

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

Form 10-Q

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

For the quarterly period ended June 27, 2005

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 800, 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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

As of the close of business on August 1, 2005, approximately 184.2 million shares of Quantum Corporation's common stock were issued and outstanding.

QUANTUM CORPORATION

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QUANTUM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per-share data)
(Unaudited)

	Three Months Ended	
	June 27, 2005	June 27, 2004
Product revenue	\$ 176,094	\$ 142,382
Royalty revenue	30,543	30,302
Total revenue	206,637	172,684
Cost of revenue	149,195	114,636
Gross margin	57,442	58,048
Operating expenses:		
Research and development	29,182	22,929
Sales and marketing	21,808	23,414
General and administrative	10,789	11,420
Special charges	(78)	6,410
	61,701	64,173
Loss from operations	(4,259)	(6,125)
Interest income and other, net	2,174	1,463
Interest expense	(2,791)	(2,777)
	(4,876)	(7,439)
Loss before income taxes	(4,876)	(7,439)
Income tax provision	601	2,750
Net loss	\$ (5,477)	\$ (10,189)
Net loss per share		
Basic	\$ (0.03)	\$ (0.06)
Diluted	\$ (0.03)	\$ (0.06)
Weighted average common and common equivalent shares		
Basic	182,868	179,713
Diluted	182,868	179,713

See accompanying notes to Condensed Consolidated Financial Statements.

QUANTUM CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	June 27, 2005	March 31, 2005
	(Unaudited)	(1)
Assets		
Current assets:		
Cash and cash equivalents	\$ 107,177	\$ 225,136
Short-term investments	130,625	25,000
Accounts receivable, net of allowance for doubtful accounts of \$8,745 and \$8,962	119,613	128,627
Inventories	70,217	67,091
Service inventories	53,911	55,216
Deferred income taxes	11,355	11,361
Other current assets	42,810	47,300
Total current assets	535,708	559,731
Long-term assets:		
Property and equipment, less accumulated depreciation	42,651	42,716
Purchased technology, less accumulated amortization	49,702	55,075
Other intangible assets, less accumulated amortization	11,811	12,944
Goodwill	47,178	47,178
Other long-term assets	6,187	6,970
Total long-term assets	157,529	164,883
	\$ 693,237	\$ 724,614
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 76,808	\$ 81,447
Accrued warranty	37,663	37,738
Accrued special charges	4,096	7,704
Other accrued liabilities	98,472	116,068
Total current liabilities	217,039	242,957

Long-term liabilities:		
Deferred income taxes	10,979	10,974
Convertible subordinated debt	160,000	160,000
	<hr/>	<hr/>
Total long-term liabilities	170,979	170,974
Commitments and contingencies		
Stockholders' equity:		
Common stock	262,524	262,409
Retained earnings	42,695	48,274
	<hr/>	<hr/>
Stockholders' equity	305,219	310,683
	<hr/>	<hr/>
	\$ 693,237	\$ 724,614

(1) Derived from the March 31, 2005 audited Consolidated Financial Statements included in the Annual Report on Form 10-K of Quantum Corporation for fiscal year 2005.

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 27, 2005	June 27, 2004
Cash flows from operating activities:		
Net loss	\$ (5,477)	\$ (10,189)
Adjustments to reconcile net loss from to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,151	10,469
Deferred income taxes	11	-
Compensation related to stock incentive plans	137	197
Changes in assets and liabilities:		
Accounts receivable	9,014	10,486
Inventories	(3,126)	(7,060)
Accounts payable	(4,639)	(5,172)
Accrued warranty	(75)	(2,887)
Income taxes payable	(710)	549
Other assets and liabilities	1,598	9,902
	<hr/>	<hr/>
Net cash provided by operating activities	7,884	6,295
Cash flows from investing activities:		
Purchases of short-term investments	(601,200)	(685,900)
Proceeds from sale of short-term investments	495,575	681,900
Purchases of property and equipment	(5,867)	(2,809)
Payments made in connection with business acquisitions	(14,329)	-
	<hr/>	<hr/>
Net cash used in investing activities	(125,821)	(6,809)
Cash flows from financing activities:		
Principal payments of short-term debt	-	(537)
Payments made to repurchase common stock, net	(22)	-
Proceeds from issuance of common stock, net	-	392
	<hr/>	<hr/>
Net cash used in financing activities	(22)	(145)
Net decrease in cash and cash equivalents	(117,959)	(659)
Cash and cash equivalents at beginning of period	225,136	214,607
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 107,177	\$ 213,948
	<hr/>	<hr/>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 347	\$ 330
	<hr/>	<hr/>
Income taxes, net of refunds	\$ (319)	\$ 1,111
	<hr/>	<hr/>
Value of common stock tendered in satisfaction of employees' income taxes on vesting of employee stock options	\$ 72	\$ -
	<hr/>	<hr/>

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" or the "Company") (NYSE: DSS) has two data storage business segments: the Tape Drive business and the Storage Systems business. The Tape Drive business designs, develops, manufactures, licenses, services, and markets tape drives (DLT®, DLT®VS, Super DLT® LTO, DAT/DDS, and Travan drives) and media cartridges (DLTtape® Super DLTtape®, and LTO ultrium media cartridges). The Storage Systems business consists of tape automation systems and services and disk-based backup systems.

Note 2: Pro Forma Stock Compensation Expense

As permitted by Statement of Financial Accounting Standards No. 123 *Accounting for Stock-Based Compensation* ("SFAS No. 123"), Quantum accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* ("APB 25") and related interpretations. Under APB 25, when the exercise price of its employee stock awards equals or exceeds the market price of the underlying stock on the date of grant, no compensation expense is recognized. Any deferred stock compensation calculated according to APB 25 is amortized over the vesting period of the individual stock awards. In general, the vesting period of these stock awards is graded. Stock awards granted to non-employees are accounted for at fair value in accordance with the provisions of SFAS No. 123, with the associated value recognized over the vesting period of the award.

Pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS 123. This information is required to be determined as if the Company had accounted for its employee stock awards (including shares issued under the Employee Stock Purchase Plan, collectively called "stock-based awards"), under the fair value method of SFAS 123, as amended by SFAS 148 *Accounting for Stock-Based Compensation—Transition and Disclosure*. Stock-based awards have been valued using the Black-Scholes option pricing model. Among other things, the Black-Scholes model considers the expected volatility of the Company's stock price, determined in accordance with SFAS 123, in arriving at an option valuation.

For purposes of pro forma disclosures, the estimated fair value of Quantum's employee stock options is amortized to expense over the vesting period of the option. The pro forma stock-based employee compensation expense has no impact on the Company's cash flows. In the future, the Company may elect, or be required, to use a different valuation model, which could result in a significantly different impact on pro forma net loss. For purposes of this reconciliation, the Company adds back to previously reported net loss all stock-based employee compensation expense that relates to acquisitions or other awards made at below fair value, then deducts the pro forma stock-based employee compensation expense determined under the fair value method for all awards. Quantum's pro forma net loss and net loss per share follow:

(In thousands, except per-share data)

	Three Months Ended	
	June 27, 2005	June 27, 2004
Reported net loss	\$ (5,477)	\$ (10,189)
Option fair value amortization, net of tax effects	(1,928)	(3,859)
Pro forma net loss	<u>\$ (7,405)</u>	<u>\$ (14,048)</u>
Reported net loss per share	\$ (0.03)	\$ (0.06)
Net effect per share of option fair value amortization	(0.01)	(0.02)
Basic and diluted pro forma net loss per share	<u>\$ (0.04)</u>	<u>\$ (0.08)</u>

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Under the Stock Option Plans, the weighted-average grant date fair values reported below have been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	June 27, 2005	June 27, 2004
Option life (in years)	3.26	3.16
Risk-free interest rate	3.73%	2.98%
Stock price volatility	0.71	0.80
Dividend yield	—	—
Weighted-average grant date fair values	\$ 1.15	\$ 1.57

Under the Stock 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 2005 and fiscal year 2004 was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	March 31, 2005	March 31, 2004
Option life (in years)	0.53	1.64
Risk-free interest rate	3.61%	1.73%
Stock price volatility	0.73	0.75
Dividend yield	—	—
Weighted-average grant date fair values	\$ 1.00	\$ 1.51

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, 2005 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, 2005, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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)

	For the Three Months Ended	
	June 27, 2005	June 27, 2004
Net loss	\$ (5,477)	\$ (10,189)
Weighted average shares outstanding used to compute basic and diluted net loss per share	182,868	179,713
Basic and diluted net loss per share	\$ (0.03)	\$ (0.06)

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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.
- Options to purchase 33.5 million shares and 34.4 million shares of Quantum common stock that were outstanding at June 27, 2005, and June 27, 2004, respectively.

Note 5: Special Charges

In fiscal years 2005 and 2004, Quantum took steps to reduce costs in an effort to return to profitability. The restructuring charges that resulted from these cost reduction efforts relate to the following:

- Outsourcing manufacturing
- Consolidating most of the operations supporting our two business segments
- 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 27, 2005 and June 27, 2004.

(In thousands)

	For the Three Months Ended	
	June 27, 2005	June 27, 2004
<u>By expense type</u>		
Severance and benefits	\$ (178)	\$ 5,495
Facilities	100	855
Fixed assets	-	60
Total	\$ (78)	\$ 6,410
<u>By cost reduction actions</u>		
Outsource certain manufacturing and service functions	\$ -	\$ 2,540
Consolidate the operations supporting our two business segments	(78)	3,859
Other general expense reduction	-	11
Total	\$ (78)	\$ 6,410

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.

First quarter fiscal year 2005

A charge of \$5.5 million was recorded primarily for severance benefits and severance related costs for 98 employees located at Quantum's facilities in Boulder, Colorado; Colorado Springs, Colorado; San Jose, California; Irvine, California; and in the United Kingdom.

A charge of \$0.9 million was recorded for vacant facilities in the United Kingdom.

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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 special charge activity in prior years, refer to Note 7 in Quantum's Annual Report on Form 10-K for the year ended March 31, 2005):

(In thousands)

	Severance and benefits	Facilities	Total
Balance as of March 31, 2005	\$ 3,656	\$ 4,048	\$ 7,704
Tape Drive special charges	-	100	100
Storage Systems special charges	-	-	-
Cash payments	(2,348)	(1,114)	(3,462)
Non-cash charges	(47)	(21)	(68)
Special charge reversal	(178)	-	(178)
Balance as of June 27, 2005	\$ 1,083	\$ 3,013	\$ 4,096
Estimated timing of future payouts:			
Fiscal Year 2006	\$ 1,083	\$ 1,954	\$ 3,037
Fiscal Year 2007 to 2008	-	1,059	1,059

The \$4.1 million remaining special charge accrual as of June 27, 2005 is comprised of obligations for severance and vacant facilities. The severance charges will be paid during fiscal year 2006. The facilities charges related to vacant facilities in Irvine, California; Colorado Springs, Colorado; Boulder, Colorado; Shrewsbury, Massachusetts; and Basingstoke, United Kingdom will be paid over the respective lease terms, which continue through the third quarter of fiscal year 2008.

The Company is considering future restructuring in order to streamline its business and lower costs, and these actions may result in special charges in fiscal year 2006.

Note 6: Acquisitions

Certance Holdings

On January 5, 2005, Quantum acquired all of the shares of Certance Holdings and its subsidiaries ("Certance"), a privately held supplier of tape backup drives and data protection solutions, for \$60 million in cash paid to the Certance shareholders plus \$2.5 million for the direct costs of the acquisition. Under the terms of the acquisition, the total consideration payable by us upon acquisition was approximately \$60 million, of which approximately \$40 million was paid as of March 31, 2005. Approximately \$5.8 million will be held back and retained by us and subsequently deposited into escrow on the eight month anniversary of the closing date, as security for certain indemnity obligations of the Certance equityholders under the Agreement. The remaining \$14.2 million was paid in the first quarter of fiscal year 2006.

With the acquisition, Quantum will offer end-users a broad range of tape technology choices for meeting their individual backup, recovery and archive needs. The acquisition will also enhance Quantum's tape drive and media business by expanding its product and intellectual property portfolio, broadening its end-user customer base and further strengthening its revenue- and cash-generating foundation.

Quantum assigned Certance's tape drive and media products into the Tape Drive segment and Certance's autoloader product into the Storage Systems segment.

The preliminary purchase price at the time of the acquisition was allocated based on the estimated fair value of net tangible and intangible assets acquired, and liabilities assumed, to the following assets and liabilities:

(In thousands)	Preliminary Purchase Price Allocation March 31, 2005	Adjustments to Preliminary Purchase Price	Preliminary Purchase Price Allocation June 27, 2005
Current assets	\$ 68,010	\$ 1,223	\$ 69,233
Property, plant and equipment	4,248	-	4,248
Long-term assets	2,261	-	2,261
Purchased Technology & Intangibles:			
Existing technology	24,368	(1,148)	23,220
Customer lists	1,601	(75)	1,526
Order backlog and other	196	-	196
Total assets acquired	100,684	-	100,684
Current liabilities *	36,399	-	36,399
Long-term liabilities	1,980	-	1,980
Total liabilities assumed	38,379	-	38,379
Net assets acquired	\$ 62,305	\$ -	\$ 62,305

* Current liabilities include approximately \$3.7 million of a restructuring liability related to the acquisition at March 31, 2005. The restructuring liability related to the severance benefits for pre-merger Certance employees at the time of the acquisition and the facility charges for certain vacant facilities in the United Kingdom.

We have currently not identified any material pre-merger contingencies where a liability is probable and the amount of the liability can be reasonably estimated.

If information becomes available to us prior to the end of the purchase price allocation period, which would indicate that it is probable that such events had occurred and the amounts can be reasonably estimated, such items will be included in the purchase price allocation. Furthermore, the preliminary nature of the purchase price allocation is also based upon the final determination of restructuring costs and completion of the Certance integration plan.

The intangible assets are being amortized on a straight-line basis over estimated useful lives generally ranging from two years to seven years.

Note 7: Goodwill and Intangible Assets

The following table summarizes goodwill by acquisition as of June 27, 2005 and March 31, 2005:

	Goodwill	Segment
ATL Products, Inc. (acquired October 1998)	\$ 7,711	Storage Systems
M4 Data	6,222	Storage Systems
Benchmark (allocated to Tape Drive)	23,948	Tape Drive
Benchmark (allocated to Storage Systems)	9,297	Storage Systems
	\$ 47,178	

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 27, 2005			As of March 31, 2005		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Purchased technology	\$ 107,820	\$ (58,118)	\$ 49,702	\$ 108,968	\$ (53,893)	\$ 55,075
Trademarks	22,560	(13,608)	8,952	22,560	(12,857)	9,703
Non-compete agreements	2,516	(2,516)	-	2,516	(2,516)	-
Customer lists	15,679	(12,820)	2,859	15,754	(12,513)	3,241
Assembled workforce	4,082	(4,082)	-	4,082	(4,082)	-
	<u>\$ 152,657</u>	<u>\$ (91,144)</u>	<u>\$ 61,513</u>	<u>\$ 153,880</u>	<u>\$ (85,861)</u>	<u>\$ 68,019</u>

As of June 27, 2005 and March 31, 2005, net goodwill and intangible assets were \$108.7 million and \$115.2 million, respectively, and represented approximately 16% of total assets.

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

(In thousands)

	Three Months Ended	
	June 27, 2005	June 27, 2004
	Purchased technology	\$ 4,225
Trademarks	751	741
Non-compete agreement	-	121
Customer lists	307	133
Assembled workforce	-	189
	<u>\$ 5,283</u>	<u>\$ 4,373</u>

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

(In thousands)

	Amortization
Nine months ended March 31, 2006	\$ 16,129
Fiscal year 2007	16,817
Fiscal year 2008	13,215
Fiscal year 2009	7,078
Fiscal year 2010 and thereafter	8,274
Total as of June 27, 2005	<u>\$ 61,513</u>

Note 8: Inventories and Service Inventories

Inventories consisted of the following:

(In thousands)

	June 27, 2005	March 31, 2005
Materials and purchased parts	\$ 27,126	\$ 21,035
Work in process	4,589	7,088
Finished goods	38,502	38,968
	<u>\$ 70,217</u>	<u>\$ 67,091</u>

Service inventories consisted of the following:

(In thousands)

	June 27, 2005	March 31, 2005
Component parts	\$ 31,989	\$ 30,369
Finished units	21,922	24,847
	<u>\$ 53,911</u>	<u>\$ 55,216</u>

Note 9: Accrued Warranty and Indemnifications

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

(In thousands)

	From March 31, 2005 to June 27, 2005	From March 31, 2004 to June 27, 2004
Beginning balance	\$ 37,738	\$ 38,015

Additional warranties issued	6,463	3,417
Adjustments for warranties issued in prior fiscal years	886	243
Settlements made in cash	(7,424)	(6,547)
Ending Balance	\$ 37,663	\$ 35,128

Quantum warrants its products against defects for periods ranging from 12 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 is recognized. Quantum's estimate of future costs to satisfy warranty obligations is primarily based on estimates of future failure rates and 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 differ significantly from its estimates, Quantum records the impact of these unforeseen cost differences in subsequent periods.

Indemnifications

Quantum has off-balance sheet transactions consisting of 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 27, 2005, Quantum did not record a liability associated with these guarantees because 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.

Note 10: Credit Agreements, Short-Term Debt and Convertible Subordinated Debt

Quantum's debt includes the following:

(In thousands)

	June 27, 2005	March 31, 2005
Convertible subordinated debt	160,000	160,000
Weighted average interest rate	4.375 %	4.375 %

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 expenses.

Short-term debt (M4 Data debentures)

Per the purchase agreement for the acquisition of M4 Data in April 2001, Quantum expects that debentures issued in the future under the earn out provisions will be approximately \$1.5 million.

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 adjusted 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 we can borrow under the revolving credit facility is limited by the amount of accounts receivable and inventory. As of June 29, 2005, \$139.1 million of this revolving credit line is available. \$27.4 million is committed to standby letters of credit, of which \$25 million secures Quantum's obligation to the lessor under its synthetic lease (see Note 14 "Commitments and Contingencies").

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 leverage ratio. 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. There is also a cross default provision between this facility and the synthetic lease facility such that a default on one facility constitutes a default on the other facility. As of June 27, 2005, Quantum was in compliance with all of the credit line covenants.

Note 11: Stock Incentive Plans

Stock Option Plans

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. The Plans have reserved 57.7 million shares of stock for future issuance. As of June 27, 2005, 24.2 million shares of stock were available for grant. Options under the Plans generally expire no later than ten years from the grant date and generally vest over four years. Restricted stock granted under the Plans generally vests over two to three years.

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

	Options (In thousands)		Weighted-Avg. Exercise Price
Outstanding as of March 31, 2005	31,432	\$	5.52
Granted	3,392	\$	2.50
Exercised	(169)	\$	1.12
Canceled	(1,153)	\$	5.35
Outstanding as of June 27, 2005	33,502	\$	5.25
Exercisable as of June 27, 2005	22,304	\$	6.37

The following tables summarize information about options outstanding and exercisable as of June 27, 2005:

Range of Exercise Prices	Options Outstanding (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Options Exercisable (In thousands)	Weighted Average Exercise Price
\$ 0.96 - \$ 2.76	8,359	\$ 2.42	6.56	2,252	\$ 2.14
\$ 2.80 - \$ 2.97	8,082	\$ 2.95	5.02	5,584	\$ 2.95
\$ 2.98 - \$ 6.70	8,756	\$ 5.10	6.39	6,246	\$ 5.45
\$ 6.75 - \$ 12.50	6,656	\$ 9.42	4.36	6,582	\$ 9.42
\$ 12.50 - \$ 24.11	1,649	\$ 14.76	4.13	1,640	\$ 14.75
	<u>33,502</u>	\$ 5.25	5.59	<u>22,304</u>	\$ 6.37

The effect on reported net loss and net loss per share of accounting for employee stock options under the fair value method is disclosed in Note 2 "Pro Forma Stock Compensation Expense".

Note 12: Income Taxes

The tax expense recorded for the three months ended June 27, 2005 and June 27, 2004 was \$0.6 million and \$2.8 million, respectively. The current quarter's tax provision reflects foreign income taxes and state taxes. Income tax substantially decreased due to the elimination of withholding taxes on royalty income based upon the new Japan -US Treaty, which became effective July 1, 2004. The prior year's provision reflects foreign withholding taxes as well as foreign income taxes and state taxes.

Note 13: Litigation

On April 15, 2003, Storage Technology Corporation ("StorageTek") filed suit against Quantum in the U.S. District Court in Colorado, alleging that Quantum infringes two patents relating to the use of an optical servo system in a tape drive. The suit seeks a permanent injunction against Quantum as well as the recovery of monetary damages, including treble damages for willful infringement. The parties have completed discovery, and a trial has been scheduled for February 27, 2006. The parties conducted a hearing during the week of March 21, 2005 on StorageTek's motion for a preliminary injunction, which was subsequently denied by the court. Quantum believes that StorageTek's patents are invalid and Quantum intends to defend itself vigorously. Given the inherent uncertainty of the litigation, Quantum currently cannot estimate the extent of the potential damages in the StorageTek dispute.

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. The outcome of this patent infringement lawsuit is uncertain. Quantum currently cannot estimate the extent of the potential damages in the Papst dispute against it because the complaint by Papst asserts an unspecified amount of damages. As part of Quantum's disposition of HDD to Maxtor, Maxtor has agreed to assume the defense of the Papst claims against HDD and has also agreed to indemnify Quantum with respect to litigation relating to this dispute.

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. Franz Inc. charges, among other things, that the defendants entered into agreements and conspired to monopolize the market and fix prices for data storage tape compatible with DLT® tape drives. Quantum denies the allegations of the complaint and intends to defend itself vigorously against the claims asserted by Franz. Franz seeks an order that the lawsuit be maintained as a class action and that defendants be enjoined from continuing the violations alleged in the complaint. Franz also seeks compensatory damages, treble damages, statutory damages, attorneys' fees, costs, and interest. A class certification hearing has been scheduled for August 2005. Given the early stages and inherent uncertainty of the litigation, Quantum currently cannot estimate the extent of the potential damages in the litigation.

Exabyte Corporation filed a complaint against Certance LLC, a subsidiary of Quantum, for patent infringement with the United States District Court for the District of Colorado on October 5, 2004. The complaint asserts that Certance's tape storage units, including the DAT 72 drives, infringe an Exabyte patent. Exabyte also alleges inducement and contributory infringement. Certance is in the process of assessing Exabyte's claims and has tendered the action to Panasonic Shikoku Electronics Co., Ltd. ("PSEC"), formerly Matsushita Kotobuki Electronics, Ltd., for PSEC's defense and indemnification under certain agreements that Certance has with PSEC. PSEC has formally assumed the defense and indemnification of this claim.

Adverse resolution of any third party infringement claim or other litigation could subject Quantum to substantial liabilities and require Quantum to refrain from manufacturing and selling certain products, which could have a material adverse effect on Quantum's business. In addition, the costs incurred in intellectual property litigation and other litigation can be substantial, regardless of the outcome.

Note 14: Commitments and Contingencies

Synthetic Lease

In December 2002, Quantum negotiated a five-year synthetic lease agreement with a group of financial institutions (collectively, the "lessor") for a campus facility in Colorado Springs, Colorado, comprised of three buildings, which expires in December 2007. The lease for the three buildings is accounted for as an operating lease in accordance with SFAS No. 13 *Accounting for Leases*. The total minimum lease payments from the first quarter of fiscal year 2006 until the scheduled expiration date in December 2007 are estimated to be approximately \$6.7 million and approximate the lessor's debt interest service costs. The minimum lease payments will fluctuate depending on short-term interest rates.

The lease is partially secured by a standby letter of credit issued under Quantum's revolving line of credit and a blanket lien on all of the assets of Quantum. The revolving line of credit expires in March 2006. At that time Quantum could be required to post cash collateral to secure the lease, unless other financial arrangements are made that are acceptable to the lessor.

The lease commitment requires Quantum to maintain specified financial covenants. If in future quarters Quantum were to fail to comply with these financial covenants and were unable to obtain a waiver, or amend the lease, for such non-compliance, the lessor could terminate the lease. This could result in Quantum having to purchase and/or cause a third party to purchase the facilities promptly and potentially at a substantial discount to their current appraised value. There is a cross default provision between this facility and the credit line facility (refer to Note 10 "Credit Agreements, Short-Term Debt and Convertible Subordinated Debt") such that a default on one facility constitutes a default on the other facility.

At the end of the lease term, Quantum has the following options and obligations:

- (1) Quantum may renew the lease if the lessor accepts a renewal at its discretion;
- (2) Quantum may purchase the facility for approximately \$50 million (the "stipulated sales price"); or

(3) If Quantum has paid all sums owing under the lease and is not otherwise in default under the lease or the credit line facility at the end of the stated lease term, Quantum may find a third party to purchase the facility. In such event, Quantum has guaranteed any shortfall between the net proceeds from the sale of the property to the third party and the stipulated sales price, up to a maximum amount payable equal to 87.7% of the stipulated sales price, or \$43.9 million.

Appraised value of the facility, the collateral that would be used to satisfy the contingent obligation, was estimated at \$50 million and is subject to reappraisal. At any time during the lease term, Quantum may purchase (or cause a third party to purchase) the facility for the stipulated sales price. If Quantum defaults under the lease, its only option is to purchase the facility for the stipulated sales price. If Quantum had to purchase the property and if the fair value is less than the stipulated sales price on the purchase date, Quantum would incur the charge for the difference, which could be material.

Commitments to purchase inventory

Quantum outsourced tape drive manufacturing to a contract manufacturer, Jabil, during the third quarter of fiscal year 2003. The Storage Systems business has increased its use of contract manufacturers for certain manufacturing functions during the same period. 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 27, 2005 Quantum issued non-cancelable purchase orders for \$81.6 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 15: Business Segment Information

Quantum's reportable segments are Tape Drive and Storage Systems. These reportable segments have distinct products with different production processes. Tape Drive segment consists of tape drives and media. Storage Systems segment consists of tape automation systems and service and includes disk based backup products. Quantum directly markets its products to computer manufacturers and through a broad range of distributors, resellers and systems integrators.

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Quantum evaluates segment performance based on operating income (loss) excluding special charges and other infrequent or unusual items. Quantum does not allocate interest and other income, interest expense, or taxes to operating segments. Additionally, Quantum does not allocate all assets by operating segment, only those assets included in the table below:

(In thousands)

	Three Months Ended					
	June 27, 2005			June 27, 2004		
	Tape Drive	Storage Systems	Total	Tape Drive	Storage Systems	Total
Revenue	\$ 138,608	\$ 68,029	\$ 206,637	\$ 105,329	\$ 67,355	\$ 172,684
Cost of revenue	95,142	54,053	149,195	67,592	47,044	114,636
Gross margin	43,466	13,976	57,442	37,737	20,311	58,048
Research and development	19,718	9,464	29,182	14,782	8,147	22,929
Sales and marketing	9,029	12,779	21,808	8,930	14,484	23,414
General and administrative	7,027	3,762	10,789	7,136	4,284	11,420
Special charges	433	(511)	(78)	2,958	3,452	6,410
Total operating expenses	36,207	25,494	61,701	33,806	30,367	64,173
Operating income (loss)	\$ 7,259	\$ (11,518)	\$ (4,259)	\$ 3,931	\$ (10,056)	\$ (6,125)

(In thousands)

	As of June 27, 2005			As of March 31, 2005		
	Tape Drive	Storage Systems	Total	Tape Drive	Storage Systems	Total
Inventories	\$ 36,200	\$ 34,017	\$ 70,217	\$ 33,532	\$ 33,559	\$ 67,091
Service inventories	\$ 26,600	\$ 27,311	\$ 53,911	\$ 28,400	\$ 26,816	\$ 55,216
Goodwill and intangibles, net	\$ 56,244	\$ 52,447	\$ 108,691	\$ 59,463	\$ 55,734	\$ 115,197

Note 16: Comprehensive Loss

Total comprehensive loss, net of tax if any, for the three months ended June 27, 2005 and June 27, 2004, is presented in the following table:

(In thousands)

	Three Months Ended	
	June 27, 2005	June 27, 2004
Net loss	\$ (5,477)	\$ (10,189)
Foreign currency translation adjustment	(102)	(424)
Total comprehensive loss	\$ (5,579)	\$ (10,613)

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Note 17: Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004) *Share-Based Payment* ("SFAS 123R"), which replaces SFAS No. 123 *Accounting for Stock-Based Compensation* ("SFAS 123") and supersedes APB Opinion No. 25 *Accounting for Stock Issued to Employees*. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. The Company is required to adopt SFAS 123R in fiscal year 2007, beginning April 1, 2006. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include a modified-prospective and a modified-retrospective adoption options. Under the modified-retrospective option, prior periods may be restated to reflect the

compensation cost previously reported in the pro forma footnote disclosures under the provisions of SFAS 123 either as of the beginning of the year of adoption or for all periods presented. The modified-prospective method requires that compensation expense be recognized for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R the Company is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on the Company's consolidated results of operations and earnings per share. In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107, *Share-Based Payment*. This statement expresses views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB No. 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management's Discussion and Analysis ("MD&A") subsequent to adoption of SFAS No. 123R. The Company has not yet determined the method of adoption or the effect of adopting this statement, and it has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

In March 2005, the FASB issued FASB Interpretation No. 47 ("FIN No. 47"), *Accounting for Conditional Retirement Obligations—an interpretation of SFAS No. 143*. This interpretation clarifies the timing of when a liability should be recognized for legal obligations associated with the retirement of a tangible long-lived asset. In addition, the interpretation clarifies the treatment when there is insufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 is effective no later than December 31, 2005. Retrospective application for interim financial information is permitted but is not required. Early adoption is encouraged. The adoption of this standard is not expected to have a material impact on the Company's consolidated balance sheet or statement of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* ("SFAS 154") which replaces APB Opinions No. 20 *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements—An Amendment of APB Opinion No. 28*. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2007. The Company is currently evaluating the effect that the adoption of SFAS No. 154 will have on its consolidated results of operations and financial condition but does not expect it to have a material impact.

Note 18: Subsequent Events

On August 2, 2005, Quantum approved a plan to terminate employees in the engineering organization to streamline its product development processes, align skills with its future product roadmaps and to reduce costs and investment to the appropriate level following product platform transitions. These actions are part of the Company's continuing work to further strengthen its operational platform and reduce its cost structure. The Company expects to complete these actions by the end of the third quarter of fiscal year 2006. The costs associated with these actions consist of one-time termination benefits. The Company's preliminary estimate of these costs is approximately \$1.8 million and substantially all of these charges will result in future cash expenditures.

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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 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, (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 expectation that M-Series libraries will begin to be replaced by the new PX500-Series libraries during the last half of calendar year 2005, (8) our belief that \$8,760,000 is sufficient to cover the remaining tax liability under the Tax Sharing and Indemnity Agreement with Maxtor, (9) 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, (10) our expectation that we will return to profitability, (11) our belief that our ultimate liability in any infringement claims made by any third parties against us will not be material to us, (12) our expectation that we will make additional acquisitions in the future, (13) our expectation that our future contractual payment obligations equal no more than approximately \$96.3 million within one year, \$16.0 million between one and two years, \$64.4 million between two and three years and \$192.6 million beyond three years, and (14) our belief that our total foreign exchange rate exposure is not significant, 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 an unparalleled range of solutions, from leading 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.

On January 5, 2005, we acquired all of the shares of Certance Holdings and its subsidiaries ("Certance"), a privately held supplier of tape backup drives and data protection solutions, in exchange for \$60 million in cash plus the direct costs of the acquisition.

Previously, we were also in the hard disk drive business, which operated as our Hard Disk Drive group ("HDD"). This business was acquired by Maxtor Corporation ("Maxtor") on April 2, 2001.

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Business Summary

We have two data storage business segments: the Tape Drive business and the Storage Systems business. Our Tape Drive business consists of tape drive and tape media cartridge product lines. Our Storage Systems business consists of tape automation systems and service and includes disk-based backup systems.

While continuing to develop and introduce new products in the storage market, we have also continued to take steps to reduce costs in order to return to profitability. Since 2001, our business has experienced declining total revenues, lower gross margins, 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 prices and unit sales. Because of the long-term impact of these trends, we have taken numerous cost reduction actions in recent years. The cost reduction steps we are taking are aimed at eventually returning us to profitability on a consistent basis.

Tape Drive business

In our Tape Drive business, 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. We earn approximately 67% of our revenue by selling tape drives and the tape media cartridges used by tape drives. 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 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 minor extent, directly by us.

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. During our quarter ended June 27, 2005, approximately 81% of our tape media cartridge unit sales occurred through this license model. 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 income and cash flow, and this trend is expected to continue.

We outsourced substantially all of our tape drive products to Jabil Circuit Inc. (“Jabil”) in fiscal year 2003. However, since our acquisition of Certance on January 5, 2005, we manufacture some of our tape drives and head assemblies for Certance products in our facility in Penang, Malaysia.

As a result of the Certance acquisition, we acquired tape drive and media products based on the following technologies: Linear Tape Open (“LTO”) Ultrium, DAT/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.

Storage Systems business

In our Storage Systems business, we 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.

Products

Our products include:

Tape Drive business

Quantum’s Tape Drive business offers the broadest set of backup products representing all major tape technology segments – DLT®, LTO, DDS/DAT and Travan – for entry to enterprise work environments. These technologies are offered by Quantum and through Original Equipment Manufacturers (“OEMs”) system and automation brands such as Dell, Hewlett-Packard, International Business Machines Corporation (“IBM”), Overland Storage Inc., Advanced Digital Information Corporation (“ADIC”), and StorageTek.

• DLT® Technology

Quantum’s line of DLT tape drives has delivered competitive capacity and proven reliability for more than ten product generations. The DLT Technology roadmap is designed to provide an ideal foundation for the future by delivering the combination of ultra-high capacity, network-optimized performance, and reliability that backup and archival environments will require.

DLT-S Series

The performance line of DLT products includes the SDLT 600 and the SDLT 320 drives. These drives deliver compressed capacities from 320 GB to 600 GB and compressed transfer rates from 115 GB/hr to 259 GB/hr.

DLT-V Series

The value line of DLT products includes the DLT VS160 and the DLT VS80 drives. With compressed capacities from 80 GB to 160 GB and compressed transfer rates from 22 GB/hr to 57 GB/hr, these drives make it possible for everyone to backup.

• LTO Technology

Designed with a six-generation roadmap that is targeted to deliver up to 6.4 TB of compressed capacity and compressed transfer rates up to 1.9 TB/hr in generation 6, LTO Technology is an industry-leading tape solution for enterprise-class performance backup in workgroup, departmental and enterprise servers.

LTO-3

The recently introduced LTO-3 drive offers the industry’s highest capacity tape drive with 800 GB of compressed capacity and a transfer rate of 490 GB/hr.

LTO-2

The LTO-2 drive offers 400 GB of compressed capacity and compressed transfer rates of 144 GB/hr. Quantum’s first-to-market, value-optimized LTO-2 HH (half-height) internal drive features reliable and affordable tape data protection targeted to medium and large businesses. The LTO-2 HH drive attempts to balance price with increased capacity and performance, providing the most affordable entry into the LTO family.

• DAT/DDS Technology

DAT/DDS Technology targets data protection for small businesses. Quantum’s DAT 72 tape drive solutions deliver compressed capacities of up to 72 GB, compressed transfer rates of up to 25.2 GB/hr and are backward compatible to DDS-4 and DDS-3 products.

• Travan Technology

Travan Technology offers more affordable data protection drives for workstations and entry-level servers and offers compressed capacities of up to 40 GB and compressed transfer rates of up to 14.4 GB/hr. With easy-to-use interfaces such as ATAPI/IDE, SCSI and USB 2.0, these backup solutions offer affordable simplicity and are backward compatible to multiple generations of Travan products.

Storage Systems business

enterprise-class applications. Our automated systems are fully compatible with major hardware platforms and are supported by nearly 30 popular data management applications including popular packages such as VERITAS NetBackup, VERITAS Backup Exec, Legato NetWorker, Computer Associates BrightStor, CommVault Galaxy, HP OmniBack and IBM Tivoli.

Our Storage Systems products are divided into the following two categories to reflect different go-to-market business models.

• **High-Volume Products**

High-volume products are sold mainly through third-party distributors, value-added resellers ("VARs") and OEMs and include the Autoloader DDS-4, Autoloader DAT 72, ValueLoader™, SuperLoader™, and the M-Series family of tape libraries featuring the M1500, M1800 and M2500. The M-Series libraries will begin to be replaced by the new PX500-Series libraries, which offer more capacity at lower price points, during the last half of calendar year 2005.

Autoloader DDS-4

The Autoloader DDS-4 is an entry-level backup automation product for PC or small workgroup data protection. Featuring a single DDS-4 tape drive and a single six-cartridge removable magazine, it offers up to 120GB of storage and performance up to 10GB/hour.

Autoloader DAT 72

The Autoloader DAT 72 is the next step up for small workgroup data protection with a single DAT 72 tape drive and a six-cartridge removable magazine. It accommodates up to 216GB of storage with performance up to 13GB/hour.

ValueLoader

The ValueLoader is designed for the desktop or standard 19-inch rack and uses a single DLT VS80, DLT VS160, SDLT 320, LTO-2 or LTO-3 tape drive with an eight-cartridge capacity and provides up to 3.2 terabytes (TB) of data storage and 288GB/hour throughput.

SuperLoader

The SuperLoader tape library is a scalable tape autoloader that provides up to 4.8TB of capacity and 130GB/hour throughput in a 2U (U is a standard of measure equaling 1.75" high) rack-mount form factor and is a modular, high-density tape automation solution designed for the workgroup environment. It contains one or two 8-cartridge removable active magazines and is available with a barcode reader for high performance inventory management. The SuperLoader supports a single DLT1, SDLT 320, SDLT 600 or LTO-2 tape drive and includes on-board, Web-based remote management.

M-Series Libraries

The M-Series family of tape libraries is comprised of the M1500, M1800 and M2500, which are modular automation systems that customers can link together as their storage needs grow. The M1500 is a modular library that is rack mountable and available with one or two tape drives and 21 (SDLT) or 25 (LTO) cartridges. The M1800 has double the performance and capacity of the M1500 and can accommodate up to four drives and 50 cartridges. The M2500 supports up to six drives and 100 cartridges and can be combined with the M1500 and/or M1800 to provide customers with scalability and investment protection. The M-Series supports SDLT 320, SDLT 600, LTO-2 or LTO-3 tape drives. Interchangeable removable magazines make it easy to bulk load and storage cartridges. Capacity ranges from 3.4TB in a single M1500 to 40TB in a single M2500. Performance ranges from 58GB/hour in a single M1500 to over 1.7TB/hour in a single M2500. The M-Series libraries scale up to 20 drives and 300 cartridges providing top-end capacity of 120TB and performance over 5.7TB/hour. Redundant power supplies can be ordered for high availability applications. The M-Series libraries also support the Fibre Channel interface for connection to Storage Area Networks ("SANs").

PX500-Series Libraries

The newest Quantum automated tape libraries are the PX500-Series. Like the M-Series, the PX500 libraries feature a modular, rackmountable design that allows customers to stack and interlink multiple units as their storage requirements change over time. The linked units function as a single larger library thus simplifying operation. The PX502 library supports up to two tape drives

and 38 LTO or 32 SDLT cartridges. The PX506 library can be expanded to six tape drives and 100 LTO or 88 SDLT cartridges. The PX510 can accommodate up to 10 tape drives and 201 LTO or 171 SDLT cartridge slots. All PX500 models supports LTO-2, LTO-3 and SDLT 600 tape drives that can be combined to handle mixed media requirements. Interchangeable removable magazines make it easy to bulk load and storage cartridges. Web-based library management simplifies remote monitoring and operation, while a redundant power option provides high availability. Capacity ranges from 7.6TB in a single PX502 to 80.4TB in a single PX510. Performance ranges from 108GB/hour in a single PX502 to over 2.9TB/hour in a single PX510. The PX500-Series libraries easily scale up to 22 drives and 438 cartridges providing maximum capacity of 175TB and performance over 6.3TB/hour. Fibre Channel is available for SAN connectivity.

• **Enterprise Products**

Enterprise products are sold mainly through VARs, OEMs, and directly to key account end customers. These products require a higher level of customer engagement to complete a more complex storage systems sale and include the P-Series libraries and our DX-Series disk-based backup systems.

P-Series Libraries

Quantum's newest tape library is the PX720, our fifth-generation enterprise tape automation platform developed by Quantum. Accommodating up to 20 tape drives and up to 726 LTO/642 SDLT cartridges in a single chassis, the PX720 provides more than 5.8TB/hour of throughput performance and 290TB capacity. It supports SDLT 320, SDLT 600, LTO-2 and LTO-3 tape drives and a mixed-media option allows customers to combine different media and tape technologies in a single unit. The PX720 is designed for high availability and includes fully redundant power and cooling, proactive component-level monitoring, and remote library management. Further flexibility is provided by the ability to mix SCSI, GbE/NDMP, routed and native Fibre Channel interfaces, programmable load ports and removable magazines. Multiple PX720 libraries can be linked together to provide up to 100 drives for up to 29TB/hour performance and up to 3,336 LTO/2,968 SDLT cartridges, for a total capacity of 1.3 petabytes (1.3PB or 1,300TB).

DX-Series Disk-Based Backup Systems

The DX-Series Disk-Based Backup Systems (DX30 and DX100) emulate a tape library and are designed to seamlessly integrate into existing backup environments without changes to policies or procedures. Supported by every major backup software vendor, the DX-Series provides user definable virtual tape drives and cartridges to meet data center requirements. Designed specifically for extremely fast and reliable backup and restore operations, the DX-Series architecture includes redundant and hot-swappable components that deliver up to 64TB (raw) capacity and up to 2TB/hr performance. The new Optyon™ hardware-based data compression option can double capacity without buying double the hardware. A Web-based Graphical User Interface (GUI) provides system management along with event monitoring and notification. The DX-Series complements tape libraries by allowing them to be dedicated to archive operations and to meet the need to create copies of data on removable media for disaster recovery and regulatory compliance.

• StorageCare Services

StorageCare™ services are a group of services that support Quantum products from purchase through product life. StorageCare services include product installation and integration, warranty support, spare part sales, and on-site service agreements.

NOTE: Capacity and performance listed above are native (non-compressed) specifications. Capacity and performance can be doubled using 2:1 data compression.

For more information about our products, please visit our website at www.quantum.com. The contents of our website are not incorporated into this Form 10-Q.

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RESULTS OF OPERATIONS

Revenue

(In thousands)

	Three Months Ended		Increase/ (decrease)	% Increase/ (decrease)
	June 27, 2005	June 27, 2004		
Tape drives	\$ 84,392	\$ 61,716	\$ 22,676	36.7%
Tape media	23,673	13,311	10,362	77.8%
Tape royalty	30,543	30,302	241	0.8%
Tape Drive Segment	138,608	105,329	33,279	31.6%
Storage Systems Segment	68,029	67,355	674	1.0%
	\$ 206,637	\$ 172,684	\$ 33,953	19.7%

Tape Drive Segment Revenue for the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005

The increase in tape drives revenue is substantially driven by sales of tape drives acquired through the Certance acquisition. To a lesser extent the increase in tape drives revenue reflected higher unit sales of latest generation VS160 and SuperDLT ®600 tape drives, partially offset by lower average unit prices and lower shipments of older tape drives reaching maturity. The decrease in shipments of all other tape drives reflected continued intense competition and less demand from our key OEM customers, both of which resulted in lower average unit selling prices for our products. In addition, the qualifications of our products with our key OEM customers and the corresponding product sales ramp for the latest generation tape drives have taken longer than we anticipated.

The significant increase in tape media revenue reflected overall higher units sales.

Tape media royalties remained relatively flat in the first quarter of fiscal year 2006 substantially driven by a significant increase in the media royalty revenue associated with the Certance acquisition, partially offset by lower media units sales sold through by our OEM customers.

Storage Systems Segment Revenue for the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005

Storage Systems Segment revenue remained relatively flat due to an increase in unit sales of our autoloader product, ValueLoaders, offset by decreases in the average unit prices of these products as well as unit and average unit price decreases in the other products.

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Gross Margin

(In thousands)

	Three Months Ended		Increase/ (decrease)
	June 27, 2005	June 27, 2004	
Tape Drive Segment	\$ 43,466	\$ 37,737	\$ 5,729
Storage Systems Segment	13,976	20,311	(6,335)
Quantum gross margin	\$ 57,442	\$ 58,048	\$ (606)
Tape Drive Segment gross margin rate	31.4%	35.8%	(4.4%)
Storage Systems Segment gross margin rate	20.5%	30.2%	(9.7%)
Quantum gross margin rate	27.8%	33.6%	(5.8%)

Tape Drive Segment Gross Margin

The increase in gross margin reflected an increase in tape drive unit sales, partially offset by lower average unit prices, lower tape royalty revenue unit sales and an increased cost of repair. As the VS80 and SDLT320 mature, average unit prices have decreased and the newer replacement products have not gained significant traction with the OEMs.

Storage Systems Segment Gross Margin

The decrease in gross margin reflected primarily a decrease in the average unit prices and increased manufacturing costs. The decrease in average unit prices is due to pricing pressures of

maturing products, such as the SuperLoader.

Gross Margin Rate Outlook

In fiscal year 2006, we will actively work to offset any media weakness by improving gross margin contributions from tape drives and automation from fiscal year 2005 levels. Efforts to improve gross margins will be focused on successful new product introductions and feature enhancements in both the tape drive and automation segments as well as new platform transitions in the automation business in the second half of the fiscal year, which will help to lower product cost structures while delivering higher overall performance and reliability. Because our media business provides relatively high gross margins, total company gross margin rates are affected significantly by changes in media market sales. There are many complicated variables that, individually and in combination, impact short-term and long-term performance in media and result in a media revenue and gross margin dollar contribution trend for the company. These include, but are not limited to, media pricing decisions among our partners/licensees, end-user media consumption habits and rates, the size of the installed base of tape drives, tape drive retirement patterns, the mix of media, channel inventory levels and other factors. In any given future quarter, the combination of these factors can cause a significant negative, neutral, or positive financial impact.

Operating Expenses

(In thousands)

	Three Months Ended					
	June 27, 2005	% of Segment Revenue	June 27, 2004	% of Segment Revenue	Increase/ (decrease)	% Increase/ (decrease)
Tape Drive Segment	\$ 35,774	25.8%	\$ 30,848	29.3%	\$ 4,926	16.0%
Storage Systems Segment	26,005	38.2%	26,915	40.0%	(910)	(3.4%)
Subtotal	61,779	29.9%	57,763	33.5%	4,016	7.0%
Special charges	(78)		6,410		(6,488)	
Total	\$ 61,701		\$ 64,173		\$ (2,472)	

Research and Development Expenses

(In thousands)

	Three Months Ended					
	June 27, 2005	% of Segment Revenue	June 27, 2004	% of Segment Revenue	Increase/ (decrease)	% Increase/ (decrease)
Tape Drive Segment	\$ 19,718	14.2%	\$ 14,782	14.0%	\$ 4,936	33.4%
Storage Systems Segment	9,464	13.9%	8,147	12.1%	1,317	16.2%
Total	\$ 29,182	14.1%	\$ 22,929	13.3%	\$ 6,253	27.3%

Tape Drive Segment Research and Development Expenses

The increase in research and development expenses in the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005 primarily reflected the additional headcount and expenses associated with our Certance acquisition.

Storage Systems Segment Research and Development Expenses

The increase in research and development expenses in the first quarter of fiscal year 2006 compared to the first quarter of fiscal year 2005 reflected an increase in material and labor investment in support of new product launches anticipated during the fiscal year.

Sales and Marketing Expenses

(In thousands)

	Three Months Ended					
	June 27, 2005	% of Segment Revenue	June 27, 2004	% of Segment Revenue	Increase/ (decrease)	% Increase/ (decrease)
Tape Drive Segment	\$ 9,029	6.5%	\$ 8,930	8.5%	\$ 99	1.1%
Storage Systems Segment	12,779	18.8%	14,484	21.5%	(1,705)	(11.8%)
Total	\$ 21,808	10.6%	\$ 23,414	13.6%	\$ (1,606)	(6.9%)

Tape Drive Segment Sales and Marketing Expenses

The slight increase in sales and marketing expenses for the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005 mainly reflected increased headcount from the Certance acquisition and increased spending on marketing and consulting programs offset by lower commissions and travel expense.

Storage Systems Segment Sales and Marketing Expenses

The decrease in sales and marketing expenses the first quarter of fiscal year 2006 mainly reflected the impact of cost reduction actions, including reduced headcount.

General and Administrative Expenses

(In thousands)

Three Months Ended					
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	June 27, 2005	% of Segment Revenue	June 27, 2004	% of Segment Revenue	Increase/ (decrease)	% Increase/ (decrease)
Tape Drive Segment	\$ 7,027	5.1%	\$ 7,136	6.8%	\$ (109)	(1.5%)
Storage Systems Segment	3,762	5.5%	4,284	6.4%	(522)	(12.2%)
Total	\$ 10,789	5.2%	\$ 11,420	6.6%	\$ (631)	(5.5%)

Tape Drive Segment General and Administrative Expenses

The slight decrease in general and administrative expenses for the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005 mainly reflected lower legal costs partially offset by increased headcount from the Certance acquisition.

Storage Systems Segment General and Administrative Expenses

The decrease in general and administrative expenses for the first quarter of fiscal year 2006 as compared to the first quarter of fiscal year 2005 resulted from the impact of cost reduction actions, including reduced headcount, and a general decline in discretionary spending.

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Special Charges

The steps we have taken to return to profitability have resulted in numerous special charges. Special charges included the cost of major restructuring steps such as the outsourcing of certain functions and consolidation of many functions within the company. Substantial steps have been completed as of June 27, 2005, and the associated costs have been recorded. Until we achieve sustained profitability, we expect to incur additional charges in the future related to additional cost reduction steps and if estimated costs associated with vacant facilities and other restructured activities are higher than estimated. The costs that we will incur associated with future cost reduction activities are not estimable at this time.

The following two tables show the special charges for the three months ended June 27, 2005 and the estimated timing of future payouts for cost reduction plans (for a discussion of our special charge activity in prior years, refer to Note 7 in our Annual Report on Form 10-K for the year ended March 31, 2005):

(In thousands)

	For the Three Months Ended	
	June 27, 2005	June 27, 2004
<u>By expense type</u>		
Severance and benefits	\$ (178)	\$ 5,495
Facilities	100	855
Fixed assets	-	60
Total	\$ (78)	\$ 6,410
<u>By cost reduction actions</u>		
Outsource certain manufacturing and service functions	\$ -	\$ 2,540
Consolidate the operations supporting our two business segments	(78)	3,859
Other general expense reduction	-	11
Total	\$ (78)	\$ 6,410

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.

First quarter fiscal year 2005

A charge of \$5.5 million was recorded primarily for severance benefits and severance related costs for 98 employees located at Quantum's facility in Boulder, Colorado; Colorado Springs, Colorado; San Jose, California; Irvine, California; and in the United Kingdom. A charge of \$0.9 million was recorded for vacant facilities in the United Kingdom.

For more information regarding Special Charges, refer to Note 5 "Special 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:

(In thousands)

	Three Months Ended		
	June 27, 2005	June 27, 2004	Increase/ (decrease)
Cost of revenue	\$ 3,983	\$ 2,975	\$ 1,008
Research and development	95	398	(303)
Sales and marketing	1,059	875	184
General and administrative	146	125	21
Total	\$ 5,283	\$ 4,373	\$ 910

For further information regarding amortization of intangible assets, refer to Note 7 "Goodwill and Intangible Assets" to the Condensed Consolidated Financial Statements.

Interest and Other Income, net

(In thousands)

	Three Months Ended		
	June 27, 2005	June 27, 2004	Increase/ (decrease)
Interest and other income	\$ 2,174	\$ 1,463	\$ 711
Interest expense	(2,791)	(2,777)	(14)
	<u>\$ (617)</u>	<u>\$ (1,314)</u>	<u>\$ 697</u>

The increase in interest income and other income, net, in the three months ended June 27, 2005 as compared to the corresponding period of the prior year was mainly due to a foreign exchange adjustment and increased rates on short-term investments.

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 belief 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 primarily reflects foreign income taxes and state taxes. Income tax substantially decreased due to the elimination of withholding taxes on royalty income based upon the new Japan - US Treaty, which became effective July 1, 2004.

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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. 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 27, 2005	June 27, 2004
Cash and cash equivalents	\$ 107,177	\$ 213,948
Days sales outstanding (DSO)	52.9	54.5
Inventory turns (Annualized)	8.7	8.3
Net cash provided by operating activities	\$ 7,884	\$ 6,295
Net cash used in investing activities	\$ (125,821)	\$ (6,809)
Net cash used in financing activities	\$ (22)	\$ (145)

First Quarter Fiscal Year 2006

During the first quarter of fiscal year 2006, our 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. In the first quarter of fiscal year 2006, our \$22,000 use of cash for financing activities reflected payments made to repurchase common stock, net of proceeds from issuance of common stock upon exercise of stock options held by our employees.

First Quarter Fiscal Year 2005

During the first quarter of fiscal year 2005, our operating activities generated cash flows of \$6 million. In the first quarter of fiscal year 2005, our \$7 million use of cash for investing activities primarily reflected purchases of short-term investments and purchases of property and equipment. In the first quarter of fiscal year 2005, our \$0.1 million use of cash for financing activities reflected principal payments for short-term debt, partially offset by proceeds from issuance of common stock upon exercise of stock options held by our employees.

Capital Resources and Financial Condition

We were unprofitable in the first quarter of fiscal year 2006. 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. Following the completion of the Certance acquisition in January 2005, this focus on improving our operating performance will include the continued integration of Certance and a continued focus to reduce the cost structure of the combined company.

We believe that our existing cash and capital resources will be sufficient to meet all currently planned expenditures and sustain operations for at least the next 12 months. This belief is generally 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 other than for completing the Certance acquisition or otherwise be impacted by restrictions of available cash associated with our existing letters of credit, our credit facility or our synthetic lease. 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 cannot provide assurance that the cost reduction actions we have taken in the past

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or any actions we may take in the future will ensure a consistent, sustainable and sufficient cost structure to allow us to generate net income and positive cash flow from operating

activities that are necessary for us 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 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 and synthetic lease (together, the "credit facilities") to do any of the following:
 - Renew our credit line facility prior to or at its expiration, which is March 30, 2006;
 - Provide a waiver or amendment for any covenant violations we may experience in future periods, thereby triggering a default under and/or termination of both the credit line and the synthetic lease; 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 \$27.4 million. In the case of our synthetic lease, this would mean the acceleration of our obligation to purchase the leased facilities for the stipulated sales price of \$50 million. This may result in our having to immediately purchase the land and buildings underlying the lease for cash or find a third party to purchase them, potentially at a substantial discount to their appraised value. We would guarantee any shortfall below the \$50 million stipulated sales price up to a maximum of \$43.9 million payable by us. Any requirement to pay off either or both of these two items would substantially restrict or reduce cash available to us.

- (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. As of June 29, 2005, \$139.1 million of this revolving credit line is available. \$27.4 million was committed to standby letters of credit, of which \$25 million secured our obligation to the lessor under our synthetic lease (see below and Note 14 "Commitments and Contingencies").

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 leverage ratio. As of June 27, 2005, 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 we are required to satisfy as a condition of the credit line. There is also a cross default provision between this facility and the synthetic lease facility such that a default on one facility constitutes a default on the other facility. As of June 27, 2005, we were in compliance with all of the credit line covenants.

Off Balance Sheet Arrangements - Synthetic Lease Commitment

As described in Note 14 "Commitments and Contingencies," we have a synthetic lease commitment accounted for as an operating lease in accordance with SFAS No. 13 *Accounting for Leases*, which requires us to maintain specified financial and reporting covenants. We originally entered into this agreement in August 1997 and renegotiated its terms in December 2002, January 2003,

March 2004, and January 2005. There is a cross default provision between this facility and the credit line facility (refer to Note 10 "Credit Agreements, Short-Term Debt and Convertible Subordinated Debt") such that a default on one facility constitutes a default on the other facility. As described in greater detail in Note 14 "Commitments and Contingencies," at the end of the term of the lease we must either renew the lease, purchase the facility for the stipulated sales price of approximately \$50 million, or find a third party to purchase the facility; in a third party sale we would guarantee any shortfall below the stipulated sales price up to a maximum amount of \$43.9 million payable by us.

Capital Resources

On July 30, 2003, we issued 4.375% convertible subordinated notes in 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.

Per the purchase agreement for the acquisition of M4 Data in April 2001, we expect that debentures issued in the future under the earn out provisions will be approximately \$1.5 million.

As of June 27, 2005, there was approximately \$87.9 million remaining on our authorization to repurchase Quantum common stock. No stock repurchases were made during the first quarter of fiscal year 2006. Our ability to repurchase common stock was restricted under our credit facilities.

The table below summarizes our commitments as of June 27, 2005:

(In thousands)	<u><1 year</u>	<u>1 year and <2 years</u>	<u>2 years and <3 years</u>	<u>3 years and beyond</u>	<u>Total</u>
Convertible subordinated debt (1)	\$ 7,000	\$ 7,000	\$ 7,000	\$ 175,750	\$ 196,750
Inventory purchase commitment	81,605	-	-	-	81,605
Operating lease - Colorado facility - contingent obligation (2)	-	-	50,000	-	50,000
Other operating leases	7,700	9,012	7,393	16,813	40,918
Total contractual cash obligations	\$ 96,305	\$ 16,012	\$ 64,393	\$ 192,563	\$ 369,273

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

(2) Appraised value of the facility, the collateral that would be used to satisfy the contingent obligation, was estimated at \$50 million.

CRITICAL ACCOUNTING 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 OEMs and distributors 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.

Royalty revenue is recognized based on actual licensee sales when such sales incorporate technology licensed from Quantum. Revenue from separately priced extended warranty and product service contracts is initially deferred and recognized as revenue ratably over the contract period.

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.

Warranty expense and liability

We generally warrant our products against defects for 12 to 48 months. A provision for estimated future costs and estimated returns for credit relating to warranty claims is recorded when products are shipped and revenue is recognized. Our estimate of future costs to satisfy warranty obligations is primarily based on our estimates of future failure rates and our 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 our estimates, we will record 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 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 changes 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 is "net realizable value", which, 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 complete 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 12 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 27, 2005, the net amount of \$108.7 million of goodwill and intangible assets represented 16% 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, or at least annually, 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.

Special Charges

In recent periods and over the past several years, we recorded significant special 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*, which superseded the Emerging Issues Task Force ("EITF") Issue No. 94-3 *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. 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

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period" be recognized over the future service period. Under SFAS No. 146, if we fail to make accurate estimates regarding these costs or to accurately estimate the timing of the completion of planned activities, we may be required to record additional expenses or expense reductions in the future.

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.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 17 "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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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 19 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 change 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 2006 represented 50% of total revenue. This sales concentration does not include revenues from sales of our media that were sold directly to our top five customers by our licensees, 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 2006 approximately 21% and 18% of our revenue was derived from Hewlett-Packard and Dell, and, therefore, we could be materially and adversely affected if Hewlett-Packard or Dell were to experience a significant decline in storage revenue, whether due to customer loss or otherwise. There is an additional risk since Hewlett-Packard markets and manufactures its own competing LTO brand of tape drive and media and markets both the LTO and Super DLTape® platforms. To the extent that Hewlett-Packard significantly reduces its purchases of DLTape® and Super DLTape® products in favor of its own LTO products and Super DLTape® platforms, our tape drive and media revenues, operating results and financial condition would be materially and adversely affected.

If any of our other top five customers were to significantly reduce, cancel or delay their orders with us, our results of operations could be materially adversely affected.

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 latest generations of SDLT tape drive, tape automation and the DX-Series Enhanced Backup Systems. 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.

For example, the qualification of our latest tape drives has progressed slower than we had anticipated. If we are not successful in timely completion of our product qualifications and then ramping sales to our key customers, our revenue and results of operations could be adversely impacted.

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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. Our principal competitors include Hewlett-Packard, IBM, Sony, Advanced Digital Information Corporation (“ADIC”), Overland Data Inc. and StorageTek. These competitors are aggressively trying to advance and develop new technologies to compete more successfully with products based on DLTtape® and Super DLTtape® technology. Linear Tape Open (LTO) 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 have developed LTO products that target the high-capacity data backup market and compete with our products based on Super DLTtape® technology. Hewlett-Packard and IBM compete not only with our Super DLTtape products but now compete with our own LTO product offerings that we acquired through our recent 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. The lower demand resulting from the adverse economic conditions experienced in fiscal year 2003 had resulted in lower demand in the tape drive and tape automation markets in general, which has also resulted in increased ongoing price competition even as economic conditions have improved. 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 our Super DLTtape® drives, Super DLTtape® media and LTO products. 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 Advanced Digital Information Corporation, Overland Data Inc. and StorageTek, which offer tape automation systems incorporating DLTtape® and Super DLTtape® technology as well as new linear tape 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 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. As a result, our business, financial condition and operating results would be materially and adversely affected.

We have experienced a downward trend in tape media and tape royalty revenues, primarily caused by year-over-year declines in tape media unit sales and media prices, which has had a negative effect on our profits and cash flow. If this trend were to continue or worsen, our business, financial condition and operating results may be even further materially and adversely affected.

Our royalty and media 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 Super DLTtape® drives, the media cartridges that sell at a higher price than DLTtape® cartridges;
- 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. Since 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. This would materially and adversely affect our business, financial condition and results of operations.

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 tape media cartridges by Fuji, Maxell, Imation and Sony Corporation (“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.

In January 2005, we acquired Certance, and the failure to successfully integrate this acquisition 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. For instance, in January 2005, we acquired Certance. If we fail to successfully integrate this acquisition, it could harm our business, financial condition and operating results. Risks that we may face in our efforts to integrate Certance, or any future acquisitions include, among others:

- 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;
- Failure to realize anticipated synergies and benefits from the acquisition;
- Insufficient revenues to offset increased expenses associated with the acquisition;
- Costs and delays in implementing common systems and procedures and costs and delays caused by communication difficulties;
- 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, such as Certance’s relationship with the Linear Tape Open (LTO) consortium;
- 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.

We cannot provide assurance that we will be able to successfully integrate Certance, or 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.

We have outsourced most of our manufacturing to Jabil and to 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.

We outsourced tape drive manufacturing to Jabil during the third quarter of fiscal year 2003. However, since our acquisition of Certance on January 5, 2005, we manufacture some of our tape drives and head assemblies for those drives in our facility in Penang, Malaysia. We face a number of risks as a result of our decision to outsource manufacturing to Jabil, including, among others:

- *Sole source of product supply*

Outside of our Penang, Malaysia facility, Jabil is our sole source of supply for our tape drives and certain tape automation products. 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 Jabil for the products they manufacture for us. Jabil procures inventory to build our products based upon a forecast of customer demand that we provide. We would be responsible for the financial impact on Jabil of any reduction or product mix shift in the forecast relative to materials that Jabil had already purchased under a prior forecast. Such a variance in forecasted demand could require us to pay Jabil 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 Jabil. 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.

In addition to Jabil, we have outsourced substantially all of our manufacturing to other contract manufacturers. We face the same risks in relation to these arrangements as those set forth above, in particular the risks of component shortages or other delays in customer deliveries that could result in customer dissatisfaction and lost sales, increased costs for products manufactured for us and the risk that the quality of the products may not be acceptable to us or to our customers, any or all of which could have a material adverse effect on our business.

We have taken considerable steps towards reducing our cost structure and anticipate taking further cost reduction actions. The steps we have taken and anticipate taking 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 in response to adverse economic, industry and competitive conditions. We anticipate taking future steps to further reduce our operating costs. These steps and additional possible future restructurings in response 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 have made and may continue to make significant changes to our infrastructure and management, including consolidating or eliminating systems and functions and reducing the number of employees supporting functions. If we do not manage the changes that we implement successfully, our business could be disrupted, and that could adversely impact our results of operations and financial condition.

Managing change will be an important focus for us. The success of our efforts will depend on, among other things, how well we address issues that arise during the process of changing systems and functions and adapt business processes and software to the requirements of our organization. If we are unable to successfully manage the changes that we implement, it could disrupt our business and adversely impact our results of operations and financial condition.

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.

We have historically used stock options and other forms of equity-related compensation as key components of our total employee compensation program in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. In recent periods, many of our employee stock options have had exercise prices in excess of our stock price, which reduces their value to employees and could affect our ability to retain or attract present and prospective employees. See also Note 17 "Recent Accounting Pronouncements" to the Condensed Consolidated Financial Statements: SFAS No. 123 (revised 2004) *Share-Based Payment* ("SFAS 123R").

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 337 United States patents and have 175 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, resellers, customers and potential customers, 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.

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. For instance, see Note 13 "Litigation" to the Condensed Consolidated Financial Statements for a description of StorageTek's patent infringement suit against us. While we currently believe the amount of ultimate liability, if any, with respect to these 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 may be materially and adversely affected.

We are exposed to general economic conditions that have continued to result in significantly reduced sales levels and significant operating losses. If we experience adverse economic conditions, our business, financial condition and operating results could be further adversely and materially impacted.

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 took actions in fiscal years 2003 through 2005 to reduce our cost of sales and operating expenses in order to address these adverse conditions. A prolonged continuation or worsening of sales trends would require us to take additional actions to further reduce our cost of sales and operating expenses in subsequent 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 special charges associated with such expense reductions that are disproportionate to sales, thereby materially and adversely affecting 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 and our business could suffer.

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, many 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

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from operations, or that future borrowings or equity financing will be available on commercially reasonable terms or at all, or available 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 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.

Our Storage Systems business currently operates at a loss and may continue to operate at a loss. If we are unable to make Storage Systems profitable, the losses from this group could materially and adversely affect our business, financial condition and results of operations.

We have invested, and will continue to invest, in the development, promotion, and sale of storage solutions. Operating expenses associated with Storage Systems revenue are comparatively high, particularly as we invest in new product platforms, resulting in losses and cash consumption out of proportion to the revenue generated by the group when compared to our Tape Drive business. In addition, the Storage Systems business operates in an increasingly competitive environment. Therefore, we will need to generate significant revenues from Storage Systems, including service and product support revenues, or significantly reduce our related operating expenses for the group in order to make Storage Systems profitable. We cannot provide assurance that Storage Systems will ever produce operating income or will ever generate positive cash flow, and, if we are unable to do so, these losses could negatively impact our business, financial condition and operating results.

Goodwill and intangible assets used in Storage Systems have been reviewed at least annually for possible impairment since the adoption on April 1, 2002 of SFAS No. 142 *Goodwill and Other Intangible Assets*. Although we incurred no goodwill impairment in fiscal years 2004 and 2005, the impairment tests conducted relative to goodwill resulted in a \$94.3 million charge upon the adoption of SFAS No. 142 in the first quarter of fiscal year 2003 and a \$58.7 million impairment charge in the second quarter of fiscal year 2003. These reviews of goodwill were based on projections of undiscounted and discounted net cash flows from Storage Systems compared to the carrying value of goodwill. The financial projections involved significant estimates with inherent uncertainties regarding future revenues, expenses and cash flows. We cannot provide assurance that future net cash flows will be sufficient to avoid future impairment charges. As a result, in the future, we may incur additional impairment charges related to Storage Systems, which could have a materially adverse impact on the results of our operations or our financial condition. Although we have not incurred impairment charges associated with our other intangible assets, we have substantial intangible asset balances, which are subject to the same risks and uncertainties related to goodwill.

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.

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Our credit agreement and synthetic lease contain 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 and synthetic lease contain 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.

Our ability to comply with covenants contained in our credit agreement or our synthetic lease may be affected by events beyond our control, including prevailing economic, financial and industry conditions. Our failure to comply with our debt-related covenants in one agreement could result in an acceleration of our indebtedness and cross-default under the other agreement, which may have a material adverse effect on our liquidity and financial condition. 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.

Pursuant to our synthetic lease, we have an obligation for a guaranteed value to the lessor at the end of the lease term, which could result in our being required to make a significant cash payment to the lessor, and if we are required to do so, our business, financial condition and results of operations could be materially and adversely impacted.

We have a synthetic lease for our Colorado Springs facility, which is accounted for as an operating lease in accordance with SFAS No. 13 *Accounting for Leases*. At the end of the lease

term, we may renew the lease, purchase the facility, or cause the facility to be sold to a third party, subject to our obligation to the lessor for the guaranteed value. The proceeds of a sale to a third party would be used to satisfy the \$50 million obligation to the lessor at the end of the lease term. In the event of sale to a third party, we would be liable for any shortfall between the net proceeds resulting from the sale of the facility and our \$50 million obligation to the lessor, up to a maximum of \$43.9 million. In the event of a default on our obligation to the lessor, we would be liable for the entire \$50 million. These obligations that would arise from either a sale to a third party or a default could have a material adverse impact on our financial condition and liquidity.

In the past we incurred both a period expense and a cash charge because of a decline in the appraised value of this facility. We have the facility independently appraised on a periodic basis. Any future declines in the appraised value of the facility could result in both a period expense and a cash charge, which could be material and adverse to our financial condition.

Our synthetic lease requires us to maintain specified financial covenants. If we fail to comply with these financial covenants and are unable to obtain a waiver, or amend the lease, for such future non-compliance, it would cause us to default under our credit agreement and synthetic lease and the lessor could terminate the lease, resulting in the acceleration of our obligation to purchase the leased facility at either the full \$50 million value or the \$43.9 million guaranteed value, either of which could have a material adverse effect on our financial condition and liquidity.

In prior year periods, we violated certain financial covenants under our credit agreement and synthetic lease 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 \$27.4 million of our cash to cover the outstanding standby letters of credit issued under the credit agreement. This would have a material and adverse impact on our liquidity.

If we violate any financial or reporting covenants in our credit agreement, it would cause a corresponding violation under our synthetic lease. Absent a waiver or an amendment to our synthetic lease, such a violation would be cause for default under that agreement. For more information regarding our synthetic lease please refer to the immediately preceding risk factor.

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.

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.

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. For instance, on May 7, 2003, Digital Storage, Inc., one of our media distributors, filed for Chapter 11 bankruptcy protection. As a result of this bankruptcy, we recorded a net bad debt charge of \$1.4 million in fiscal year 2003. 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.

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.

Under a tax sharing and indemnity agreement between us and Maxtor entered into in connection with the disposition of the Hard Disk Drive group, 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'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 HDD, 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 material adverse impact on our business, financial condition and operating results.

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 Ernst & Young LLP, 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.

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.

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.
- 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.

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.

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.

Three institutional investors own approximately 49% 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 Quantum DLT® and Storage Systems 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 has 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; and
- Changes in our capital structure, including issuance of additional debt or equity to the public.

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

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;
- 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;
- 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.

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. 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:

- Adverse movement of foreign currencies against the U.S. dollar (the currency in which our results are reported);
- Import and export duties and value-added taxes;
- Import and export regulation changes that could erode our profit margins or restrict our exports;

- Potential restrictions on the transfer of funds between countries;

- Inflexible employee contracts in the event of business downturns; and
- The burden and cost of complying with foreign laws.

In addition, our suppliers have operations in several emerging or developing economies that have a potential for higher risk than in the developed markets. The risks associated with these economies include, but are not limited to, political risks and natural disasters, including earthquakes. In particular, with several of our outsourced manufacturers located in Malaysia and the Philippines, a significant portion of our product manufacturing may be subject to such political and climatic risks.

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.

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.

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 short-term fixed income investments 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 result in an approximate \$1.5 million annual decrease in interest income.

As of June 2005, our senior credit facilities are comprised of a \$145 million revolving line of credit expiring in March 2006 and a \$50 million synthetic lease expiring in December 2007. 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 leverage ratio. The synthetic lease payments are based on LIBOR or a base rate, plus a margin. 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 10 "Credit Agreements, Short-Term Debt and Convertible Subordinated Debt" to the Condensed Consolidated Financial Statements).

We do not enter into derivative transactions related to our cash equivalents or short-term investments nor for our existing or anticipated liabilities.

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. Currently, we do not utilize foreign currency forward contracts to manage the risk of exchange rate fluctuations because we believe that we have 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

- 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.
- 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.

QUANTUM CORPORATION

PART II - OTHER INFORMATION

Item 1. Legal proceedings

The information contained in Note 13 "Litigation" to the Condensed Consolidated Financial Statements is incorporated into this Part II, Item 1 by reference.

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

On August 2, 2005, Quantum approved a plan to terminate employees in the engineering organization to streamline its product development processes, align skills with its future product roadmaps and to reduce costs and investment to the appropriate level following product platform transitions. These actions are part of the Company's continuing work to further strengthen its operational platform and reduce its cost structure. The Company expects to complete these actions by the end of the third quarter of fiscal year 2006. The costs associated with these actions consist of one-time termination benefits. The Company's preliminary estimate of these costs is approximately \$1.8 million and substantially all of these charges will result in future cash expenditures.

Item 6. Exhibits

The Exhibit Index beginning on page 54 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.

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

Dated: August 5, 2005

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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 5, 2005

QUANTUM CORPORATION

/s/ RICHARD E. BELLUZZO

Richard E. Belluzzo
Chairman and
Chief Executive Officer

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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 5, 2005

QUANTUM CORPORATION

/s/ EDWARD J. HAYES, JR.

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

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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 27, 2005 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 5, 2005

QUANTUM CORPORATION

/s/ RICHARD E. BELLUZZO

Richard E. Belluzzo
Chairman and
Chief Executive Officer

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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 27, 2005 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 5, 2005

QUANTUM CORPORATION

/s/ EDWARD J. HAYES, JR.

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.	Filing Date
3.1	Amended and Restated Certificate of Incorporation of Registrant.	10-K	001-13449	3.1 June 29, 2001
3.2	Amended and Restated By-laws of Registrant, as amended.	10-K	001-13449	3.2 June 28, 2000
3.3	Amendment to Amended and Restated By-laws of Registrant, effective September 2, 2004.	10-Q	001-13449	3.3 November 3, 2004
3.4	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	Employment Offer Letter, dated May 26, 2005, between the Company and Howard L. Matthews III*	8-K	001-13449	10.1 June 2, 2005
10.3	Termination Agreement and General Release of All Claims, dated June 1, 2005, between the Company and George Kreigler III*	8-K	001-13449	10.2 June 2, 2005
10.4	Transaction Bonus and Severance Protection Agreement, dated January 4, 2005, between Certance, LLC and Howard L. Matthews III*	8-K	001-13449	10.3 June 2, 2005
10.5	Chief Executive Officer Change of Control Agreement, dated April 1, 2005, between Registrant and the Chief Executive Officer*	8-K	001-13449	10.1 April 7, 2005
10.6	Form of Officer Change of Control Agreement, dated April 1, 2005, between Registrant and the Executive Officers (other than the Chief Executive Officer)*	8-K	001-13449	10.2 April 7, 2005
10.7	Form of Director Change of Control Agreement, dated April 1, 2005, between Registrant and the Directors.	8-K	001-13449	10.3 April 7, 2005
24	Power of Attorney (see signature page).			

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Exhibit Number	Exhibit Description	Incorporated by Reference		
		Form	File No.	Filing Date
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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