating results, we will have significantly less liquidity to invest in our business, which could have a material adverse impact on our business, results of operations, liquidity, and financial condition.

Our ability to achieve profitability may be adversely impacted by higher energy prices to the extent that we, or our key suppliers experience higher energy costs, which we are unable to offset or recover in the form of higher prices for our products and services.

**Decreased effectiveness of equity compensation could adversely affect our ability to attract and retain employees, and proposed changes in accounting for equity compensation will adversely affect earnings.**

Beginning in our first quarter of fiscal year 2007, Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004) Share-Based Payment ("SFAS No. 123R"), which requires us to recognize compensation expense in our statement of operations for the fair value of unvested employee stock options at the date of adoption and new stock options granted to our employees after the adoption date over the related vesting periods of the stock options. The requirement to expense stock options granted to employees reduces their attractiveness to Quantum because the expense associated with these grants may result in future compensation charges. In addition, the expenses recorded may not accurately reflect the value of our stock options because the option pricing models used to estimate fair value were not developed for use in valuing employee stock options and are based on highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. Alternative compensation arrangements that can replace stock option programs may also negatively impact profitability. Stock options remain an important employee recruitment and retention tool, and we may not be able to attract and retain key personnel if we reduce the scope of our employee stock option program following the adoption of SFAS No. 123R. Our employees are critical to our ability to develop and design systems that advance our productivity and technology goals, increase our sales goals and provide support to customers. Accordingly, as a result of the requirement under SFAS No. 123R to recognize the fair value of stock options as compensation expense, beginning in the first quarter of fiscal year 2007, our future profitability can be expected to be reduced. See also Recent Accounting Pronouncements in Note 2 "Share-based Compensation Expense" to the Condensed Consolidated Financial Statements: SFAS No. 123 (revised 2004) *Share-Based Payment* ("SFAS No. 123R").

**Our stock price could become more volatile if certain institutional investors were to increase or decrease the number of shares they own. In addition, there are other factors and events that could affect the trading prices of our common stock.**

Five institutional investors own approximately 58% of our common stock. If any or all of these investors were to decide to purchase additional shares or to sell some or all of the common shares they currently own, that may cause our stock price to be more volatile. For example, there have been instances in the past where a shareholder with a significant equity position begins selling shares, putting downward pressure on our stock price for the duration of their selling activity. In these situations, selling pressure outweighs buying demand and our stock price declined.

Trading prices of our common stock may fluctuate in response to a number of other events and factors, such as:

- General economic conditions;
- Changes in interest rates;
- Fluctuations in the stock market in general and market prices for high technology companies in particular;
- Quarterly variations in our operating results;
- New products, services, innovations and strategic developments by our competitors or us, or business combinations and investments by our competitors or us;
- Changes in financial estimates by us or securities analysts and recommendations by securities analysts,
- Changes in our capital structure, including issuance of additional debt or equity to the public; and
- Strategic acquisitions.

Any of these events and factors may cause our stock price to rise or fall and may adversely affect our business and financing opportunities.

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**We are exposed to general economic conditions which, if these conditions were to deteriorate, could result in significantly reduced sales levels and significant operating losses, which would materially and adversely affect our business, financial condition, and operating results.**

If we experience adverse economic conditions in the United States and throughout the world economy, our business, operating results, and financial condition could be further adversely and materially impacted. We have taken actions in the past to reduce our cost of sales and operating expenses in order to address the adverse conditions. A prolonged continuation or worsening of sales trends could require us to take additional actions to further reduce our cost of sales and operating expenses in future quarters in order to align these costs with reduced revenue. We may be unable to reduce our cost of sales and operating expenses at a rate and to a level consistent with such a future adverse sales environment. If we are required to undertake further expense reductions, we may incur significant additional incremental restructuring charges associated with such expense reductions that are disproportionate to sales, thereby materially and adversely affecting our business, financial condition, and operating results.

**Our reliance on a limited number of third party suppliers could result in significantly increased costs and delays in the event these suppliers experience shortages or quality problems, and, as a result, our business, financial condition, and operating results may be materially and adversely affected.**

We depend on a limited number of suppliers for components and sub-assemblies, including recording heads, media cartridges, and integrated circuits, all of which are essential to the manufacture of tape drives and tape automation systems.

If component shortages occur, or if we experience quality problems with component suppliers, shipments of products could be significantly delayed and/or costs significantly increased, and as a result, our business, financial condition, and operating results could be materially and adversely affected. In addition, we qualify only a single source for many components and sub-assemblies, which magnifies the risk of future shortages.

Furthermore, the main supplier of recording heads for our products is located in China. Political instability, trade restrictions, changes in tariff or freight rates, or currency fluctuations in China could result in increased costs and delays in shipment of our products and could materially and adversely impact our business, financial condition, and operating results.

**Some of our production processes and materials are environmentally sensitive, and new environmental regulation could lead to increased costs, or otherwise adversely affect our business, financial condition, and results of operations.**

We are subject to a variety of laws and regulations relating to, among other things, the use, storage, discharge and disposal of chemicals, gases and other hazardous substances used in our manufacturing processes, air emissions, waste discharges, waste disposal, as well as the investigation and remediation of soil and ground water contamination. A recent directive in the European Union imposes a “take back” obligation on manufacturers for the financing of the collection, recovery and disposal of electrical and electronic equipment. Additional European legislation will ban the use of some heavy metals including lead and some flame retardants in electronic components beginning in July 2006. We are in the process of implementing procedures to comply with this new legislation. However, this legislation may adversely affect our manufacturing costs or product sales by requiring us to acquire costly equipment or materials, or to incur other significant expenses in adapting our manufacturing processes or waste and emission disposal processes. Furthermore, environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us, or the suspension of affected operations, which could have an adverse effect on our business, financial condition, and results of operations.

**Our credit agreement contains various covenants that limit our discretion in the operation of our business, which could have an adverse effect on our business, financial condition, and results of operations.**

Our credit agreement contains numerous restrictive covenants that require us to comply with and maintain certain financial tests and ratios, thereby restricting our ability to:

- Incur debt;
- Incur liens;
- Redeem or prepay subordinated debt;
- Make acquisitions of businesses or entities or sell certain assets;
- Make investments, including loans, guarantees, and advances;
- Make capital expenditures beyond a certain threshold;
- Engage in transactions with affiliates;
- Pay dividends or engage in stock

- repurchases;
- and
- Enter into certain restrictive agreements.

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Our ability to comply with covenants contained in our credit agreement may be affected by events beyond our control, including prevailing economic, financial, and industry conditions. Even if we are able to comply with all covenants, the restrictions on our ability to operate our business could harm our business by, among other things, limiting our ability to take advantage of financings, mergers, acquisitions, and other corporate opportunities.

Our credit agreement is secured by a pledge of all of our assets. If we were to default under our credit agreement and were unable to obtain a waiver for such a default, the lenders would have a right to foreclose on our assets in order to satisfy our obligations under the credit agreement. Any such action on the part of the lenders against us could have a materially adverse impact on our business, financial condition, and results of operations.

**In prior year periods, we violated certain financial covenants under our credit agreement and received waivers or amendments for such violations. If in the future we violate financial covenants, it could materially and adversely impact our financial condition and liquidity.**

If our operating results do not improve in the future and we violate any financial or reporting covenant in our credit agreement and receive a notice of default letter from our bank group, our credit line could become unavailable, and any amounts outstanding could become immediately due and payable. If we were unsuccessful in securing a waiver of such violation or an amendment to our credit agreement, we might have to restrict \$2.5 million of our cash to cover the outstanding standby letters of credit issued under the credit agreement.

Without the availability of the credit agreement, we would have to rely on operating cash flows and debt or equity arrangements other than the credit agreement, if such alternative funding arrangements are available to us at all, in order to maintain sufficient liquidity. If we were not able to obtain sufficient cash from our operations or from these alternative funding sources under such circumstances, our operations, financial condition, and liquidity would be materially and adversely affected.

**We may be sued by our customers for product liability claims as a result of failures in our data storage products.**

We face potential liability for performance problems of our products because our end users employ our storage technologies for the storage and backup of important data and to satisfy regulatory requirements. Although we maintain general liability insurance, our insurance may not cover potential claims of this type or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability that is not covered by insurance or is in excess of our insurance coverage could harm our business.

**We must maintain appropriate levels of service inventories. If we have too little service inventory, we may experience increased levels of customer dissatisfaction. If we have too much service inventory, we may incur financial losses.**

We maintain levels of service inventories to satisfy future warranty obligations and also to earn service revenue to repair products for which the warranty has expired. We estimate the required amount of service inventories based on historical usage and forecasts of future warranty requirements, including estimates of failure rates and costs to repair, and out of warranty revenue. Given the significant levels of judgment inherently involved in the process, we cannot

provide assurance that we will be able to maintain appropriate levels of service inventories to satisfy customer needs and to avoid financial losses from excess inventory charges. If we are unable to maintain appropriate levels of service inventories, our business, financial condition, and results of operations may be materially and adversely impacted.

**Because we rely heavily on distributors and other resellers to market and sell our products, if one or more distributors were to experience a significant deterioration in its financial condition or its relationship with us, this could disrupt the distribution of our products and reduce our revenue, which could materially and adversely affect our business, financial condition, and operating results.**

In certain product and geographic segments we heavily utilize distributors and value added resellers to perform the functions necessary to market and sell our products. To fulfill this role, the distributor must maintain an acceptable level of financial stability, creditworthiness and the ability to successfully manage business relationships with the customers it serves directly. Under our distributor agreements with these companies, each of the distributors determines the type and amount of our products that it will purchase from us and the pricing of the products that it sells to its customers. If the distributor is unable to perform in an acceptable manner, we may be required to reduce the amount of sales of our product to the distributor or terminate the relationship. We may also incur financial losses for product returns from distributors or for the failure or refusal of distributors to pay obligations owed to us. Either scenario could result in fewer of our products being available to the affected market segments, reduced levels of customer satisfaction and/or increased expenses, which could in turn have a material and adverse impact on our business, results of operations, and financial condition.

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**If the future outcomes related to the estimates used in recording tax liabilities to various taxing authorities result in higher tax liabilities than estimated, then we would have to record tax charges, which could be material.**

We have provided amounts and recorded liabilities for probable and estimable tax adjustments that may be proposed by various taxing authorities in the U.S., states, and foreign jurisdictions. If events occur that indicate payments of these amounts will be less than estimated, then reversals of these liabilities would create tax benefits being recognized in the periods when we determine the liabilities have reduced. Conversely, if events occur which indicate that payments of these amounts will be greater than estimated, then tax charges and additional liabilities would be recorded. In particular, various foreign jurisdictions could challenge the characterization or transfer pricing of certain intercompany transactions. In the event of an unfavorable outcome of such challenge, there exists the possibility of a material tax charge and adverse impact on the results of operations in the period in which the matter is resolved or an unfavorable outcome becomes probable and estimable.

**Maxtor's failure to perform under the indemnification provisions of a tax sharing and indemnity agreement entered into with us providing for payments to us that relate to tax liabilities, penalties, and interest resulting from the conduct of our business prior to the Hard Disk Drive group disposition date could have a material adverse effect on our business, financial condition, and operating results.**

The Company entered into a Settlement Agreement with Maxtor on December 23, 2004, and included a Mutual General Release and Global Settlement Agreement with Maxtor Corporation, the corporation to which Quantum sold its former Hard Disk Drive business on April 2, 2001. Under this agreement, Maxtor has agreed to assume limited responsibility for payments related to certain taxes, penalties, and interest resulting from the conduct of business by the Quantum Tape Drive and Storage Systems group for all periods before our issuance of tracking stock and the conduct of the Quantum Hard Disk Drive group for all periods before the disposition of the Hard Disk Drive group to Maxtor. If audit adjustments are successfully asserted with respect to such conduct, and if Maxtor fails to indemnify us under this obligation or is not able to pay the reimbursement in full, we would nevertheless be obligated, as the taxpayer, to pay the tax. As a result, we could experience a material adverse effect on our business, financial

condition, and operating results. Maxtor has recently been acquired by Seagate, which has assumed Maxtor's defense and indemnification obligations.

**Maxtor's failure to perform under the agreements in connection with contingent liabilities would harm our business, financial condition, and operating results.**

We may have contingent liabilities for some obligations assumed by Maxtor in connection with the disposition of the Hard Disk Drive group, including real estate and litigation, and Maxtor's failure to perform under these obligations could result in significant costs to us that could have a materially adverse impact on our business, financial condition, and operating results. Maxtor has recently been acquired by Seagate, which has assumed Maxtor's defense and indemnification obligations.

**The disposition of the Hard Disk Drive group may be determined not to be tax-free, which would result in us or our stockholders, or both, incurring a substantial tax liability, which could materially and adversely affect our business, financial condition, and results of operations.**

Maxtor and Quantum have agreed not to request a ruling from the Internal Revenue Service, or any state tax authority confirming that the structure of the combination of Maxtor with the Hard Disk Drive group will not result in any federal income tax or state income or franchise tax to Quantum or the previous holders of the Hard Disk Drive common stock. Instead, Maxtor and Quantum have agreed to effect the disposition and the merger on the basis of an opinion from our tax advisor, and a tax opinion insurance policy issued by a syndicate of major insurance companies to us covering up to \$340 million of tax loss caused by the disposition and merger.

If the disposition of the Hard Disk Drive group is determined not to be tax-free and the tax opinion insurance policy does not fully cover the resulting tax liability, we or our stockholders or both could incur substantial tax liability, which could materially and adversely affect our business, financial condition, and results of operations. Maxtor has recently been acquired by Seagate, which has assumed Maxtor's defense and indemnification obligations.

**The tax opinion insurance policy issued in conjunction with the disposition of the Hard Disk Drive group does not cover all circumstances under which the disposition could become taxable to us, and as a result, we could incur an uninsured tax liability, which could materially and adversely affect our business, financial condition, and results of operations.**

In addition to customary exclusions from its coverage, the tax opinion insurance policy does not cover any federal or state tax payable by us if the disposition becomes taxable to us as a result of a change in relevant tax law. We could incur uninsured tax liability, which could materially and adversely affect our business, financial condition, and results of operations.

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**If we incur an uninsured tax liability as a result of the disposition of the Hard Disk Drive group, our financial condition and operating results could be negatively affected.**

If the disposition of the Hard Disk Drive group were determined to be taxable to Quantum, we would not be able to recover an amount to cover the tax liability either from Maxtor or under the insurance policy in the following circumstances:

- If the tax loss were not covered by the policy because it fell under one of the exclusions from coverage under the tax opinion insurance policy described above, insurance proceeds would not be available to cover the loss;
- If the tax loss were caused by our own acts or those of a third party that made the disposition taxable (for instance, an acquisition of control of Quantum which began during the one-year period before and nine-month period



- following the closing), Maxtor would not be obligated to indemnify us for the amount of the tax liability; or
- If Maxtor were required to reimburse us for the amount of the tax liability according to its indemnification obligations under the Hard Disk Drive group disposition, but was not able to pay the reimbursement in full, we would nevertheless be obligated, as the taxpayer, to pay the tax.

In any of these circumstances, the tax payments due from us could be substantial. In order to pay the tax, we would have to either deplete our existing cash resources or borrow cash to cover our tax obligation. Our payment of a significant tax prior to payment from Maxtor under Maxtor's indemnification obligations, or in circumstances where Maxtor has no payment obligation, could harm our business, financial condition, and operating results. Maxtor has recently been acquired by Seagate, which has assumed Maxtor's defense and indemnification obligations.

**We are exposed to fluctuations in foreign currency exchange rates, and an adverse change in foreign currency exchange rates relative to our position in such currencies could have a materially adverse impact on our business, financial condition, and results of operations.**

We do not use derivative financial instruments for hedge or speculative purposes. To minimize foreign currency exposure, we use foreign currency obligations to match and offset net currency exposures associated with certain assets and liabilities denominated in non-functional currencies. Corresponding gains and losses on the underlying transaction generally offset the gains and losses on these foreign currency obligations. We have used in the past, and may use in the future, foreign currency forward contracts to hedge our exposure to foreign currency exchange rates. To the extent that we have assets or liabilities denominated in a foreign currency that are inadequately hedged or not hedged at all, we may be subject to foreign currency losses, which could be significant.

Our international operations can act as a natural hedge when both operating expenses and sales are denominated in local currencies. In these instances, although an unfavorable change in the exchange rate of a foreign currency against the U.S. dollar would result in lower sales when translated to U.S. dollars, operating expenses would also be lower in these circumstances. Also, since an insignificant amount of our current sales are denominated in currencies other than the U.S. dollar, we do not believe that our total foreign exchange rate exposure is significant. Nevertheless, an increase in the rate at which a foreign currency is exchanged for U.S. dollars would require more of that particular foreign currency to equal a specified amount of U.S. dollars than before such rate increase. In such cases, and if we were to price our products and services in that particular foreign currency, we would receive fewer U.S. dollars than we would have received prior to such rate increase for the foreign currency. Likewise, if we were to price our products and services in U.S. dollars while competitors priced their products in a local currency, an increase in the relative strength of the U.S. dollar would result in our prices being uncompetitive in those markets. Such fluctuations in currency exchange rates could materially and adversely affect our business, financial condition, and results of operations.

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**Item 2. Unregistered sales of equity securities and use of proceeds**  
None.

**Item 3. Defaults upon senior securities**  
None.

**Item 4. Submission of matters to a vote of security holders**  
None.

**Item 5. Other information**  
None.

**Item 6.**

**Exhibits**

The Exhibit Index beginning on page 49 of this report sets forth a list of exhibits.

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**SIGNATURE**

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

QUANTUM CORPORATION

/s/ EDWARD J. HAYES, JR.

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Edward J. Hayes, Jr.  
Executive Vice President, Finance  
and Chief Financial Officer

Dated: August 7, 2006

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Exhibit 31.1

**CERTIFICATION PURSUANT TO SECTION 302(a)  
OF THE SARBANES-OXLEY ACT OF 2002**

I, Richard E. Belluzzo, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Quantum Corporation;
- 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 quarterly 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 officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)4 and 15d-15(e)4) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with

- generally accepted accounting principles;
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
- 5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of 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 controls over financial reporting.

Date: August 7, 2006

/s/ RICHARD E. BELLUZZO

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Richard E. Belluzo  
Chairman and  
Chief Executive Officer

CERTIFICATION PURSUANT TO SECTION 302(a)  
OF THE SARBANES-OXLEY ACT OF 2002

I, Edward J. Hayes, Jr, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Quantum Corporation;
- 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 officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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) designed such internal control over financial reporting ,or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
- 5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of 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: August 7, 2006

/s/ EDWARD J. HAYES, JR.

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Edward J. Hayes, Jr.  
Executive Vice President, Finance and  
Chief Financial Officer

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

I, Richard E. Belluzzo, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Quantum Corporation, on Form 10-Q for the quarterly period ended June 30, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Quantum Corporation.

Date: August 7, 2006

QUANTUM CORPORATION

/s/ RICHARD E. BELLUZZO

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 Richard E. Belluzo  
 Chairman and  
 Chief Executive Officer

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Exhibit 32.2

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

I, Edward J. Hayes, Jr., certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Quantum Corporation, on Form 10-Q for the quarterly period ended June 30, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Quantum Corporation.

Date: August 7, 2006

QUANTUM CORPORATION

/s/ EDWARD J. HAYES, JR.

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 Edward J. Hayes, Jr.  
 Executive Vice President, Finance  
 and  
 Chief Financial Officer

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 QUANTUM CORPORATION

## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit(s)	Filing Date
2.1	Agreement and Plan of Merger by and among Quantum Corporation, Agate Acquisition Corporation and Advanced Digital Information Corporation, dated as of May 2, 2006.	8-K	001-13449	2.1	May 5, 2006
3.1	Amended and Restated Certificate of Incorporation of Registrant.	10-K	001-13449	3.1	June 29, 2001
3.2	Certificate of Correction to the Amended and Restated Certificate of Incorporation of Registrant	10-Q	001-13449	3.2	November 5, 2005

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3.3	Amended and Restated By-laws of Registrant, as amended.	10-K	001-13449	3.2	June 28, 2000
3.4	Amendment to Amended and Restated By-laws of Registrant, effective November 14, 2005.	8-K	001-13449	3.1	November 18, 2005
3.5	Certificate of Designation of Rights, Preferences and Privileges of Series B Junior Participating Preferred Stock.	S-3	333-109587	4.7	October 9, 2003
4.1	Amended and Restated Preferred Shares Rights Agreement between the Registrant and Harris Trust and Savings Bank.	S-4/A	333-75153	4.1	June 10, 1999
4.2	First Amendment to the Amended and Restated Preferred Shares Rights Agreement and Certification Of Compliance With Section 27 Thereof, dated as of October 28, 2002.	10-Q	001-13449	4.1	November 13, 2002
4.3	Stockholder Agreement, dated as of October 28, 2002, by and between Registrant and Private Capital Management.	10-Q	001-13449	4.2	November 13, 2002
10.1	Indenture, dated as of July 30, 2003, between Registrant and U.S. Bank National Association, related to the Registrant's convertible debt securities.	S-3	333-109587	4.1	October 9, 2003
10.2	Change of Control Agreement, dated November 5, 1999, between ADIC and Jon W. Gacek*	8-K	001-13449	10.1	July 25, 2006
10.3	Particulars and Conditions of Sale between Quantum Perepheral Products (Ireland) Limited (as Vendor) and Ronan Egan ( in Trust) (as Purchaser)	8-K	001-13449	10.1	May 9, 2006
10.4	License Agreement, between Quantum Perepheral Products (Ireland) Limited (as Licensee) and Ciaran O' Donoghue and Nuiall O' Donoghue (as Licensor)	8-K	001-13449	10.2	May 9, 2006
10.5	Form of Voting Agreement entered into with certain Directors and Officers, dated May 2, 2006*	8-K	001-13449	10.1	May 5, 2006

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Exhibit Number	Exhibit Description	Incorporated by Reference		
		Form	File No.	Filing Date
24	Power of Attorney (see signature page).			
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. ‡			
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002. ‡			
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002. †			
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002. †			

\* Indicates management contract or compensatory plan, contract or arrangement.

‡ Filed herewith.

† Furnished herewith.

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