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

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Form 10-Q

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

For the quarterly period ended December 28, 2003

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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Commission File Number 1-13449

**QUANTUM CORPORATION**

Incorporated Pursuant to the Laws of the State of Delaware

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IRS Employer Identification Number 94-2665054

1650 Technology Drive, Suite 800, San Jose, California 95110

(408) 944-4000

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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 February 9, 2004, approximately 180.0 million shares of Quantum Corporation's common stock were issued and outstanding.

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**QUANTUM CORPORATION**

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**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**QUANTUM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Product revenue	\$ 171,900	\$ 180,388	\$ 501,729	\$ 497,125
Royalty revenue	33,483	48,382	100,744	138,548
Total revenue	205,383	228,770	602,473	635,673
Cost of revenue	140,322	156,607	415,742	441,311
Gross margin	65,061	72,163	186,731	194,362
Operating expenses:				
Research and development	24,373	27,683	77,500	82,694
Sales and marketing	24,163	24,400	73,135	77,535
General and administrative	13,391	15,684	40,513	55,398
Goodwill impairment	—	—	—	58,689
Special charges	4,584	9,401	8,160	24,121
	66,511	77,168	199,308	298,437
Loss from operations	(1,450)	(5,005)	(12,577)	(104,075)
Equity investment write-downs	—	—	—	(17,061)
Interest and other income	527	3,878	5,573	8,904
Interest expense	(2,893)	(5,988)	(14,447)	(18,250)
Loss on debt extinguishment	—	—	(2,565)	—
Loss before income taxes	(3,816)	(7,115)	(24,016)	(130,482)
Income tax provision (benefit)	2,660	(1,193)	29,914	(5,159)
Loss from continuing operations	(6,476)	(5,922)	(53,930)	(125,323)
Discontinued operations:				
Income (loss) from discontinued operations, net of income taxes	1,043	(9,607)	1,043	(38,235)
Income (loss) from discontinued operations	1,043	(9,607)	1,043	(38,235)
Loss before cumulative effect of an accounting change	(5,433)	(15,529)	(52,887)	(163,558)

Cumulative effect of an accounting change	—	—	—	(94,298)
Net loss	\$ (5,433)	\$ (15,529)	\$ (52,887)	\$ (257,856)
Loss per share from continuing operations				
Basic	\$ (0.04)	\$ (0.04)	\$ (0.31)	\$ (0.79)
Diluted	\$ (0.04)	\$ (0.04)	\$ (0.31)	\$ (0.79)
Income (loss) per share from discontinued operations				
Basic	\$ 0.01	\$ (0.06)	\$ 0.01	\$ (0.24)
Diluted	\$ 0.01	\$ (0.06)	\$ 0.01	\$ (0.24)
Cumulative effect per share of an accounting change				
Basic	\$ —	\$ —	\$ —	\$ (0.59)
Diluted	\$ —	\$ —	\$ —	\$ (0.59)
Net loss per share				
Basic	\$ (0.03)	\$ (0.09)	\$ (0.30)	\$ (1.62)
Diluted	\$ (0.03)	\$ (0.09)	\$ (0.30)	\$ (1.62)
Weighted average common and common equivalent shares				
Basic	176,550	163,907	175,002	159,094
Diluted	176,550	163,907	175,002	159,094

See accompanying notes to Condensed Consolidated Financial Statements.

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**QUANTUM CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

	December 28, 2003 (Unaudited)	March 31, 2003 (1)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 219,930	\$ 221,734
Short-term investments	35,047	97,055
Accounts receivable, net of allowance for doubtful accounts of \$10,432 and \$8,927	123,851	133,760
Inventories	54,463	61,735
Deferred income taxes	35,052	46,370
Service inventories	50,446	49,104
Other current assets	29,166	26,080
Total current assets	547,955	635,838
Long-term assets:		
Property and equipment, net	44,895	59,092
Goodwill	44,179	40,916
Purchased technology, net	47,918	57,485
Other intangible assets, net	17,472	21,959
Other long-term assets	11,892	10,606
Receivable from Maxtor Corporation	—	95,833
Total long-term assets	166,356	285,891
	\$ 714,311	\$ 921,729
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 60,402	\$ 104,495
Accrued warranty	41,283	49,582

Short-term debt	976	—
Other accrued liabilities	105,460	99,899
<b>Total current liabilities</b>	<b>208,121</b>	<b>253,976</b>
Long-term liabilities:		
Deferred income taxes	35,052	25,091
Convertible subordinated debt	160,000	287,500
<b>Total long-term liabilities</b>	<b>195,052</b>	<b>312,591</b>
Stockholders' equity:		
Common stock	250,447	243,426
Retained earnings	60,691	111,736
<b>Total stockholders' equity</b>	<b>311,138</b>	<b>355,162</b>
	<b>\$ 714,311</b>	<b>\$ 921,729</b>

(1) Derived from the March 31, 2003 audited Consolidated Financial Statements included in the Annual Report on Form 10-K of Quantum Corporation for fiscal year 2003.

See accompanying notes to Condensed Consolidated Financial Statements.

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

(In thousands)  
(Unaudited)

	Nine Months Ended,	
	December 28, 2003	December 29, 2002
Cash flows from operating activities:		
Loss from continuing operations including cumulative effect of an accounting change	\$ (53,930)	\$ (219,621)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:		
Cumulative effect of an accounting change	—	94,298
Depreciation	23,049	27,955
Amortization	15,358	10,449
Goodwill write-down	—	58,689
Deferred income taxes	21,279	(15,091)
Compensation related to stock incentive plans	409	1,154
Equity investment write-down	—	17,061
Impairment of former manufacturing facility	2,335	—
Changes in assets and liabilities:		
Accounts receivable	9,909	15,245
Inventories	7,272	34,569
Accounts payable	(44,093)	25,940
Accrued warranty	(8,299)	(2,213)
Income taxes payable	1,923	(11,755)
Other assets and liabilities	11,902	(7,582)
Net cash provided by (used in) operating activities of continuing operations	(12,886)	29,098
Net cash used in operating activities of discontinued operations	—	(13,140)

Net cash provided by (used in) operating activities	(12,886)	15,958
<b>Cash flows from investing activities:</b>		
Purchases of short-term investments	(1,502,683)	(448,925)
Proceeds from sale of short-term investments	1,564,880	349,925
Proceeds from sale of equity securities	—	11,000
Investment in SANlight Inc. (net of cash acquired)	—	(776)
Investment in Benchmark Storage Innovations Inc. (net of cash acquired)	—	(3,020)
Purchases of property and equipment	(17,674)	(17,365)
Net cash provided by (used in) investing activities of continuing operations	44,523	(109,161)
Net cash provided by (used in) investing activities of discontinued operations	—	4,709
Net cash provided by (used in) investing activities	44,523	(104,452)
<b>Cash flows from financing activities:</b>		
Receipt of 7% convertible subordinated notes allocated to Maxtor Corporation	95,833	—
Settlement of 7% convertible subordinated notes	(287,500)	—
Issuance of 4.375% convertible subordinated notes (net of commissions and expenses)	155,207	—
Principle payments of short-term debt	—	(41,363)
Proceeds from issuance of common stock, net	3,019	3,064
Net cash used in financing activities of continuing operations	(33,441)	(38,299)
Net cash provided by financing activities of discontinued operations	—	97
Net cash used in financing activities	(33,441)	(38,202)
Decrease in cash and cash equivalents from continuing operations	(1,804)	(118,362)
Decrease in cash and cash equivalents from discontinued operations	—	(8,334)
Net decrease in cash and cash equivalents	(1,804)	(126,696)
Cash and cash equivalents at beginning of period	221,734	343,878
Cash and cash equivalents at end of period	\$ 219,930	\$ 217,182
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the year for:		
Interest	\$ 20,105	\$ 9,336
Income taxes	\$ 6,206	\$ 21,549
Notes payable issued for achievement of certain earn out provisions of M4 Data (Holdings) Ltd. acquisition	\$ 976	\$ 443
Common stock issued for achievement of certain earn out provisions of Benchmark Storage Innovations Inc. acquisition	\$ 3,591	\$ —
Value of common stock tendered in satisfaction of employees' income taxes on vesting of employee stock options	\$ 337	\$ 4,868

See accompanying notes to Condensed Consolidated Financial Statements.

**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 DLT business and the Storage Solutions business. DLT designs, develops, manufactures, licenses, services, and markets tape drives (DLTtape and Super DLTtape drives), and media cartridges (DLTtape and Super DLTtape media cartridges). The Storage Solutions business consists of tape automation

systems and services and includes disk-based enhanced backup solutions.

Until the beginning of fiscal year 2002, Quantum Corporation operated its business through two separate business groups: the DLT & Storage Systems group (“DSS”) and the Hard Disk Drive group (“HDD”). On March 30, 2001, Quantum’s stockholders approved the disposition of HDD to Maxtor Corporation (“Maxtor”). On April 2, 2001, each authorized share of HDD common stock was exchanged for 1.52 shares of Maxtor common stock.

Since the sale of HDD, Quantum’s business has included the two business segments described above: DLT and Storage Solutions.

In April 2001, Quantum completed the acquisition of M4 Data (Holdings) Ltd., (“M4 Data”) a privately held data storage company based in the United Kingdom, to leverage M4 Data’s complementary high performance and scalable tape automation products and technologies. In November 2002, Quantum completed the acquisition of Benchmark Storage Innovations, Inc. (“Benchmark”), a privately held company. The acquisition enabled Quantum to expand its tape business by adding Benchmark’s complementary products. In March 2003, Quantum completed the acquisition of the remaining outstanding shares of SANlight Inc. (“SANlight”) that it did not already own. The acquisition provided Quantum with software technology and expertise that it can leverage in its enhanced disk-based backup solutions.

Quantum sold its Network Attached Storage (“NAS”) business, which was part of Storage Solutions, to SNAP Appliance, Inc. (formerly known as Broadband Storage, Inc.), a privately held company, in October 2002. Quantum engaged in the NAS business following the acquisition of Meridian Data, Inc., in September 1999 and of certain assets of Connex in August 2001.

**Note 2: Pro Forma Stock Compensation Expense**

In accordance with Statement of Financial Accounting Standard (“SFAS”) No. 123, *Accounting for Stock-Based Compensation*, Quantum elected to continue to account for its stock-based compensation plans under APB Opinion No. 25, and related interpretations, and disclose the pro forma effects of its employee stock options on net loss and net loss per share.

Pro forma net loss and net loss per share information, as required by SFAS No. 123, has been determined as if Quantum had accounted for its employee stock options under the fair value method of SFAS No. 123. The estimated fair value of the options is amortized to expense over the vesting period of the options.

The following table presents the effect on reported net loss and net loss per share of accounting for employee stock options under the fair value method:

(In thousands, except per-share data)

	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Reported net loss	\$ (5,433)	\$ (15,529)	\$ (52,887)	\$ (257,856)
Add back employee stock option expense	150	264	409	1,154
Option fair value amortization	(3,295)	(3,952)	(12,726)	(15,468)
Pro forma net loss	\$ (8,578)	\$ (19,217)	\$ (65,204)	\$ (272,170)
Reported net loss per share	\$ (0.03)	\$ (0.09)	\$ (0.30)	\$ (1.62)
Net effect per share of option fair value amortization	(0.02)	(0.02)	(0.07)	(0.09)
Basic and diluted pro forma net loss per share	\$ (0.05)	\$ (0.11)	\$ (0.37)	\$ (1.71)

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:

	Stock Option Plans Three Months Ended		Stock Purchase Plan Three Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Option life (in years)	3.05	3.01	1.75	1.33
Risk-free interest rate	1.86%	1.48%	1.48%	2.19%
Stock price volatility	0.81	0.68	0.68	0.69
Dividend yield	-	-	-	-

	Stock Option Plans Nine Months Ended		Stock Purchase Plan Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Option life (in years)	2.16	3.01	1.50	1.33
Risk-free interest rate	1.63%	1.48%	1.48%	2.19%
Stock price volatility	0.64	0.68	0.68	0.69
Dividend yield	-	-	-	-

The following is a summary of weighted-average grant date fair values using a Black-Scholes option pricing model:

(In thousands, except per-share data)	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Options granted under the Long-Term Incentive Plan, Supplemental Plan and Stock Options Plans	\$ 1.68	\$ 1.94	\$ 1.34	\$ 1.94
Restricted stock granted under the Long-Term Incentive Plan	n/a	\$ 7.52	n/a	\$ 7.52
Shares granted under the Stock Purchase Plan	\$ 1.07	\$ 2.13	\$ 1.02	\$ 2.13

### **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.

Certain items previously reported in specific financial statement captions have been reclassified to conform to the current period's classification. Such reclassifications have not impacted previously reported net loss amounts. Specifically, automation units used for permanent demonstration and testing purposes have been reclassified from "Inventories" to "Property and Equipment, net" in the Condensed Consolidated Balance Sheets and the Condensed Consolidated Statements of Cash Flows have been adjusted to reflect this reclassification. Automation units that were permanently used for demonstration and testing purposes with a net carrying amount of \$4.6 million and which were included in inventories at March 31, 2003 in Quantum's Form 10-K have been reclassified to property and equipment in the Condensed Consolidated Balance Sheets. The purchases of property and equipment in the nine-month periods ended December 28, 2003 and December 29, 2002, as presented in the Condensed Consolidated Statements of Cash Flows, include \$5.4 million and \$4.9 million, respectively, of cost for automation units used for permanent demonstration and testing purposes.

The Condensed Consolidated Balance Sheet as of March 31, 2003, has been derived from the audited financial statements at that date, but 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, 2003, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Quantum sold its NAS business on October 28, 2002. The NAS business had been part of Quantum since the acquisition of Meridian Data, Inc. in September 1999 and of certain assets of Connex in August 2001. As a result of this disposition, the Condensed Consolidated Financial Statements and related notes have been restated to present the results of the NAS business as discontinued operations. Accordingly, in the Condensed Consolidated Statements of Operations, the operating results of the NAS business have been classified as "Income (loss) from discontinued operations, net of income taxes" for the three and nine-month periods ended December 28, 2003 and December 29, 2002. The cash flows from the NAS business have been presented as net cash flows from discontinued operations in the Condensed Consolidated Statements of Cash Flows for the nine-month period ended December 29, 2002.

### **Note 4: Discontinued Operations**

#### Disposition of the NAS Business

Quantum was previously engaged in the business of developing, manufacturing, and selling network attached storage solutions for the desktop, workgroups and enterprises. These NAS products consisted primarily of server appliances that incorporated hard disk drives and an operating system designed to meet the requirements of entry, workgroup, and enterprise computing environments, where multiple computer

users access shared data files over a local area network.

On October 7, 2002, Quantum entered into an agreement with a privately held third party to sell certain assets and assign certain contract rights related to its NAS business. The NAS assets that were sold included inventories for resale to customers, service inventories, fixed assets and intellectual property. The proceeds from the sale included approximately \$4.7 million in cash, \$3.9 million in restricted equity securities of the buyer with an option to acquire additional equity securities, a secured promissory note for \$2.4 million issued by the buyer and the assumption by the buyer of \$1.6 million of warranty liability in connection with the prior installed base of NAS products. The sale was completed on October 28, 2002. The secured promissory note was settled in the first quarter of fiscal year 2004 in exchange for the third party acquirer assuming additional obligations.

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The following table summarizes the results of the NAS business:

(In thousands, except per-share data)	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Revenue	\$ —	\$ 190	\$ —	\$ 19,899
Gross margin	402	(3,935)	402	(3,075)
Operating expenses	(641)	10,838	(641)	46,209
Income (loss) from operations	1,043	(14,773)	1,043	(49,284)
Income (loss) before income taxes	1,043	(14,620)	1,043	(49,156)
Income tax benefit	—	(5,013)	—	(10,921)
Net income (loss)	1,043	(9,607)	1,043	(38,235)

The income from operations in the three and nine-month periods ended December 28, 2003 consisted of a reversal of accrued warranty on NAS products sold by Quantum with the lapse of the warranty period and a reversal of remaining severance benefit accruals associated with certain employees impacted by the disposition of the NAS business, which would have been payable by Quantum had the employees been terminated by the acquirer of the NAS business within a set time from the acquisition date.

The losses from operations in the nine-month period ended December 29, 2002 included an impairment charge of \$16.4 million. In the second quarter of fiscal year 2003, Quantum determined that the sale of the NAS business was probable and wrote down the assets held for sale to fair value less cost to sell. The fair value of the assets held for sale was determined to be the proceeds from the sale. The resulting impairment charge related mainly to completed technology arising from the acquisitions of Meridian Data Inc. and certain assets of Connex.

The loss from operations in the nine-month period ended December 29, 2002 also included special charges of \$4.3 million incurred in the first quarter of fiscal year 2003 related to the consolidation of sales and marketing activities within Storage Solutions. These charges primarily related to severance benefits for approximately 60 NAS employees who were terminated as a result of this restructuring plan.

#### **Note 5: Cumulative Effect of an Accounting Change**

SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires companies to discontinue the amortization of goodwill and certain intangible assets with an indefinite useful life, became effective for Quantum on April 1, 2002. Accordingly, goodwill and intangible assets deemed to have an indefinite useful life must be reviewed for impairment upon adoption of SFAS No. 142 and annually thereafter, or more frequently when indicators of impairment exist.

The assessment of impairment conducted in the first quarter of fiscal year 2003, the quarter in which Quantum adopted SFAS No. 142, required Quantum to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units. At the time of adoption, Storage Solutions was the only business unit with goodwill. The fair values of the reporting units underlying Storage Solutions were estimated using both a discounted cash flow and market approach methodology. The reporting units' carrying amounts exceeded their fair values, indicating that the reporting units' goodwill was impaired, therefore requiring Quantum to perform the second step of the transitional impairment test. In the second step, Quantum compared the implied fair values of the reporting units' goodwill, determined by allocating the reporting units' fair values to all of its assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation in accordance with SFAS No. 141, *Business Combinations*.

Upon adoption of SFAS No. 142 in the first quarter of fiscal year 2003, Quantum recorded a non-cash accounting change adjustment of \$94.3 million, reflecting a reduction to the carrying value of its goodwill, as a cumulative effect of an accounting change in the accompanying Condensed Consolidated Statements of Operations.

Note 6, *Goodwill and Intangible Assets*, provides additional disclosure on the impact to Quantum's financial statements as a result of applying SFAS No. 141 and SFAS No. 142.

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**Note 6: Goodwill and Intangible Assets**

The following table provides a summary of the change in the carrying amount of goodwill:

(In thousands)	<u>Goodwill</u>
Balance as of March 31, 2003	\$ 40,916
Additional goodwill resulting from the achievement of certain earn out provisions of the Benchmark acquisition agreement	3,591
Reversal of excess accrual for severance liabilities related to Benchmark acquisition	(328)
Balance as of December 28, 2003	<u>\$ 44,179</u>

The following tables provide a summary of the carrying amounts of intangible assets:

(In thousands)	<u>December 28, 2003</u>		
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>
Purchased technology	\$ 84,600	\$ (36,682)	\$ 47,918
Trademarks	22,560	(9,138)	13,422
Non-compete agreements	2,556	(1,962)	594
Customer lists	14,100	(11,587)	2,513
Other	4,163	(3,220)	943
	<u>\$ 127,979</u>	<u>\$ (62,589)</u>	<u>\$ 65,390</u>

  

(In thousands)	<u>March 31, 2003</u>		
	<u>Gross Amount</u>	<u>Accumulated Amortization</u>	<u>Net Amount</u>
Purchased technology	\$ 84,600	\$ (27,115)	\$ 57,485
Trademarks	22,560	(6,914)	15,646
Non-compete agreements	2,556	(1,566)	990
Customer lists	14,100	(10,308)	3,792
Other	4,133	(2,602)	1,531
	<u>\$ 127,949</u>	<u>\$ (48,505)</u>	<u>\$ 79,444</u>

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

(In thousands)	<u>Three Months Ended</u>		<u>Nine Months Ended</u>		<u>Amortized by</u>
	<u>December 28, 2003</u>	<u>December 29, 2002</u>	<u>December 28, 2003</u>	<u>December 29, 2002</u>	
Purchased technology	\$ 3,189	\$ 2,505	\$ 9,567	\$ 6,146	September 2008
Trademarks	741	673	2,224	1,506	September 2008
Non-compete agreements	132	–	396	–	February 2005
Customer lists	133	573	1,278	1,720	September 2008
Other	208	–	619	–	February 2005
	<u>\$ 4,403</u>	<u>\$ 3,751</u>	<u>\$ 14,084</u>	<u>\$ 9,372</u>	

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

(In thousands) Amortization

Three Months Ended March 31, 2004	\$ 4,404
Fiscal year 2005	17,448
Fiscal year 2006	16,253
Fiscal year 2007	14,025
Fiscal year 2008	9,699
Fiscal year 2009	3,561
<b>Total</b>	<b>\$ 65,390</b>

**Note 7: Inventories**

Inventories consisted of the following:

(In thousands)	December 28, 2003	March 31, 2003
Materials and purchased parts	\$ 23,239	\$ 32,415
Work in process	1,620	4,264
Finished goods	29,604	25,056
	<b>\$ 54,463</b>	<b>\$ 61,735</b>

Automation units that were permanently used for demonstration and testing purposes with a net carrying amount of \$4.6 million and which were included in finished goods at March 31, 2003 in Quantum's Form 10-K have been reclassified to property and equipment.

**Note 8: Service Inventories**

Service inventories consisted of the following:

(In thousands)	December 28, 2003	March 31, 2003
Component parts	\$ 16,782	\$ 13,688
Finished units	33,664	35,416
	<b>\$ 50,446</b>	<b>\$ 49,104</b>

**Note 9: Accrued Warranty and Indemnifications**

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

(In thousands)	Accrued Warranty
Balance at March 31, 2003	\$ 49,582
Additional warranties issued	18,503
Adjustments for warranties issued in prior fiscal years	4,311
Costs of repair	(31,113)
Balance at December 28, 2003	<b>\$ 41,283</b>

Quantum warrants its products against defects for periods ranging from one to three years. A provision for estimated future costs and estimated returns for credit relating to warranty is recorded when products are shipped and revenue recognized. Quantum's estimate of future costs to satisfy warranty obligations was primarily based on estimates of future failure rates and its estimates of future costs of repair

including materials consumed in the repair, and labor and overhead or outside service amounts necessary to perform the repair.

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

#### Indemnifications

Under its normal terms and conditions of sale, Quantum may provide its customers with certain standard indemnifications regarding the safety of its products and the intellectual property used in its products. Quantum did not record a liability associated with these guarantees, as Quantum has little or no history of costs associated with such indemnification requirements. Contingent liabilities associated with product liability may be mitigated by insurance coverage that Quantum maintains.

#### **Note 10: Net Loss Per Share**

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

(in thousands, except per-share data)

	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Loss from continuing operations	\$ (6,476)	\$ (5,922)	\$ (53,930)	\$ (125,323)
Income (loss) from discontinued operations	1,043	(9,607)	1,043	(38,235)
Cumulative effect of an accounting change	—	—	—	(94,298)
Net loss	\$ (5,433)	\$ (15,529)	\$ (52,887)	\$ (257,856)
Loss per share from continuing operations	\$ (0.04)	\$ (0.04)	\$ (0.31)	\$ (0.79)
Income (loss) per share from discontinued operations	0.01	(0.06)	0.01	(0.24)
Cumulative effect per share of an accounting change	—	—	—	(0.59)
Basic and diluted net loss per share	\$ (0.03)	\$ (0.09)	\$ (0.30)	\$ (1.62)
Weighted average shares outstanding used in computing basic and diluted net income per share	176,550	163,907	175,002	159,094

The computations of diluted net loss per share for the nine-month period ended December 28, 2003 and the three and nine-month periods ended December 29, 2002 exclude the effect of the 7% convertible subordinated notes issued in July 1997 and redeemed in August 2003, which were convertible into 6.2 million shares of Quantum common stock (21.587 shares per \$1,000 note), because the effect would have been antidilutive. The computations of diluted net loss per share for the three and nine-month periods ended December 28, 2003, exclude the effect of the 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), because the effect would have been antidilutive.

Options to purchase 34.9 million shares and 34.8 million shares of Quantum common stock were outstanding at December 28, 2003, and December 29, 2002, respectively, but were not included in the computation of diluted net loss per share for the three and nine-month periods ended December 28, 2003, and December 29, 2002, respectively, because the effect would have been antidilutive.

#### **Note 11: Common Stock Repurchase**

At December 28, 2003, there was approximately \$87.9 million remaining on Quantum's authorization to repurchase Quantum common stock. No stock repurchases were made during the nine months ended December 28, 2003. Quantum's ability to repurchase common stock is restricted under its credit facilities.

#### **Note 12: Credit Agreements, Short-Term Debt and Convertible Subordinated Debt**

Quantum's debt includes the following:

(In thousands)	December 28, 2003	March 31, 2003
Convertible subordinated debt	\$ 160,000	\$ 287,500
Short-term debt	976	—
	<u>\$ 160,976</u>	<u>\$ 287,500</u>
Weighted average interest rate	4.38%	7.00%

#### Convertible subordinated debt

On July 30, 2003, Quantum issued \$160.0 million in aggregate principal amount of 4.375% convertible subordinated notes due 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 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 \$155.2 million, after deducting commissions and expenses. Quantum used the net proceeds from the sale of the notes plus a portion of available cash to redeem its 7% convertible subordinated notes due in 2004.

In July 1997, Quantum issued \$287.5 million of 7% convertible subordinated notes. The notes had a maturity date of August 1, 2004, and were convertible at the option of the holder at any time prior to maturity, unless previously redeemed, into shares of Quantum common stock and Maxtor common stock. The notes were classified as long-term and were convertible into 6.2 million shares of Quantum common stock (or 21.587 shares per \$1,000 note), and 4.7 million shares of Maxtor common stock (or 16.405 shares per \$1,000 note). Quantum recorded a receivable from Maxtor of \$95.8 million for the principal portion of the debt previously attributed to the HDD group and for which Maxtor agreed to reimburse Quantum for both principal and associated interest payments. On August 21, 2003, Quantum redeemed all these 7% convertible subordinated notes at 101% of the aggregate principal amount. The aggregate redemption price of the notes was \$290.4 million, which included a premium paid of \$2.9 million. On August 14, 2003, Quantum received \$96.8 million from Maxtor, which represented the full amount for Maxtor's portion of the debt plus the premium on their portion of the notes due 2004.

#### Short-term debt

Quantum acquired all the outstanding stock of M4 Data on April 12, 2001 for approximately \$58.0 million in consideration, including \$41.4 million in debentures. The debenture holders called and received payment from Quantum for this \$41.4 million in fiscal year 2003. The purchase agreement also included additional contingent consideration to be paid annually from 2002 through 2005 based on future revenues, which may result in additional debentures being issued and this occurred in the first quarter of fiscal year 2004. The outstanding debentures of \$1.0 million that were issued in the first quarter of fiscal year 2004 based on revenues in the preceding fiscal year are immediately callable by the holders.

The debentures are unsecured obligations subordinated in right of payment to all of Quantum's existing and future senior indebtedness. The debentures do not contain financial covenants, reporting covenants or cross default provisions.

#### Credit lines

In December 2002, Quantum entered into a secured senior credit facility with a group of five banks, providing a \$100.0 million revolving credit line that expires in June 2004. Also in December 2002, Quantum entered into a \$50.0 million synthetic lease that contains the same financial covenants as the revolving credit line. As of December 28, 2003, \$90.4 million of this revolving credit line is committed to standby letters of credit, of which \$50.0 million secures Quantum's obligation to the lessor under its synthetic lease (see below and Note 18, *Commitments and Contingencies*). Borrowings under the revolving credit line bear interest at either the London interbank offering rate or a base rate, plus a margin determined by a leverage ratio with option periods of one to nine months. 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. In several prior quarters Quantum violated certain of these financial covenants and received waivers or amendments for such violations. 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 December 28, 2003, Quantum was in compliance with all of the credit line covenants.

#### Note 13: Litigation

On August 7, 1998, Quantum was named as one of several defendants in a patent infringement lawsuit filed in the U.S. District Court for the Northern District of Illinois, Eastern Division. The plaintiff, Papst Licensing GmbH, owns numerous United States patents, which Papst alleges are infringed 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. Nevertheless, if Papst prevails and Maxtor were unable for any reason to indemnify Quantum in accordance with the merger agreement, Quantum's resulting liability could have a materially adverse impact on Quantum's results of operations and financial position.

On April 14, 2003, Quantum filed a patent infringement complaint in the U.S. District Court in the Northern District of California against Storage Technology Corporation ("StorageTek"). The suit alleges that StorageTek has engaged in the unlawful manufacture and sale within the United States of tape and tape drive products that infringe two separate Quantum patents. The suit seeks a permanent injunction against StorageTek as well as the recovery of monetary damages, including treble damages for willful infringement. On April 15, 2003, 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. Quantum believes that StorageTek's claims are without merit, that the patents are invalid and Quantum intends to defend the lawsuit vigorously. Given the early stages and inherent uncertainty of the litigation, Quantum currently cannot estimate the extent of the potential damages in the StorageTek 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 and 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 vigorously 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. Given the early stages and inherent uncertainty of the litigation, Quantum currently cannot estimate the extent of the potential damages in the litigation.

On December 30, 2003, a lawsuit was filed against Quantum and Maxtor Corporation in the U.S. District Court in the Northern District of California. The plaintiff, Matsushita Kotobuki Electronics Industries, Ltd. ("MKE"), alleges breach of contract, breach of fiduciary relationship, fraud, violation of California unfair business practices law, and unjust enrichment and charges, among other things, that certain Quantum intellectual property transferred to Maxtor in connection with the purchase by Maxtor of Quantum's hard disk drive business belongs to MKE. MKE seeks a declaratory judgment that it is the sole owner of the specified intellectual property, as well as unspecified damages, attorneys' fees, costs, and interest. In addition, MKE seeks to recover amounts MKE paid in settlement to Papst. Given the early stages and inherent uncertainty of the litigation, Quantum currently cannot estimate the extent of the potential damages in the litigation. Quantum denies the allegations of the complaint, believes they are without merit and intends to vigorously defend against the claims asserted by MKE.

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**Note 14: Special Charges**

Special charges were recorded in the first nine months of fiscal years 2004 and 2003 related to plans to reduce operating costs and return to profitability.

Fiscal year 2004 special charges

In the first nine months of fiscal year 2004, Quantum implemented plans to reduce costs in an effort to return to profitability. The restructuring charges that resulted from these cost reduction efforts resulted from:

- Plans to consolidate most of the operations supporting Quantum's two business segments;
- Additional headcount reductions and costs following the outsourcing of certain of Quantum's manufacturing to Jabil in fiscal year 2003;
- Plans to outsource manufacturing of certain automation products in the U.K; and
- Other headcount reductions.

These plans to reduce costs impacted both of Quantum's operating segments, DLT and Storage Solutions, as well as corporate functions.

*Company-wide cost reduction activities*

In November 2003, Quantum began consolidating most of the operations supporting its DLT and Storage Solutions businesses into one organization with consolidated operational functions and a combined sales force. Quantum recorded charges in the third quarter of fiscal year 2004 of \$4.0 million for severance benefits for 110 employees located in Colorado Springs, Colorado, Irvine, California and San Jose, California.

#### *DLT cost reduction activities*

In the first and second quarters of fiscal year 2004, charges of \$0.3 million and \$0.4 million, respectively, were recorded for severance benefits for eight and nine employees, respectively, located at Quantum's facility in Colorado Springs, Colorado. These costs result from plans to reduce procurement activities following the outsourcing of certain manufacturing to Jabil and reductions following the integration of the Benchmark acquisition.

In addition, in the second quarter of fiscal year 2004, Quantum incurred a non-cash charge of \$2.3 million to write down its former manufacturing facility in Malaysia to its appraised value, following Quantum vacating this facility as part of the outsourcing of certain manufacturing to Jabil.

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#### *Storage Solutions cost reduction activities*

In the first and second quarters of fiscal year 2004, charges of \$0.1 million and \$0.5 million, respectively, were recorded for severance benefits for three and 20 employees, respectively, located in the U.K., mostly reflecting initial steps in the plan to eliminate an automation product manufacturing site in the U.K. In the third quarter of fiscal year 2004, additional charges of \$0.6 million were recorded related to this plan for a portion of the severance benefits for 69 employees.

In the second quarter of fiscal year 2004, Quantum reversed a \$0.5 million portion of previously recorded special charges. Of this amount, \$0.2 million was originally recorded in the first quarter of fiscal year 2002 for vacant facility costs for a facility in Irvine, California, and the remaining \$0.3 million was originally recorded in the second quarter of fiscal year 2003 related to severance charges recorded for site and function consolidation activities. The facility charges were reversed as a result of lower estimated vacant facilities costs and the severance charges were reversed due to costs being lower than originally anticipated.

#### *Corporate severance*

In the second quarter of fiscal year 2004, a charge of \$0.4 million was recorded for separation costs related to an executive officer, as part of plans to reduce operating costs.

#### Fiscal year 2003 special charges

##### *DLT cost reduction activities*

In the second quarter of fiscal year 2003, a charge of \$3.2 million was recorded for headcount reductions as part of the integration of Benchmark under a plan to have no net increase in headcount following the acquisition, which resulted in a reduction to DLT's existing headcount. The charge related to severance benefits for 75 employees.

In the third quarter of fiscal year 2003, the following special charges were recorded by DLT:

- A charge of \$3.8 million related to severance for 870 employees who were terminated as a result of Quantum outsourcing its tape drive manufacturing and certain tape automation manufacturing to Jabil Circuit Inc. ("Jabil");
- A charge of \$2.3 million was recorded in order to reduce future operating costs through a headcount reduction. The charge related to severance benefits for 44 employees; and
- A charge of \$1.3 million was recorded for vacant facilities' costs following the renegotiation and extension of an operating lease (refer to note 18, 'Commitments and Contingencies').

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#### *Storage Solutions cost reduction activities*

In the first quarter of fiscal year 2003, a charge of \$1.1 million was recorded for severance benefits for 30 employees who were terminated as part of a plan to consolidate sales and marketing activities within Storage Solutions.

In the second quarter of fiscal year 2003, a charge of \$7.2 million was recorded as part of a plan to outsource sub-assembly manufacturing of Quantum's P-Series enterprise tape libraries, consolidate the number of research and development sites for disk-based backup and tape automation, and centralizing sales and marketing support functions. The charge included severance benefits for 140 employees, fixed asset write-offs and vacant facility charges.

In the third quarter of fiscal year 2003, Storage Solutions recorded the following amounts:

- A special charge of \$2.6 million related to severance costs for 41 employees. The severance costs were mostly related to the elimination of engineering in the UK and reduced sales in Japan; and

- A special charge of \$0.7 million was reversed on Quantum's statement of operations related to special charges recorded in the second quarter of fiscal year 2003 for U.K. vacant facilities due to a favorable renegotiation of the lease terms.

#### *Corporate severance*

In the second quarter of fiscal year 2003, a charge of \$3.7 million was recorded primarily for separation costs related to Quantum's former Chief Executive Officer, who remains on Quantum's Board of Directors.

#### *European operations reorganization*

In the first quarter of fiscal year 2003, Quantum reversed a charge of \$0.4 million on its statement of operations related to special charges originally recorded in the second quarter of fiscal year 2002 for the closure of its Geneva, Switzerland sales office. Quantum reversed the special charge because the landlord was able to sublease the space to a new tenant on terms more favorable than originally anticipated.

#### *Special charge activity and future payouts*

The following two tables show the activity for the nine months ended December 28, 2003 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 8 in Quantum's Annual Report on Form 10-K for the year ended March 31, 2003):

#### Discontinuation of Manufacturing in Colorado Springs

(In thousands)	Facilities
<b>Balance March 31, 2003</b>	<b>\$ 2,384</b>
Cash payments	(306)
<b>Balance June 29, 2003</b>	<b>\$ 2,078</b>
Cash payments	(306)
<b>Balance September 28, 2003</b>	<b>\$ 1,772</b>
Cash payments	(306)
<b>Balance December 28, 2003</b>	<b>\$ 1,466</b>

Estimated timing of future payouts:

4 <sup>th</sup> Quarter of Fiscal Year 2004	\$ 306
Fiscal Year 2005 to 2008	1,160
	<b>\$ 1,446</b>

The cash payments in the three months ended December 28, 2003 represented vacant facilities lease payments of \$0.3 million. The remaining special charge accrual reflects a vacant space accrual of \$1.5 million related to Quantum's facility in Colorado Springs, Colorado, which will be paid over the lease term through the third quarter of fiscal year 2008.

#### Other Restructuring Programs

(In thousands)	Severance and Benefits	Facilities	Other	Total
<b>Balance at March 31, 2003</b>	<b>\$ 1,338</b>	<b>\$ 1,464</b>	<b>\$ 886</b>	<b>\$ 3,688</b>
DLT special charges	296	—	47	343
Storage Solutions special charges	133	—	—	133
Cash payments	(839)	(245)	(8)	(1,092)
Non-cash charges	—	—	(47)	(47)
<b>Balance at June 29, 2003</b>	<b>\$ 928</b>	<b>\$ 1,219</b>	<b>\$ 878</b>	<b>\$ 3,025</b>
DLT special charges	349	—	—	349
Storage Solutions special charges	487	—	—	487
Corporate severance	432	—	—	432

Facility impairment	—	2,335	—	2,335
Cash payments	(1,182)	(253)	(878)	(2,313)
Non-cash charges	—	(2,335)	—	(2,335)
Restructuring charge benefit	(339)	(164)	—	(503)
<b>Balance at September 28, 2003</b>	<b>\$ 675</b>	<b>\$ 802</b>	<b>\$ —</b>	<b>\$ 1,477</b>
Special charges related to plan to integrate business groups	4,023	—	—	4,023
Storage Solutions special charges	561	—	—	561
Cash payments	(919)	(231)	—	(1,150)
<b>Balance at December 28, 2003</b>	<b>\$ 4,340</b>	<b>\$ 571</b>	<b>\$ —</b>	<b>\$ 4,911</b>
Estimated timing of future payouts:				
4 <sup>th</sup> Quarter of Fiscal Year 2004	\$ 3,291	\$ 121	\$ —	\$ 3,412
Fiscal Year 2005 to 2006	1,049	450	—	1,499
	<b>\$ 4,340</b>	<b>\$ 571</b>	<b>\$ —</b>	<b>\$ 4,911</b>

The cash payments in the three months ended December 28, 2003 represented severance payments of \$0.9 million and vacant facilities lease payments of \$0.2 million. The \$4.9 million remaining special charge accrual at December 28, 2003 is comprised of obligations for severance and vacant facilities. The severance charges will be paid during the fourth quarter of fiscal year 2004 and the facilities charges relating to vacant facilities in Irvine, California, will be paid over the lease term, which is through the third quarter of fiscal year 2006.

#### Note 15: Comprehensive Loss

Total comprehensive loss, net of tax, if any, for the three and nine months ended December 28, 2003, and December 29, 2002, are presented in the following table:

	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
(in thousands)				
Net loss	\$ (5,433)	\$ (15,529)	\$ (52,887)	\$ (257,856)
Foreign currency translation adjustment	1,157	285	1,843	1,499
Total comprehensive loss	\$ (4,276)	\$ (15,244)	\$ (51,044)	\$ (256,357)

#### Note 16: Business Segment Information

Quantum has two data storage business segments: the DLT business and the Storage Solutions business. These reportable segments include two distinct product groups. DLT consists of tape drives and related tape media cartridges. Storage Solutions consists of tape automation systems and service, and hard disk drive based enhanced backup solutions. Quantum directly markets its products to computer manufacturers and through a broad range of distributors, resellers and systems integrators.

Quantum evaluates segment performance based on operating income (loss). 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:

	Three Months Ended					
	December 28, 2003			December 29, 2002		
	DLT	Storage Solutions	Total	DLT	Storage Solutions	Total
Total revenue	\$ 139,722	\$ 71,293	\$ 211,015	\$ 173,365	\$ 64,313	\$ 237,678
Inter-segment revenue	(5,632)	—	(5,632)	(8,908)	—	(8,908)
Revenue from external customers	134,090	71,293	205,383	164,457	64,313	228,770
Cost of revenue	84,702	55,620	140,322	111,098	45,509	156,607
Gross margin	49,388	15,673	65,061	53,359	18,804	72,163
Research and development	16,143	8,230	24,373	18,615	9,068	27,683



Sales and marketing	9,152	15,011	24,163	10,478	13,922	24,400
General and administrative	8,279	5,112	13,391	8,700	6,984	15,684
Special charges	866	3,718	4,584	7,513	1,888	9,401
<b>Total operating expenses</b>	<b>34,440</b>	<b>32,071</b>	<b>66,511</b>	<b>45,306</b>	<b>31,862</b>	<b>77,168</b>
<b>Operating income (loss)</b>	<b>\$ 14,948</b>	<b>\$ (16,398)</b>	<b>\$ (1,450)</b>	<b>\$ 8,053</b>	<b>\$ (13,058)</b>	<b>\$ (5,005)</b>

(In thousands)

Nine Months Ended

	December 28, 2003			December 29, 2002		
	DLT	Storage Solutions	Total	DLT	Storage Solutions	Total
Total revenue	\$ 421,003	\$ 201,873	\$ 622,876	\$ 495,935	\$ 165,457	\$ 661,392
Inter-segment revenue	(20,403)	–	(20,403)	(25,719)	–	(25,719)
Revenue from external customers	400,600	201,873	602,473	470,216	165,457	635,673
Cost of revenue	260,593	155,149	415,742	324,594	116,717	441,311
Gross margin	140,007	46,724	186,731	145,622	48,740	194,362
Research and development	51,529	25,971	77,500	56,149	26,545	82,694
Sales and marketing	28,004	45,131	73,135	35,589	41,946	77,535
General and administrative	25,656	14,857	40,513	34,643	20,755	55,398
Goodwill impairment	–	–	–	–	58,689	58,689
Special charges	4,191	3,969	8,160	12,859	11,262	24,121
<b>Total operating expenses</b>	<b>109,380</b>	<b>89,928</b>	<b>199,308</b>	<b>139,240</b>	<b>159,197</b>	<b>298,437</b>
<b>Operating income (loss)</b>	<b>\$ 30,627</b>	<b>\$ (43,204)</b>	<b>\$ (12,577)</b>	<b>\$ 6,382</b>	<b>\$ (110,457)</b>	<b>\$ (104,075)</b>

As of

(In thousands)

	December 28, 2003			March 31, 2003		
	DLT	Storage Solutions	Total	DLT	Storage Solutions	Total
Accounts receivable, net	\$ 74,760	\$ 49,091	\$ 123,851	\$ 91,415	\$ 42,345	\$ 133,760
Inventories	19,722	34,741	54,463	22,131	39,604	61,735
Service inventories	33,370	17,076	50,446	35,760	13,344	49,104
Property, plant and equipment, net	29,470	15,425	44,895	40,200	18,892	59,092
Goodwill and intangibles, net	39,822	69,747	109,569	39,861	80,499	120,360

## Note 17: Stock Incentive Plans

### Stock Option Plans

Quantum has Stock Option Plans (the “Plans”) under which options to purchase 51.9 million shares of Quantum common stock were reserved for future issuance at December 28, 2003 to employees, officers and directors of Quantum. Options under the Plans were granted at prices determined by the Board of Directors, but at prices not less than the fair market value of the underlying common stock on the date of grant. Options currently expire no later than ten years from the date of grant and generally vest ratably over one to four years.

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

	Options (000s)	Weighted Average Exercise Price
Outstanding at March 31, 2003	33,174	\$ 7.46
Granted	6,161	\$ 3.01
Canceled	(4,109)	\$ 8.36
Exercised	(337)	\$ 2.23

Outstanding at December 28, 2003	34,889	\$	6.62
Exercisable at December 28, 2003	19,766	\$	8.32

The following tables summarize information about options outstanding and exercisable at December 28, 2003:

Range of Exercise Prices	Options Outstanding at December 28, 2003 (000s)	Weighted Average Exercise Price	Remaining Contractual Life (Years)
\$ 0.96 – \$ 2.95	10,271	\$ 2.58	6.50
\$ 2.97 – \$ 3.44	4,191	\$ 3.17	8.66
\$ 6.11 – \$ 8.69	9,340	\$ 6.96	6.72
\$ 8.79 – \$10.93	6,835	\$ 9.62	6.13
\$12.02 – \$24.11	4,252	\$ 14.22	5.40
	34,889		
Range of Exercise Prices	Options Exercisable at December 28, 2003 (000s)	Weighted Average Exercise Price	
\$ 0.96 – \$ 2.95	2,957	\$ 2.45	
\$ 2.97 – \$ 3.44	1,197	\$ 3.13	
\$ 6.11 – \$ 8.69	6,092	\$ 7.15	
\$ 8.79 – \$10.93	5,543	\$ 9.53	
\$12.02 – \$24.11	3,977	\$ 14.35	
	19,766		

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 18: Commitments and Contingencies**

### Synthetic Lease

In August 1997, Quantum entered into a five-year synthetic lease agreement with a group of financial institutions (the “lessor”) for the construction and lease of a campus facility in Colorado Springs, Colorado, comprised of three buildings. The campus was the center of DLT’s operations until the transfer in fiscal year 2002 of tape drive production to Penang, Malaysia. The Colorado Springs facility now houses administrative and procurement resources and testing operations within one of the three buildings. The lease has been accounted for as an operating lease in accordance with SFAS No. 13, *Accounting for Leases*.

In December 2002, Quantum renegotiated this lease, which now expires in December 2007. The total minimum lease payments from the fourth quarter of fiscal year 2004 until the scheduled expiration date in December 2007 were estimated to be approximately \$4.0 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 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 June 2004 and at that time Quantum will be required to post cash collateral to secure the lease, unless other financial arrangements are made that are acceptable to the lessor.

There is a cross default provision between this facility and the credit line facility (refer to Note 12, *Credit Agreements, Short-Term Debt and Convertible Subordinated Debt*) such that a default on one facility constitutes a default on the other facility. Given the cross default provision, in several prior quarters we violated certain financial covenants under this agreement and received waivers or amendments for such violations. If an event of default was to occur in the future and Quantum 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 immediately having to purchase the facilities, or find a third party to purchase them, potentially at a substantial discount to their current appraised value.

At the end of the lease term, Quantum must undertake one of the following options:

- (1) Quantum may renew the lease if the lessor accepts a renewal at its discretion;
- (2) Quantum may purchase the facility for \$50.0 million, which is known as 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 to the lessor any shortfall between the net proceeds from the sale of the property to a 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.

At any time during the lease term, Quantum may purchase (or find 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.

#### Debentures contingently issuable in connection with the acquisition of M4 Data

The agreement to acquire M4 Data included additional contingent consideration to be paid annually from 2002 through 2005 based on revenues, which may result in additional debentures being issued. Debentures of \$0.4 million and \$1.0 million were issued in fiscal years 2003 and 2004, respectively, based on revenues in the preceding fiscal year.

#### Commitments to purchase inventory

The DLT business outsourced tape drive manufacturing to a contract manufacturer, Jabil Circuit Inc. ("Jabil"), during the third quarter of fiscal year 2003. Storage Solutions has also increased its use of contract manufacturers for certain manufacturing functions. Under these arrangements, the contract manufacturer procures inventory to manufacture products based upon a forecasted 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 demand or for costs of excess or obsolete inventory.

At December 28, 2003, Quantum had issued non-cancelable purchase orders for \$39.0 million to purchase finished goods from its contract manufacturers, and had not incurred any significant liability for finished goods in excess of current demand or for the costs of excess or obsolete inventory.

#### Related to the disposition of HDD to Maxtor

Tax allocations under a tax sharing and indemnity agreement with Maxtor are the subject of a dispute. This agreement between Quantum and Maxtor entered into in connection with the disposition of HDD provided for the allocation of certain liabilities related to taxes and the indemnification by Maxtor of Quantum with respect to certain liabilities relating to taxes and attributable to the conduct of business prior to the disposition of HDD. Maxtor and Quantum presently disagree as to the amounts owed under this agreement. The parties are in negotiations to resolve this matter, and no litigation has been initiated to date. However, there can be no assurance that Quantum will be successful in asserting its position. If disputes under this agreement cannot be resolved favorably, Quantum may incur significant liabilities and costs, including litigation costs, as well as costs to settle the related obligations. An unfavorable settlement or litigation outcome could have a material and adverse effect on Quantum's results of operations and financial condition.

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#### **Note 19: Income Taxes**

The tax expense recorded for the three months ended December 28, 2003 was \$2.7 million compared to a tax benefit of \$1.2 million for the three months ended December 29, 2002. The tax expense for the three months ended December 28, 2003 reflected foreign withholding taxes incurred and no tax benefit for current period net operating losses and special charges. The tax benefit recorded in the three months ended December 29, 2002 reflected tax benefits related to operating losses and special charges, offset by a tax charge related to a foreign subsidiary's purchase of international technology and marketing rights as a part of the acquisition of Benchmark.

The tax expense recorded for the nine months ended December 28, 2003 was \$29.9 million compared to a tax benefit of \$5.2 million for the nine months ended December 29, 2002. The tax expense recorded in the nine months ended December 28, 2003 reflected foreign withholding taxes incurred, no tax benefit on current period net operating losses and a \$21.3 million charge to provide a valuation allowance against Quantum's net deferred tax assets. The valuation allowance was recorded because Quantum believes that it cannot rely on projections of future taxable income to realize the deferred tax assets as a result of Quantum's recent history of net losses and difficulty in predicting future results. The tax benefit recorded in the nine months ended December 29, 2002 reflected write-downs of equity investments, special charges, and tax charges related to the repatriation of offshore earnings connected with the outsourcing of Quantum's tape drive manufacturing in Malaysia as well as for a foreign subsidiary's purchase of Benchmark's international technology and marketing rights.

#### **Note 20: Recent Accounting Pronouncements**

##### Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation (FIN) No. 46, *Consolidation of Variable Interest Entities*. FIN No. 46 requires that if a business enterprise has a controlling interest in a variable interest entity (also known as a special purpose entity), the assets, liabilities and results of operations of the variable interest entity should be included in the Consolidated Financial Statements of the business enterprise. FIN No. 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies at the end of the first fiscal year or interim period ending after March 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The synthetic lease disclosed in Note 18, *Commitments and Contingencies*, is subject to FIN 46 and Quantum is in the process of evaluating the financial statement impact, if any, of adoption of FIN No. 46.

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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 belief that the installed base of tape drives will result in continued demand for tape media cartridges, (2) our belief that media royalties will continue to be a significant source of our 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 belief that we will take continued steps to reduce our operating costs, (5) our intention to provide a broader range of autoloaders and libraries from the desktop computer to the data center and expand our sales channels to sell our tape automation products to more customers, (6) our intention to pursue product initiatives in order to improve gross margins, increase operating efficiencies and effectiveness, and reduce operating costs, (7) our belief that strong competition in the tape drive and tape media markets will result in further price erosion and lower margins, (8) our expectation that we will realize annual cost savings from our current restructuring programs of approximately \$45 million, (9) our expectation that any debentures that we issue after the date of this Quarterly Report on Form 10-Q in connection with our acquisition of M4 Data will total approximately \$1 million annually through fiscal 2005, (10) our expectation that our future contractual cash obligations as of December 28, 2003 total approximately \$293 million, (11) 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, (12) our expectation that we will make additional acquisitions in the future, (13) our intention to continue to invest in the development, promotion and sale of storage solutions, (14) our expectation that we will continue to devote considerable management and financial resources to improving existing products and introducing new ones, (15) our expectation that our consolidation of operations supporting DLT and Storage Solutions will be completed over the next several quarters and (16) 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 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, is a global leader in storage, delivering highly reliable backup, archive and recovery solutions that meet demanding requirements for data integrity and availability with superior price performance. We are the world's largest supplier of half-inch cartridge tape drives, and our DLTtape™ technology is the standard for tape backup, archiving, and recovery of business-critical data for the mid-range enterprise. We are also a leader in the design, sale and service of autoloaders and automated tape libraries used to manage, store and transfer data. Over the past year, we have been one of the pioneers in the emerging market of disk-based backup, offering solutions that emulate a tape library and are optimized for data protection.

Quantum’s stock symbol is DSS and this is the only stock symbol that represents Quantum. In the past, we had two separate classes of common stock. Until the beginning of fiscal year 2002, we operated our business through two separate business groups: the DLT & Storage Systems group (“DSS”) and the Hard Disk Drive group (“HDD”), which were represented by two classes of Quantum common stock, DSS common stock and HDD common stock, which were intended to track separately the respective businesses of the Company. Our stockholders approved the tracking stock structure on July 23, 1999, and on August 3, 1999, each authorized share of Quantum common stock was exchanged for one share of DSS common stock and one-half share of HDD common stock. On March 30, 2001, our stockholders approved the disposition of HDD to Maxtor Corporation (Maxtor). On April 2, 2001, each authorized share of HDD common stock was exchanged for 1.52 shares of Maxtor common stock. The DSS business now represents Quantum, and as such, DSS is no longer a tracking stock, but is now the only common stock for Quantum Corporation.

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## Business Summary

Quantum has two data storage business segments: the DLT business and the Storage Solutions business. Our DLT business consists of tape drive and tape media cartridge product lines. Our Storage Solutions business consists of tape automation systems and service and includes disk-based enhanced backup solutions.

While continuing to develop and introduce new products in the storage market during the first nine months of fiscal year 2004, we have also continued to take steps to reduce cost in order to return to profitability. In recent years, our business has experienced declining revenues, lower gross margins and operating losses. The factors driving these trends included, among other things, the generally weak economic conditions that persisted between 2000 and 2002 and which resulted in generally lower prices and unit sales because of reduced customer spending on Information Technology ("IT"), and increased competition from other computer equipment manufacturers. Because of these trends and the reduced corporate infrastructure that we required following the disposition of HDD to Maxtor at the beginning of fiscal year 2002, which represented a major corporate realignment for Quantum, we have taken numerous cost reduction actions. Spending on IT has increased in recent quarters and this has benefited our business. However, the overall impact of the negative trends has not been fully reversed or offset and we had operating losses in the first nine months of fiscal year 2004. While we expect revenue to increase in the future, the cost reduction steps we are taking are aimed at returning Quantum to profitability at current revenue levels.

Among the steps taken last fiscal year to improve operating results, we sold our Network Attached Storage (NAS) business in October 2002 to SNAP Appliance, Inc., (formerly known as Broadband Storage, Inc.), a privately held company. The NAS business was part of our Storage Solutions business. We had engaged in the NAS business following the acquisition of Meridian Data, Inc., in September 1999 and of certain assets of Connex in August 2001.

### DLT

In our DLT business, we design, develop, license, service, and market tape drives - DLTtape and Super DLTtape drives (collectively referred to as "tape drives"), as well as tape media cartridges - DLTtape and Super DLTtape media cartridges (collectively referred to as "tape media cartridges"). The DLTtape drives are targeted at the "value" or "price sensitive" segment of the tape drive market. The Super DLTtape drives are targeted at the "performance sensitive" segment of the tape drive market in which we compete. We earn most of our revenue by selling tape drives and the tape media cartridges used by tape drives and earn most of our media revenue from royalties paid to us by manufacturers who license tape media cartridge technology from us. Super DLTtape technology has a higher storage capacity and transfer rate than DLTtape technology. Both DLTtape and Super DLTtape products are used to back up large amounts of data stored on network servers. DLTtape and Super DLTtape is our half-inch Digital Linear Tape technology that is the leader in mid-range UNIX and NT system backup and archive applications.

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

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. Currently, approximately 90% of our tape media cartridge unit sales occur 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.

The manufacturing of tape drives was outsourced to Jabil Circuit Inc. ("Jabil") in fiscal year 2003, under an agreement dated August 29, 2002.

On November 13, 2002, we completed the acquisition of Benchmark Storage Innovations, Inc. ("Benchmark"), a privately held company. The acquisition has enabled us to expand our tape business by adding Benchmark's complementary products to better serve the data protection needs of both new and existing customers in the value segment of the tape drive business. The acquisition combined our leadership in providing high-performance, high-capacity tape drives with Benchmark's expertise in delivering high-quality tape products at a lower price for more value-oriented customers.

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### Storage Solutions

In our Storage Solutions business, we design, develop, manufacture, market and sell tape automation systems, disk-based backup solutions and related service and support. Our tape automation systems, including tape libraries and autoloaders, serve the entire tape library data storage market from desktop computers to enterprise-class computers. We offer a broad line of tape automation systems, which are used to manage, store and transfer data in enterprise networked computing environments. Our Storage Solutions business includes disk-based enhanced backup appliances.

With the Benchmark acquisition we expanded our tape automation business by adding Benchmark's complementary low cost automation product to our product range.

In April 2001, we completed the acquisition of M4 Data (Holdings) Ltd. (“M4 Data”), a privately held data storage company based in the United Kingdom, to leverage M4 Data’s complementary high performance and scalable tape automation products and technologies to enhance the range of storage solutions offered to our customers.

In March 2003, we completed the acquisition of the remaining outstanding shares of SANlight, which we did not already own. The acquisition provided us with software technology and expertise that we planned to leverage in our enhanced backup solutions.

## Strategy

Our strategy includes growing our tape drive and tape automation businesses, generating cash and operating profitably, increasing the efficiency of our operating structure and investing in new product categories for future growth. Our strategy consists of the following four strategic priorities:

1. *Establish Quantum as the undisputed leader in tape drives.* Our goal is to continue to deliver innovative tape drives and solutions to meet growing customer demand. This involves both Super DLTtape drive and Value DLTtape drive products and maintaining compatibility between the two product families.
2. *Significantly grow the tape automation business.* To achieve this goal, we intend to provide a range of autoloaders and libraries from the desktop computer to the data center. Further, we intend to expand our sales channels to sell our tape automation products to more customers.
3. *Build a new category of enhanced backup solutions (“EBS”).* The goal of EBS is to improve the data backup process by offering a disk-based storage appliance with integrated storage management software, which enables a company to better leverage its existing infrastructure to significantly accelerate the data backup and restore process.
4. *Build an efficient operational platform.* Our goal is to continue to streamline our processes, optimize our cost structure and focus on reducing expenses in order to improve our operating and financial performance. We intend to pursue product initiatives, including quality programs, system architecture streamlining and supply chain improvement efforts, in order to improve gross margins, as well as other streamlining initiatives to increase operating efficiency and effectiveness and reduce operating costs.

## Products

Our products include:

### DLT business:

We offer tape drive products and tape media cartridges based on DLTtape™ technology, which are targeted to serve workgroup, mid-range and enterprise business needs.

#### • **Super DLTtape drives**

The SDLT series includes drives that have native capacities of up to 300 gigabytes (GB) (600 GB compressed) and transfer rates of up to 36 megabytes (MB) per second (72 MB compressed). The SDLT 600 drive uses new Super DLTtape II media cartridges and can back-read cartridges written on the DLT VS160 drive and the SDLT 320 drive. The SDLT 600 also incorporates DLTSage, which is a new architecture-based suite of predictive and preventive maintenance diagnostic tools that enable users to more simply manage tape storage environments. The DLTSage architecture is built on standards that interface into current storage environments. The SDLT 320 and SDLT 220 drives use Super DLTtape I media cartridges and can back-read cartridges written on most DLTtape and DLTtape VS drives.

#### • **DLT VS tape drives**

The family of DLT VS drives includes drives with up to 80 GB of native capacity (160 GB compressed) and sustained data transfer rates of up to 8 MB per second (16 MB compressed). The DLT VS80 drive is compatible with DLTtape IV media cartridges. The DLT VS160 drive uses DLT VS1 media cartridges.

#### • **Super DLTtape media cartridges**

The Super DLTtape media cartridges are designed and formulated specifically for use with SDLT tape drives. The capacity of a Super DLTtape II media cartridge is up to 300 GB native (600 GB compressed). The capacity of a Super DLTtape I media cartridge is up to 160 GB native (320 GB compressed).

#### • **DLTtape media cartridges**

The DLTtape and DLTtape VS media cartridges are designed and formulated for use with DLT VS tape drives. The capacity of these media cartridges is up to 80 GB (160 GB compressed).

### Storage Solutions business:

Quantum Tape Libraries™, Autoloaders and enhanced backup solutions automatically manage and protect business-critical data in network environments. Our modular solutions maximize customer investment with simple-to-manage systems for workgroup, departmental, mid-range, and enterprise-class applications. Our automated systems are fully compatible with major hardware platforms and are supported by nearly 30 popular data management software applications.

The Storage Solutions 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 and OEMs, and include the ValueLoader™, the SuperLoader™ and the M-Series family of tape libraries featuring the M1500, M1800 and M2500.

The ValueLoader was added to our product portfolio with the acquisition of Benchmark in the third quarter of fiscal year 2003. The ValueLoader is designed for the desktop or standard 19 inch rack and uses a single DLT VS80, DLT VS160, SDLT320 or LTO-1 tape drive with an eight-cartridge capacity and provides up to 1.28TB of data storage and 57.6GB/hour throughput.

The SuperLoader tape library is a scalable tape autoloader that provides up to 3.2 terabytes (TB) of capacity and 108GB/hour throughput in a 2U (U is a standard of measure, 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 removable active magazines and is available with up to 16 cartridges and a bar code reader for high performance inventory management. The SuperLoader supports a single DLT1, SDLT320, LTO-1 or LTO-2 tape drive and comes standard with on-board web-based remote management.

Completing our high-volume line is the M-Series family of tape libraries. The M1500, M1800 and M2500 are modular automation systems which customers can integrate together as their storage needs grow. The M1500 is a modular library that is rack mountable and available in increments of one or two drives and 21 (DLT and Super DLT) 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 6 drives and 84 cartridges and can be combined with the M1500 and/or M1800 to provide customers with scalability and investment protection. The M-Series now supports the SDLT600 tape drives for a capacity of 25.2TB and 777GB/hr throughput in a single M2500. The M-Series libraries easily scale up to 20 drives and 250 cartridges.

#### • Enterprise Products

Enterprise products are sold mainly through value-added resellers, OEMs, and to direct accounts. These products require a higher level of customer engagement to complete a more complex storage solutions sale and include the P-Series libraries and our DX enhanced backup solutions.

##### P-Series Libraries

Quantum's newest tape library is the PX720, the fifth generation enterprise tape automation platform developed by Quantum. Accommodating up to 20 SCSI or native Fibre Channel tape drives and up to 732 LTO/648 SDLT cartridges in a single chassis, the PX720 provides more than 2.5TB/hr of native throughput performance and 194TB native capacity. The PX720 includes fully redundant power and cooling, proactive component-level monitoring, remote library management and programmable load ports as standard offerings.

The P4000 and the P7000 feature Prism Library Architecture™ and are high-performance storage solutions for the enterprise data center. The 4000 scales to 322 data cartridges and 10 tape drives, providing up to 97TB of native capacity and 1.3TB/hour native throughput performance. The P7000 scales up to 679 data cartridges and 16 tape drives, providing up to 204TB native capacity and 2.1TB/hour native performance. Multiple P-Series libraries can be linked together to form a single library system providing up to 718TB capacity and 10.1TB/hour native performance.

##### Enhanced Backup Solutions

The Quantum DX-Series (DX30 and DX100) enhanced backup solutions significantly reduce backup and restore times and increase reliability by incorporating RAID-protected disks into the backup architecture (RAID denotes Redundant Array of Independent Disks, also known as Redundant Array of Inexpensive Disks). The Quantum DX30 provides up to 16TB of raw storage capacity, performance of up to 1TB/hr, and emulates up to six virtual tape drives. The Quantum DX100 provides up to 64TB of raw storage capacity, performance of up to 2TB/hr, and emulates up to 24 virtual tape drives. By emulating a tape library, the DX-Series solutions require no changes to existing backup policies or processes and can be easily integrated into data center environments.

#### 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, and on-site service agreements.

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## CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of the financial condition and results of operations is based on the Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. 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. Our reported financial position or results of operations may be materially different under different conditions or when using different estimates and assumptions. 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 collection is reasonably assured. In the period when the revenue is recognized, allowances are provided for estimated future price adjustments, such as volume rebates and 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 deferred and recognized as revenue ratably over the contract period.

### Warranty expense and liability

We warrant our products against defects for periods ranging from one to three years. A provision for estimated future costs and estimated returns for credit relating to warranty claims is recorded when products are shipped and revenue 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 in subsequent periods.

### Inventory Valuation

We value our inventories that are held for resale to customers at the lower of cost or market. Cost is determined by the first-in, first-out ("FIFO") method and includes direct material, direct labor, factory overhead and other direct costs. Market is "net realizable value", which, for finished goods and goods in process, is the estimated selling price, less costs to complete and dispose of the inventory. For raw materials, it is replacement cost or the cost of acquiring similar products from our vendors. While cost is readily determinable, estimates of market value involve significant estimates and judgments about the future.

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We initially record our inventory at cost and each quarter evaluate the difference, if any, between cost and market. The determination of the market value of inventories is primarily dependent on estimates of future demand for our products, which in turn is based on other market estimates such as technological change, competitor actions and estimates of future selling prices.

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

### 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 provide product warranty for one to three years and earn revenue by providing enhanced warranty and repair service outside this warranty period. We initially record our service inventories at cost and each quarter evaluate the difference, if any, between cost and market. 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 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. At December 28, 2003, the net amount of \$109.6 million of goodwill and intangible assets represented 15% 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 will be reviewed annually thereafter, or more frequently when indicators of impairment are present. Refer to Note 5 and Note 6 of the Condensed Consolidated Financial Statements for a discussion of the impact of adopting and applying SFAS No. 142.

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 range from three 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.

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## **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 represent expenses incurred in connection with certain cost reduction programs that we have undertaken and consist of the cost of involuntary termination benefits, separation benefits, stock compensation charges, facilities charges and other costs of exiting activities.

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 EITF Issue No. 94-3. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of an entity’s commitment to an exit plan. The statement further establishes fair value as the objective for initial measurement of the liability and that employee benefit arrangements requiring future service beyond a “minimum retention period” be recognized over the future service period. Under SFAS No. 146, if we fail to make accurate estimates regarding these costs or to the timing of the completion of planned activities, we may be required to record additional expenses or expense reductions in the future.

Prior to the fourth quarter of fiscal year 2003, we accounted for special charges under the provisions of EITF Issue No. 94-3. Under that pronouncement, we recorded a liability in the period in which management approved a restructuring plan if:

- Management having the appropriate level of authority approved and committed Quantum to the specific exit plan;
- The period of time to complete the plan indicated that significant changes to the plan of termination were not likely; and
- The plan, if it involved terminations, identified the number of employees and positions to be terminated, and the benefit arrangements were communicated to affected employees.

## 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 believe that we cannot rely on projections of future taxable income to realize value from the deferred tax assets because of our history of net losses and the difficulty in predicting future results. Accordingly, we have recorded a valuation allowance of \$21.3 million against our net deferred tax assets in the second quarter of fiscal year 2004.

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. Our income tax expense recorded in the future will be reduced to the extent that sufficient positive evidence materializes to support a reversal of, or decrease in, our valuation allowance.

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## RESULTS OF OPERATIONS

The results of DLT and Storage Solutions, the two segments that represent Quantum, are presented as "Results of Continuing Operations". The results of operations of the NAS business, sold on October 28, 2002, are separately presented as "Results of Discontinued Operations".

### Results of Continuing Operations

#### Revenue

(Dollars in thousands)	Three Months Ended			
	December 28, 2003	December 29, 2002	Increase, (decrease)	% increase/ decrease
Tape drives	\$ 87,591	\$ 92,476	\$ (4,885)	-5.3%
Tape media	18,648	32,507	(13,859)	-42.6%
Tape royalty	33,483	48,382	(14,899)	-30.8%
DLT	139,722	173,365	(33,643)	-19.4%
Storage Solutions	71,293	64,313	6,980	10.9%
Inter-group elimination*	(5,632)	(8,908)	3,276	36.8%
	\$ 205,383	\$ 228,770	\$ (23,387)	-10.2%

(Dollars in thousands)	Nine Months Ended			
	December 28, 2003	December 29, 2002	Increase, (decrease)	% increase/ decrease
Tape drives	\$ 265,233	\$ 231,265	\$ 33,968	14.7%
Tape media	55,026	126,122	(71,096)	-56.4%
Tape royalty	100,744	138,548	(37,804)	-27.3%
DLT	421,003	495,935	(74,932)	-15.1%
Storage Solutions	201,873	165,457	36,416	22.0%
Inter-group elimination*	(20,403)	(25,719)	5,316	20.7%
	\$ 602,473	\$ 635,673	\$ (33,200)	-5.2%

\* Represents inter-group sales of tape drives for incorporation into tape automation systems, for which the sales are included in Storage Solutions revenue.

Revenue in the three months ended December 28, 2003 was \$205.4 million, compared to \$228.8 million in the three months ended December 29, 2002. Revenue in the nine months ended December 28, 2003 was \$602.5 million compared to \$635.7 million in the nine months ended December 29, 2002. The overall decrease in both the three and nine-month comparisons reflected decreased DLT revenue, slightly offset by

an increase in Storage Solutions revenue.

*DLT Revenue:*

DLT revenue decreased \$33.7 million, or 19.4 percent, to \$139.7 million in the three months ended December 28, 2003, compared to \$173.4 million in the three months ended December 29, 2002. DLT revenue decreased \$75.0 million, or 15.1 percent, to \$421.0 million in the nine months ended December 28, 2003, compared to \$496.0 million in the nine months ended December 29, 2002. The main causes for the decreases in revenue were a decrease in tape media revenue, and to a lesser extent, tape media royalty revenue, partially offset by an increase in tape drive revenue.

Tape drive revenue decreased \$4.9 million, or 5.3 percent, to \$87.6 million in the three months ended December 28, 2003, compared to \$92.5 million in the three months ended December 29, 2002. Tape drive revenue increased \$33.9 million, or 14.7 percent, to \$265.2 million in the nine months ended December 28, 2003, compared to \$231.3 million in the nine months ended December 29, 2002. The decline in tape drive revenue for the three-month comparison was mainly due to lower average unit prices, slightly offset by an increase in tape drive unit volume, reflecting sales of tape drive products added to our product family with the acquisition of Benchmark in the third quarter of fiscal year 2003. The increase in tape drive revenue for the nine-month comparison resulted mainly from sales of tape drives acquired from Benchmark. The lower average unit prices in the three and nine-month comparisons reflected competitive pricing in the markets in which we compete and a mix shift towards the Value Smart drives that we acquired from Benchmark.

Tape media revenue for direct sales of Quantum-branded media in the three months ended December 28, 2003 was \$18.6 million, down \$13.9 million, or 42.6 percent, from \$32.5 million in the three months ended December 29, 2002. Tape media revenue for the nine months ended December 28, 2003 was \$55.0 million, down \$71.1 million, or 56.4 percent, from \$126.1 million in the nine months ended December 29, 2002. The majority of the decline in tape media revenue for the three and nine-month comparisons was due to lower unit sales volume, and to a lesser extent, due to lower average unit prices.

Tape media royalty revenue in the three months ended December 28, 2003 was \$33.5 million, down \$14.9 million, or 30.8 percent, from \$48.4 million in the three months ended December 29, 2002. Tape media royalty revenue in the nine months ended December 28, 2003 was \$100.7 million, down \$37.8 million, or 27.3 percent, from \$138.5 million in the nine months ended December 29, 2002. The majority of the decline in tape media royalty revenue for the three-month comparison was due to lower average unit prices, partially offset by an increase in overall media market unit sales. In the nine-month comparison, the decline in tape media royalty revenue was due to lower average unit prices, and to a lesser extent, due to lower overall media market unit sales.

The decline in media royalties and direct sales volume reflects the impact on demand for our products from competition and the effect of lower tape drive unit sales in recent years. This weaker demand trend has also resulted in lower-than-expected media prices, further reducing royalties, which are based on our licensees' media sales.

*Storage Solutions Revenue:*

Storage Solutions revenue in the three months ended December 28, 2003 was \$71.3 million, up \$7.0 million, or 10.9 percent, compared to \$64.3 million in the three months ended December 29, 2002. Storage Solutions revenue in the nine months ended December 28, 2003 was \$201.9 million, up \$36.4 million, or 22.0 percent, compared to \$165.5 million in the nine months ended December 29, 2002. The increase in revenue reflected our expanded product line and improved OEM sales. Revenue from sales of the ValueLoader, which we added to our product family and began selling with the acquisition of Benchmark, contributed the majority of this increase. Increased unit shipments of our SuperLoader and M-series products as well as increased service revenues, also contributed to the increase in revenue.

**Gross Margin and Gross Margin Rate**

(Dollars in thousands)	Three Months Ended		
	December 28, 2003	December 29, 2002	Decrease
DLT gross margin	\$ 49,388	\$ 53,359	\$ (3,971)
Storage Solutions gross margin	15,673	18,804	(3,131)
Quantum gross margin	\$ 65,061	\$ 72,163	\$ (7,102)
DLT gross margin rate	35.3%	30.8%	4.5%
Storage Solutions gross margin rate	22.0%	29.2%	-7.2%
Quantum gross margin rate*	31.7%	31.5%	0.2%

**Nine Months Ended**

(Dollars in thousands)

	December 28, 2003	December 29, 2002	Decrease
DLT gross margin	\$ 140,007	\$ 145,622	\$ (5,615)
Storage Solutions gross margin	46,724	48,740	(2,016)
Quantum gross margin	\$ 186,731	\$ 194,362	\$ (7,631)
DLT gross margin rate	33.3%	29.4%	3.9%
Storage Solutions gross margin rate	23.1%	29.5%	-6.4%
Quantum gross margin rate*	31.0%	30.6%	0.4%

\*Includes the impact of eliminating inter-group revenue.

*DLT Gross Margin Rate:*

The DLT gross margin rate in the three months ended December 28, 2003 increased to 35.3% from 30.8% in the three months ended December 29, 2002, an increase of 4.5 percentage points. The DLT gross margin rate in the nine months ended December 28, 2003 increased to 33.3% from 29.4% in the nine months ended December 29, 2002, an increase of 3.9 percentage points. These improvements in gross margin rates mainly reflect the impact of lower costs from outsourced manufacturing as well as a favorable sales mix shift, which resulted from increased shipments of higher-margin SDLT products and value segment drives following the acquisition of Benchmark. These gross margin rate increases, however, were partially offset by the materially downward trend in media revenues and royalties, which lowered the gross margin dollar contribution we received from our media business.

*Storage Solutions Gross Margin Rate:*

The Storage Solutions gross margin rate in the three months ended December 28, 2003, decreased to 22.0% from 29.2% in the three months ended December 29, 2002. The Storage Solutions gross margin rate in the nine months ended December 28, 2003 decreased to 23.1% from 29.5% in the nine months ended December 29, 2002. The decline of 7.2 percentage points and 6.4 percentage points in the three and nine-month comparisons, respectively, mainly resulted from a mix shift towards lower-margin products, slightly offset by higher unit sales volumes primarily contributed by the sales of ValueLoader following the acquisition of Benchmark in the third quarter of fiscal year 2003.

**Operating Expenses**

**Three Months Ended**

(Dollars in thousands)	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 33,574	24.0%	\$ 37,793	21.8%	\$ (4,219)	2.2%
Storage Solutions	28,353	39.8%	29,974	46.6%	(1,621)	-6.8%
Total Quantum	\$ 61,927	30.2%	\$ 67,767	29.6%	\$ (5,840)	0.6%

**Nine Months Ended**

(Dollars in thousands)	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 105,189	25.0%	\$ 126,381	25.5%	\$ (21,192)	-0.5%
Storage Solutions	85,959	42.6%	89,246	53.9%	(3,287)	-11.4%
Total Quantum	\$ 191,148	31.7%	\$ 215,627	33.9%	\$ (24,479)	-2.2%

Operating expenses in the three months ended December 28, 2003 were \$61.9 million, or 30.2 percent of revenue, down \$5.8 million or 0.6 percentage points of revenue from the three months ended December 29, 2002. Operating expenses in the nine months ended December 28,

2003 were \$191.1 million, or 31.7 percent of revenue, down \$24.5 million or 2.2 percentage points of revenue from the nine months ended December 29, 2002.

### Research and Development Expenses

(Dollars in thousands)	Three Months Ended					
	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 16,143	11.6%	\$ 18,615	10.7%	\$ (2,472)	0.9%
Storage Solutions	8,230	11.5%	9,068	14.1%	(838)	-2.6%
<b>Total Quantum</b>	<b>\$ 24,373</b>	<b>11.9%</b>	<b>\$ 27,683</b>	<b>12.1%</b>	<b>\$ (3,310)</b>	<b>-0.2%</b>

(Dollars in thousands)	Nine Months Ended					
	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 51,529	12.2%	\$ 56,149	11.3%	\$ (4,620)	0.9%
Storage Solutions	25,971	12.9%	26,545	16.0%	(574)	-3.1%
<b>Total Quantum</b>	<b>\$ 77,500</b>	<b>12.9%</b>	<b>\$ 82,694</b>	<b>13.0%</b>	<b>\$ (5,194)</b>	<b>-0.1%</b>

Research and development expenses in the three months ended December 28, 2003 were \$24.4 million, or 11.9 percent of revenue, a decrease of \$3.3 million from \$27.7 million, or 12.1 percent of revenue, in the three months ended December 29, 2002. Research and development expenses in the nine months ended December 28, 2003 were \$77.5 million, or 12.9 percent of revenue, a decrease of \$5.2 million from \$82.7 million, or 13.0 percent of revenue, in the nine months ended December 29, 2002.

#### *DLT Research and Development Expenses:*

DLT's research and development expenses decreased \$2.5 million to \$16.1 million in the three months ended December 28, 2003, compared to \$18.6 million in the three months ended December 29, 2002. DLT's research and development expenses decreased \$4.6 million to \$51.5 million in the nine months ended December 28, 2003, compared to \$56.1 million in the nine months ended December 29, 2002. The decrease in research and development expenses was mainly due to reduced product development costs and cost reduction actions. The increase in research and development expenses as a percentage of revenue in the three and nine-month comparisons reflected lower DLT revenue in the three and nine-month periods of fiscal year 2004 compared to the corresponding periods in fiscal year 2003.

#### *Storage Solutions Research and Development Expenses:*

Storage Solutions' research and development expenses decreased \$0.9 million to \$8.2 million in the three months ended December 28, 2003, compared to \$9.1 million in the three months ended December 29, 2002. Storage Solutions' research and development expenses decreased \$0.5 million to \$26.0 million in the nine months ended December 28, 2003, compared to \$26.5 million in the nine months ended December 29, 2002. The decrease in research and development expense in the three and nine-month comparisons was mainly due to the closure of M4 engineering facilities and other cost reduction actions that have resulted in reduced employee headcount. The decrease in research and development expenses as a percentage of revenue reflected higher revenue in the three and nine-month periods of fiscal year 2004 compared to the corresponding periods in fiscal year 2003.

### Sales and Marketing Expenses

(Dollars in thousands)	Three Months Ended					
	December 28, 2003		December 29, 2002		Increase/ (decrease)	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 9,152	6.6%	\$ 10,478	6.0%	\$ (1,326)	0.6%
Storage Solutions	15,011	21.1%	13,922	21.6%	1,089	-0.5%
<b>Total Quantum</b>	<b>\$ 24,163</b>	<b>11.8%</b>	<b>\$ 24,400</b>	<b>10.7%</b>	<b>\$ (237)</b>	<b>1.1%</b>

(Dollars in thousands)	Nine Months Ended					
	December 28, 2003		December 29, 2002		Increase/ (decrease)	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 28,004	6.7%	\$ 35,589	7.2%	\$ (7,585)	-0.5%
Storage Solutions	45,131	22.4%	41,946	25.4%	3,185	-3.0%
<b>Total Quantum</b>	<b>\$ 73,135</b>	<b>12.1%</b>	<b>\$ 77,535</b>	<b>12.2%</b>	<b>\$ (4,400)</b>	<b>-0.1%</b>

Sales and marketing expenses in the three months ended December 28, 2003 were \$24.2 million, or 11.8 percent of revenue, a decrease of \$0.2 million from \$24.4 million, or 10.7 percent of revenue, in the three months ended December 29, 2002. Sales and marketing expenses in the nine months ended December 28, 2003 were \$73.1 million, or 12.1 percent of revenue, a decrease of \$4.4 million from \$77.5 million, or 12.2 percent of revenue, in the nine months ended December 29, 2002.

*DLT Sales and Marketing Expenses:*

DLT's sales and marketing expenses decreased \$1.3 million to \$9.2 million in the three months ended December 28, 2003, compared to \$10.5 million in the three months ended December 29, 2002. DLT's sales and marketing expenses decreased \$7.6 million to \$28.0 million in the nine months ended December 28, 2003, compared to \$35.6 million in the nine months ended December 29, 2002. The decrease in sales and marketing expenses in both the three and nine-month comparisons reflected lower spending on channel development programs, cost reduction actions and reduced headcount. The increase in sales and marketing expenses as a percentage of revenue in the three-month comparison reflected lower revenue, without a proportional reduction in sales and marketing expenses.

*Storage Solutions Sales and Marketing Expenses:*

Storage Solutions' sales and marketing expenses increased \$1.1 million to \$15.0 million in the three months ended December 28, 2003, compared to \$13.9 million in the three months ended December 29, 2002. Storage Solutions' sales and marketing expenses increased \$3.2 million to \$45.1 million in the nine months ended December 28, 2003, compared to \$41.9 million in the nine months ended December 29, 2002. The increase in sales and marketing expenses for the three and nine months ended December 28, 2003 was mainly due to increased employee headcount, higher commission expenses and increased marketing expenses. The decrease in sales and marketing expenses as a percentage of revenue reflected higher revenue in the three and nine-month periods of fiscal year 2004 compared to the corresponding periods in fiscal year 2003.

General and Administrative Expenses

(Dollars in thousands)	Three Months Ended					
	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 8,279	5.9%	\$ 8,700	5.0%	\$ (421)	0.9%
Storage Solutions	5,112	7.2%	6,984	10.9%	(1,872)	-3.7%
<b>Total Quantum</b>	<b>\$ 13,391</b>	<b>6.5%</b>	<b>\$ 15,684</b>	<b>6.9%</b>	<b>\$ (2,293)</b>	<b>-0.4%</b>

(Dollars in thousands)	Nine Months Ended					
	December 28, 2003		December 29, 2002		Decrease	
		% of segment revenue		% of segment revenue		% of segment revenue
DLT	\$ 25,656	6.1%	\$ 34,643	7.0%	\$ (8,987)	-0.9%
Storage Solutions	14,857	7.4%	20,755	12.5%	(5,898)	-5.1%
<b>Total Quantum</b>	<b>\$ 40,513</b>	<b>6.7%</b>	<b>\$ 55,398</b>	<b>8.7%</b>	<b>\$ (14,885)</b>	<b>-2.0%</b>

General and administrative expenses in the three months ended December 28, 2003 were \$13.4 million, or 6.5 percent of revenue, a decrease of \$2.3 million from \$15.7 million, or 6.9 percent of revenue, in the three months ended December 29, 2002. General and administrative expenses in the nine months ended December 28, 2003 were \$40.5 million, or 6.7 percent of revenue, a decrease of \$14.9 million from \$55.4 million, or 8.7 percent of revenue, in the nine months ended December 29, 2002.

*DLT General and Administrative Expenses:*

DLT's general and administrative expenses decreased \$0.4 million to \$8.3 million in the three months ended December 28, 2003, compared to \$8.7 million in the three months ended December 29, 2002. DLT's general and administrative expenses decreased \$8.9 million to \$25.7 million in the nine months ended December 28, 2003, compared to \$34.6 million in the nine months ended December 29, 2002. The decrease in general and administrative expenses in the three-month comparison was mainly due to reduced headcount and cost reduction actions, slightly offset by additional legal costs incurred in the three months ended December 28, 2003 mostly related to lawsuits with StorageTek. The decrease in general and administrative expenses in the nine-month comparison was mainly due to the settlement of lawsuits related to Imation in the three months ended June 30, 2002 and to legal costs incurred in the nine months ended December 29, 2002 related to disputes with Maxtor.

*Storage Solutions General and Administrative Expenses:*

Storage Solutions' general and administrative expenses decreased by \$1.9 million to \$5.1 million in the three months ended December 28, 2003, compared to \$7.0 million in the three months ended December 29, 2002. Storage Solutions' general and administrative expenses decreased by \$5.9 million to \$14.9 million in the nine months ended December 28, 2003, compared to \$20.8 million in the nine months ended December 29, 2002. The majority of the decrease in the level of general and administrative expenses in both the three and nine-month comparisons was a result of cost reduction actions, including reduced headcount.

**Special Charges**

Special charges were recorded in the first nine months of fiscal years 2004 and 2003 related to plans to reduce operating costs and return to profitability.

Fiscal year 2004 special charges

In the first nine months of fiscal year 2004, we implemented plans to reduce costs in an effort to return to profitability. The restructuring charges that resulted from these cost reduction efforts resulted from:

- Plans to consolidate most of the operations supporting Quantum's two business segments;
- Additional headcount reductions and costs following the outsourcing of certain of Quantum's manufacturing to Jabil in fiscal year 2003;
- Plans to outsource manufacturing of certain automation products in the U.K; and
- Other headcount reductions.

These plans to reduce costs impacted both of our operating segments, DLT and Storage Solutions, as well as corporate functions.

*Company-wide cost reduction activities*

In November 2003, we began consolidating most of the operations supporting our DLT and Storage Solutions business into one organization with consolidated operational functions and a combined sales force. We recorded charges in the third quarter of fiscal year 2004 of \$4.0

million for severance benefits for 110 employees located in Colorado Springs, Colorado, Irvine, California and San Jose, California.

#### *DLT cost reduction activities*

In the first and second quarters of fiscal year 2004, charges of \$0.3 million and \$0.4 million, respectively, were recorded for severance benefits for eight and nine employees, respectively, located at our facility in Colorado Springs, Colorado. These costs result from plans to reduce procurement activities following the outsourcing of certain manufacturing to Jabil and reductions following the integration of the Benchmark acquisition.

In addition, in the second quarter of fiscal year 2004, we incurred a non-cash charge of \$2.3 million to write down our former manufacturing facility in Malaysia to its appraised value, following Quantum vacating this facility as part of the outsourcing of certain manufacturing to Jabil.

#### *Storage Solutions cost reduction activities*

In the first and second quarters of fiscal year 2004, charges of \$0.1 million and \$0.5 million, respectively, were recorded for severance benefits for three and 20 employees, respectively, located in the U.K., mostly reflecting initial steps in the plan to eliminate an automation product manufacturing site in the U.K. In the third quarter of fiscal year 2004, additional charges of \$0.6 million were recorded related to this plan for a portion of the severance benefits for 69 employees.

In the second quarter of fiscal year 2004, we reversed a \$0.5 million portion of previously recorded special charges. Of this amount, \$0.2 million was originally recorded in the first quarter of fiscal year 2002 for vacant facility costs for a facility in Irvine, California, and the remaining \$0.3 million was originally recorded in the second quarter of fiscal year 2003 related to severance charges recorded for site and function consolidation activities. The facility charges were reversed as a result of lower estimated vacant facilities costs and the severance charges were reversed due to costs being lower than originally anticipated.

#### *Corporate severance*

In the second quarter of fiscal year 2004, a charge of \$0.4 million was recorded for separation costs related to an executive officer, as part of plans to reduce operating costs.

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#### Fiscal year 2003 special charges

##### *DLT cost reduction activities*

In the second quarter of fiscal year 2003, a charge of \$3.2 million was recorded for headcount reductions as part of the integration of Benchmark under a plan to have no net increase in headcount following the acquisition, which resulted in a reduction to DLT existing headcount. The charge related to severance benefits for 75 employees.

In the third quarter of fiscal year 2003, the following special charges were recorded by DLT:

- A charge of \$3.8 million related to severance for 870 employees who were terminated as a result of Quantum outsourcing our tape drive manufacturing and certain tape automation manufacturing to Jabil;
- A charge of \$2.3 million was recorded in order to reduce future operating costs through a headcount reduction. The charge related to severance benefits for 44 employees; and
- A charge of \$1.3 million was recorded for vacant facilities' costs following the renegotiation and extension of an operating lease (refer to note 18, '*Commitments and Contingencies*').

##### *Storage Solutions cost reduction activities*

In the first quarter of fiscal year 2003, a charge of \$1.1 million was recorded for severance benefits for 30 employees who were terminated as part of a plan to consolidate sales and marketing activities within Storage Solutions.

In the second quarter of fiscal year 2003, a charge of \$7.2 million was recorded as part of a plan to outsource sub-assembly manufacturing of our P-Series enterprise tape libraries, consolidate the number of research and development sites for disk-based backup and tape automation, and centralizing sales and marketing support functions. The charge included severance benefits for 140 employees, fixed asset write-offs and vacant facility charges.

In the third quarter of fiscal year 2003, Storage Solutions recorded the following amounts:



- A special charge of \$2.6 million related to severance costs for 41 employees. The severance costs were mostly related to the elimination of engineering in the UK and reduced sales in Japan; and
- A special charge of \$0.7 million was reversed on our statement of operations related to special charges recorded in the second quarter of fiscal year 2003 for U.K. vacant facilities due to a favorable renegotiation of the lease terms.

#### *Corporate severance*

In the second quarter of fiscal year 2003, a charge of \$3.7 million was recorded primarily for separation costs related to our former Chief Executive Officer, who remains on Quantum's Board of Directors.

#### *European operations reorganization*

In the first quarter of fiscal year 2003, we reversed a charge of \$0.4 million on our statement of operations related to special charges originally recorded in the second quarter of fiscal year 2002 for the closure of our Geneva, Switzerland sales office. We reversed the special charge because the landlord was able to sublease the space to a new tenant on terms more favorable than originally anticipated.

#### *Special charge activity and future payouts*

The following two tables show the activity for the nine months ended December 28, 2003 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 8 in our Annual Report on Form 10-K for the year ended March 31, 2003):

(In thousands)	Facilities
<b>Balance March 31, 2003</b>	<b>\$ 2,384</b>
Cash payments	(306)
<b>Balance June 29, 2003</b>	<b>\$ 2,078</b>
Cash payments	(306)
<b>Balance September 28, 2003</b>	<b>\$ 1,772</b>
Cash payments	(306)
<b>Balance December 28, 2003</b>	<b>\$ 1,466</b>

Estimated timing of future payouts:

4 <sup>th</sup> Quarter of Fiscal Year 2004	\$ 306
Fiscal Year 2005 to 2008	1,160
	<b>\$ 1,446</b>

The cash payments in the three months ended December 28, 2003 represented vacant facilities lease payments of \$0.3 million. The remaining special charge accrual reflects a vacant space accrual of \$1.5 million related to our facility in Colorado Springs, Colorado, which will be paid over the lease term through the third quarter of fiscal year 2008.

#### Other Restructuring Programs.

(In thousands)	Severance and Benefits	Facilities	Other	Total
<b>Balance at March 31, 2003</b>	<b>\$ 1,338</b>	<b>\$ 1,464</b>	<b>\$ 886</b>	<b>\$ 3,688</b>
DLT special charges	296	—	47	343
Storage Solutions special charges	133	—	—	133
Cash payments	(839)	(245)	(8)	(1,092)
Non-cash charges	—	—	(47)	(47)
<b>Balance at June 29, 2003</b>	<b>\$ 928</b>	<b>\$ 1,219</b>	<b>\$ 878</b>	<b>\$ 3,025</b>
DLT special charges	349	—	—	349
Storage Solutions special charges	487	—	—	487
Corporate severance	432	—	—	432

Facility impairment	—	2,335	—	2,335
Cash payments	(1,182)	(253)	(878)	(2,313)
Non-cash charges	—	(2,335)	—	(2,335)
Restructuring charge benefit	(339)	(164)	—	(503)
<b>Balance at September 28, 2003</b>	<b>\$ 675</b>	<b>\$ 802</b>	<b>\$ —</b>	<b>\$ 1,477</b>
Special charges related to plan to integrate business groups	4,023	—	—	4,023
Storage Solutions special charges	561	—	—	561
Cash payments	(919)	(231)	—	(1,150)
<b>Balance at December 28, 2003</b>	<b>\$ 4,340</b>	<b>\$ 571</b>	<b>\$ —</b>	<b>\$ 4,911</b>
Estimated timing of future payouts:				
4 <sup>th</sup> Quarter of Fiscal Year 2004	\$ 3,291	\$ 121	\$ —	\$ 3,412
Fiscal Year 2005 to 2006	1,049	450	—	1,499
	<b>\$ 4,340</b>	<b>\$ 571</b>	<b>\$ —</b>	<b>\$ 4,911</b>

The cash payments in the three months ended December 28, 2003 represented severance payments of \$0.9 million and vacant facilities lease payments of \$0.2 million. The \$4.9 million remaining special charge accrual at December 28, 2003 is comprised of obligations for severance and vacant facilities. The severance charges will be paid during the fourth quarter of fiscal year 2004 and the facilities charges relating to vacant facilities in Irvine, California, will be paid over the lease term, which is through the third quarter of fiscal year 2006.

We expect to realize annual cost savings from the restructuring programs detailed in the above two tables of approximately \$45 million, resulting mainly from employee reductions and reduced facility costs. Of this \$45 million, approximately \$27 million of the savings is expected to consist of reduced cost of revenue, with the remaining savings to come from reduced operating expenses. However, many factors, including reduced sales volume and price reductions, which have impacted gross margins in the past, and the addition of, or increase in, other operating costs, may offset some or all of these anticipated savings.

#### Goodwill and Amortization of Intangible Assets

SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*, became effective for us on April 1, 2002. Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but will be subject to annual impairment tests. With the adoption of SFAS No. 142, we ceased amortization of goodwill as of April 1, 2002. Our initial impairment test of goodwill was conducted in the first quarter of fiscal year 2003 and resulted in a non-cash accounting change adjustment of \$94.3 million, reflecting a reduction in the carrying amount of our goodwill. This charge is reflected as a cumulative effect of an accounting change in our Condensed Consolidated Statements of Operations and reflected deterioration in the market values of comparable companies, and to a lesser extent, a reduction in anticipated future cash flows of Storage Solutions due to the slump in spending in the IT industry at that time. The fair value of the Storage Solutions reporting entity was calculated using a combination of a discounted cash flow analysis involving projected data, and a comparable market approach, which was a comparison with companies also in the tape automation sector.

In the second quarter of fiscal year 2003, we recorded an additional goodwill impairment charge related to our Storage Solutions group of \$58.7 million due to a re-evaluation of the Storage Solutions group in light of deterioration in the market values of comparable companies, and to a lesser extent, a reduction in anticipated future cash flows. The slump in spending in the IT industry at that time contributed to this decrease in estimated future cash flows.

The amortization expense associated with intangible assets increased by \$0.6 million to \$4.4 million in the three months ended December 28, 2003 from \$3.8 million in the three months ended December 29, 2002. This increase was a result of a full quarter of amortization expense associated with the acquisition of Benchmark, which was completed during the third quarter of fiscal year 2003 and the acquisition of SANlight completed in the fourth quarter of fiscal year 2003.

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

(In thousands)	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Cost of revenue	\$ 2,974	\$ 2,335	\$ 8,922	\$ 5,725
Research and development	430	44	1,283	391
Sales and marketing	874	1,246	3,502	3,225
General and administrative	125	126	377	378
	<b>\$ 4,403</b>	<b>\$ 3,751</b>	<b>\$ 14,084</b>	<b>\$ 9,719</b>

The following table summarizes our goodwill and intangible assets:

(In thousands)	December 28, 2003		March 31, 2003	
Intangible assets	\$	144,835	\$	144,804
Less accumulated amortization		(79,445)		(65,360)
		65,390		79,444
Goodwill		44,179		40,916
	\$	109,569	\$	120,360

Net goodwill and intangible assets at December 28, 2003 and March 31, 2003 represented approximately 15% and 13% of total assets respectively. The goodwill and intangible assets balances, net of amortization, at December 28, 2003 and March 31, 2003, were \$109.6 million and \$120.4 million, respectively. The following table presents goodwill from acquisitions net of amortization and impairment charges:

(In thousands)	December 28, 2003		March 31, 2003		Segment
Goodwill from acquisition of:					
ATL Products, Inc	\$	7,711	\$	7,711	Storage Solutions
M4 Data		3,223		3,223	Storage Solutions
Benchmark (allocated to DLT)		24,012		21,736	DLT
Benchmark (allocated to Storage Solutions)		9,233		8,246	Storage Solutions
	\$	44,179	\$	40,916	

The \$3.3 million increase in goodwill from March 31, 2003 to December 28, 2003 reflected \$3.6 million of common stock distributed in relation to the earn out provisions of the Benchmark acquisition agreement, partially offset by a \$0.3 million reversal of excess accrual of severance liabilities related to the Benchmark acquisition.

Acquired intangible assets are amortized over their estimated useful lives, which range from three to ten years. Management, in estimating the useful lives of intangible assets, 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 to therefore extend the lives of these technologies.

We assess the recoverability of our long-lived assets, including intangible assets with finite lives, in accordance with SFAS No. 144 by comparing projected undiscounted net cash flows associated with those assets against their respective carrying amounts to determine whether impairment exists. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets. As of December 28, 2003, no such impairment has been identified with respect to our acquired intangible assets.

Goodwill will be reviewed for impairment at least on an annual basis, or more frequently when indicators of impairment are present. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its fair value. The fair values of the reporting units underlying Storage Solutions and DLT are estimated using a discounted cash flow methodology. If the reporting units' net book values exceed their fair values, therefore indicating impairment, then we will compare the implied fair values of the reporting units' goodwill to their carrying amounts.

### Interest and Other Income, net, and Equity Investment Write-downs

	Three Months Ended			
	December 28, 2003		December 29, 2002	
	(in thousands)	% of revenue	(in thousands)	% of revenue
Interest and other income	\$ 527	0.3%	\$ 3,878	1.7%
Interest expense	(2,893)	-1.4%	(5,988)	-2.6%

	Nine Months Ended			
	December 28, 2003		December 29, 2002	
	(in thousands)	% of revenue	(in thousands)	% of revenue
Interest and other income	\$ 5,573	0.9%	\$ 8,904	1.4%
Interest expense	(14,447)	-2.4%	(18,250)	-2.9%
Loss on debt extinguishment	\$ (2,565)	-0.4%	\$ —	0.0%
Equity investments write-downs	\$ —	0.0%	\$ (17,061)	-2.7%

Interest and other income was \$0.5 million in the three months ended December 28, 2003 compared to \$3.9 million in the three months ended December 29, 2002. Interest and other income was \$5.6 million in the nine months ended December 28, 2003 compared to \$8.9 million in the nine months ended December 29, 2002. The decrease in the interest and other income in both the three and nine-month comparisons reflected a \$1.7 million and \$3.1 million decline in interest received from Maxtor in the three and nine month periods ended December 28, 2003, respectively, due to the redemption of the \$287.5 million 7% convertible subordinated notes in the second quarter of fiscal year 2004. Maxtor had been paying us interest for their one-third portion of the notes prior to the redemption. The decrease in interest and other income also reflected foreign currency exchange losses attributable to the effect that the weakening U.S dollar had on dollar-denominated bank accounts and assets held by our European subsidiaries, which use foreign functional currencies.

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Interest expense was \$2.9 million in the three months ended December 28, 2003 compared to \$6.0 million in the three months ended December 29, 2002. Interest expense was \$14.4 million in the nine months ended December 28, 2003 compared to \$18.3 million in the nine months ended December 29, 2002. The decrease in interest expense in the three and nine-month comparisons reflected the lower interest expense following from the redemption of the \$287.5 million 7% convertible subordinated notes and issuance of the \$160.0 million convertible subordinated notes at a lower rate of 4.375%. As a result of this redemption, in the second quarter of fiscal year 2004 we recorded a charge of \$2.6 million, which was the redemption premium plus the write-off of unamortized debt issuance fees.

In the nine months ended December 29, 2002, we recorded charges of \$17.1 million to write down our equity investments to net realizable value based on other-than-temporary declines in the estimated value of these investments. The portfolio of equity investments on which this write-down was based was sold in the second quarter of fiscal year 2003.

### Income Taxes

The tax expense recorded for the three months ended December 28, 2003 was \$2.7 million compared to a tax benefit of \$1.2 million for the three months ended December 29, 2002. The tax expense for the three months ended December 28, 2003 reflected foreign withholding taxes incurred and no tax benefit for current period net operating losses. The tax benefit recorded in the three months ended December 29, 2002 reflected tax benefits related to operating losses and special charges, offset by a tax charge related to a foreign subsidiary's purchase of international technology and marketing rights as a part of the acquisition of Benchmark.

The tax expense recorded for the nine months ended December 28, 2003 was \$29.9 million compared to a tax benefit of \$5.2 million for the nine months ended December 29, 2002. The tax expense recorded in the nine months ended December 28, 2003 reflected foreign withholding taxes incurred, no tax benefit on current period net operating losses and a \$21.3 million charge to provide a valuation allowance against Quantum's net deferred tax assets. The valuation allowance was recorded because Quantum believes that it cannot rely on projections of future taxable income to realize the deferred tax assets as a result of Quantum's recent history of net losses and difficulty in predicting future results. The tax benefit recorded in the nine months ended December 29, 2002 reflected write-downs of equity investments, special charges, and tax charges related to the repatriation of offshore earnings connected with the outsourcing of our tape drive manufacturing in Malaysia as well as for our foreign subsidiary's purchase of Benchmark's international technology and marketing rights.

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. Our income tax expense recorded in the future will be reduced to the extent that sufficient positive evidence materializes to support a reversal of, or decrease in, our valuation allowance.

### Results of Discontinued Operations

## Disposition of the NAS Business

We were previously engaged in the business of developing, manufacturing, and selling network attached storage solutions for the desktop, workgroups and enterprises. These NAS products consisted primarily of server appliances that incorporated hard disk drives and an operating system designed to meet the requirements of entry, workgroup, and enterprise computing environments, where multiple computer users access shared data files over a local area network.

On October 7, 2002, we entered into an agreement with a privately held third party to sell certain assets and assign certain contract rights related to our NAS business. The NAS assets that were sold included inventories for resale to customers, service inventories, fixed assets and intellectual property. The proceeds from the sale included approximately \$4.7 million in cash, \$3.9 million in restricted equity securities of the buyer with an option to acquire additional equity securities, a secured promissory note for \$2.4 million issued by the buyer and the assumption by the buyer of \$1.6 million of warranty liability in connection with the prior installed base of NAS products. The sale was completed on October 28, 2002. The secured promissory note was settled in the first quarter of fiscal year 2004 in exchange for the third party acquirer assuming additional obligations.

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The following table summarizes the results of the NAS business:

(In thousands, except per-share data)

	Three Months Ended		Nine Months Ended	
	December 28, 2003	December 29, 2002	December 28, 2003	December 29, 2002
Revenue	\$ —	\$ 190	\$ —	\$ 19,899
Gross margin	402	(3,935)	402	(3,075)
Operating expenses	(641)	10,838	(641)	46,209
Income (loss) from operations	1,043	(14,773)	1,043	(49,284)
Income (loss) before income taxes	1,043	(14,620)	1,043	(49,156)
Income tax benefit	—	(5,013)	—	(10,921)
Net income (loss)	1,043	(9,607)	1,043	(38,235)

The income from operations in the three and nine-month periods ended December 28, 2003 consists of a reversal of an accrual for warranty expense on NAS products sold by Quantum with the lapse of the warranty period and a reversal of remaining severance benefits accruals associated with certain employees impacted by the disposition of the NAS business, which would have been payable by Quantum had the employees been terminated by the acquirer of the NAS business within a set time from the acquisition date.

The losses from operations in the three and nine-month periods ended December 29, 2002 include an impairment charge of \$16.4 million. In the second quarter of fiscal year 2003, we determined that the sale of the NAS business was probable and wrote down the assets held for sale to fair value less cost to sell. The fair value of the assets held for sale was determined to be the proceeds from the sale. The resulting impairment charge related mainly to completed technology arising from the acquisitions of Meridian Data Inc. and certain assets of Connex.

The loss from operations in the nine-month period ended December 29, 2002 also includes special charges of \$4.3 million incurred in the first quarter of fiscal year 2003 related to the consolidation of sales and marketing activities within Storage Solutions. These charges primarily relate to severance benefits for approximately 60 NAS employees who were terminated as a result of this restructuring plan.

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## Recent Accounting Pronouncements

### Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board issued FASB Interpretation (FIN) No. 46, *Consolidation of Variable Interest Entities*. FIN No. 46 requires that if a business enterprise has a controlling interest in a variable interest entity (also known as a special purpose entity), the assets, liabilities and results of operations of the variable interest entity should be included in the Consolidated Financial Statements of the business enterprise. FIN No. 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies at the end of the first fiscal year or interim period ending after March 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The synthetic lease disclosed in Note 18, *Commitments and Contingencies*, is subject to FIN 46 and we are in the process of evaluating the financial statement impact, if any, of adoption of FIN No. 46.

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## **LIQUIDITY AND CAPITAL RESOURCES**

## As of or for Nine Months Ended

(Dollars in thousands)

	December 28, 2003	December 29, 2002
Cash and short-term investments	\$ 254,977	\$ 316,278
Days sales outstanding (DSO)	54.9	54.4
Inventory turns—annualized	10.2	8.9
Net cash provided by (used in) operating activities of continuing operations	\$ (12,886)	\$ 29,098
Net cash provided by (used in) investing activities of continuing operations	\$ 44,523	\$ (109,161)
Net cash used in financing activities of continuing operations	\$ (33,441)	\$ (38,299)

**First Nine Months of Fiscal Year 2004 compared to the First Nine Months of Fiscal Year 2003**Net cash provided by (used in) operating activities:

Net cash from operating activities of continuing operations decreased to \$12.9 million used in the first nine months of fiscal year 2004 from \$29.1 million provided in the first nine months of fiscal year 2003. The primary sources and uses of cash that resulted in this change are listed in the following table:

(In thousands)

	Nine Months Ended		
	December 28, 2003	December 29, 2002	Change in cash (used), provided
	cash (used), provided	cash (used), provided	
Loss from continuing operations including cumulative effect of an accounting change	\$ (53,930)	\$ (219,621)	\$ 165,691
Non-cash income statement items	62,430	194,515	(132,085)
Adjusted income (loss) from operations	8,500	(25,106)	33,606
Accounts payable	(44,093)	25,940	(70,033)
Accounts receivable	9,909	15,245	(5,336)
Inventories	7,272	34,569	(27,297)
Income taxes payable	1,923	(11,755)	17,122
Other, net	3,603	(9,795)	9,954
	\$ (12,886)	\$ 29,098	\$ (41,984)

Net cash provided by (used in) operating activities of continuing operations decreased by \$42.0 million in the nine months ended December 28, 2003 compared to the nine months ended December 29, 2002. The overall decrease in net cash provided by operating activities was primarily due to the increase in cash used for accounts payable in the nine months ended December 28, 2003, due to lower payables as cost of goods sold and operating costs trend lower and the timing of vendor payments. The decrease in cash provided by inventories in the nine-month period ended December 28, 2003 compared to the nine-month period ended December 29, 2002 reflected the efforts made by Quantum in fiscal year 2003 to reduce inventory levels, in part achieved from the outsource of tape drive manufacturing. The increase in cash used for accounts payable and inventories were partially offset by cash provided by adjusted income from operations, which increased \$33.6 million due to decreased operating expenses in the nine months ended December 28, 2003 as a result of cost reduction activities, and decreases in cash used for income tax payments and net other liabilities.

Net cash provided by (used in) investing activities:

Net cash used in investing activities of continuing operations decreased by \$153.7 million to \$44.5 million provided in the nine months ended December 28, 2003 from \$109.2 million used in the nine months ended December 29, 2002. The decrease in cash used in investing activities reflected a \$161.2 million decrease in the net acquisition of short-term investments, \$3.8 million cash used in investments in SANlight Inc and Benchmark in the first nine months of fiscal year 2003, partially offset by a \$0.3 million increase in purchases of property and equipment and \$11.0 million received in the second quarter of fiscal year 2003 for the sale of our portfolio of equity investments.

Net cash used in financing activities:

Net cash used by financing activities of continuing operations decreased by \$4.9 million to \$33.4 million in the nine months ended December 28, 2003 from \$38.3 million used in the nine months ended December 29, 2002. This decrease reflected the payment of M4 Data debentures

of \$41.4 million in the nine months ended December 29, 2002, partially offset by net cash used of \$36.5 million in the nine months ended December 28, 2003 related to the redemption of our 7% convertible subordinated notes and issuance of our 4.375% convertible subordinated notes. This \$36.5 million cash used, which excludes the net redemption premium for the 7% notes of \$1.9 million, consisted of the \$287.5 million settlement of our 7% convertible subordinated notes, partially offset by \$155.2 million provided from the issuance of our 4.375% convertible subordinated notes and the receipt from Maxtor of its \$95.8 million portion of the 7% convertible subordinated notes.

### Credit lines

In December 2002, we entered into a secured senior credit facility with a group of five banks, providing us with a \$100.0 million revolving credit line that expires in June 2004. Also in December 2002, we entered into a \$50.0 million synthetic lease that contains the same financial covenants as the revolving credit line. As of December 28, 2003, \$90.4 million of this revolving credit line is committed to standby letters of credit, of which \$50.0 million secures our obligation to the lessor under our synthetic lease (see below and Note 18, *Commitments and Contingencies*). Borrowings under the revolving credit line bear interest at either the London interbank offering rate or a base rate, plus a margin determined by a leverage ratio with option periods of one to nine months. 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. In several prior quarters we violated certain financial covenants under this credit agreement and received waivers or amendments for such violations. 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 December 28, 2003, we were in compliance with all of the credit line covenants. We are currently working with our bank group in an effort to extend this revolving credit line expiring in June 2004.

### Synthetic Lease Commitment

As described in Note 18, *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. There is a cross default provision between this facility and the credit line facility (refer to Note 12, *Credit Agreements, Short-Term Debt and Convertible Subordinated Debt*) such that a default on one facility constitutes a default on the other facility. Given the cross default provision, in several prior quarters we violated certain financial covenants under this agreement and received waivers or amendments for such violations. As described in greater detail in Note 18, *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 \$50.0 million, or find a third party to purchase the facility (as to which 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).

For a discussion of the potential impact should the bank group not renew the secured senior credit facility prior to its June 2004 expiration or should Quantum violate any financial or reporting covenant in future quarters either on the unsecured senior credit facility or the synthetic lease, and as a result of such violation the bank group refuses to waive or amend for the violation such that non-compliance results in a default or termination of either the credit facility or the synthetic lease or both, see the section below titled "General Outlook".

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### **Capital Resources**

On July 30, 2003, we issued \$160.0 million in aggregate principal amount of 4.375% convertible subordinated notes due 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 holder at any time prior to maturity, unless previously converted, into 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 \$155.2 million, after deducting commissions and expenses. We used the net proceeds from the sale of these notes, plus a portion of available cash, to redeem our 7% convertible subordinated notes due 2004. The principal amount of the 7% convertible subordinated notes plus the premium of 1%, net of the amount paid to us by Maxtor, was \$193.6 million. The shortfall of approximately \$38 million between this amount and the amount ultimately received for the 4.375% convertible subordinated notes was paid from existing cash balances.

In July 1997, we issued \$287.5 million of 7% convertible subordinated notes. The notes had a maturity date of August 1, 2004, and were convertible at the option of the holder at any time prior to maturity, unless previously redeemed, into shares of Quantum common stock and Maxtor common stock. The notes were classified as long-term and were convertible into 6.2 million shares of Quantum common stock (or 21.587 shares per \$1,000 note), and 4.7 million shares of Maxtor common stock (or 16.405 shares per \$1,000 note). We recorded a receivable from Maxtor of \$95.8 million for the principal portion of the debt previously attributed to the HDD group and for which Maxtor agreed to reimburse us for both principal and associated interest payments. On August 21, 2003, we redeemed all these 7% convertible subordinated notes at 101% of the aggregate principal amount. The aggregate redemption price of the notes was \$290.4 million, which included a premium paid of \$2.9 million. On August 14, 2003, we received \$96.8 million from Maxtor, which represents the full amount for Maxtor's portion of the debt plus the premium on their portion of the notes due 2004.

At December 28, 2003, there was approximately \$87.9 million remaining on our authorization to repurchase Quantum common stock. No stock repurchases were made during the nine months ended December 28, 2003. Our ability to repurchase common stock is restricted under our credit facilities.

Debentures payable of \$41.4 million were issued as partial consideration for the acquisition of M4 Data in April 2001. The debenture holders called and received payment from Quantum for \$38.7 million in the first quarter of fiscal year 2003 and \$2.7 million in the third quarter of fiscal year 2003. The purchase agreement included additional contingent consideration to be paid annually from 2002 through 2005 based on future revenues, which may result in additional debentures being issued. Additional debentures of \$0.4 million were issued in the first quarter of fiscal year 2003 based on revenues in the preceding fiscal year and were paid to the debenture holders in fiscal year 2003. The additional debentures of \$1.0 million that were issued in the first quarter of fiscal year 2004 based on revenues in the preceding fiscal year are immediately callable by the holders. We expect that debentures issued in the future, if any, under the earn out provisions of the acquisition agreement will be approximately \$1 million annually through to fiscal year 2005, when the earn out provisions of the acquisition agreement expire.

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The table below summarizes our commitments at December 28, 2003:

(In thousands)	<u>&lt; 1 year</u>	<u>1 year and &lt; 2 years</u>	<u>2 years and &lt;3 years</u>	<u>3 years and beyond</u>	<u>Total</u>
Convertible subordinated debt	\$ —	\$ —	\$ —	\$ 160,000	\$ 160,000
Short-term debt	976	—	—	—	976
Inventory purchase commitment	38,989	—	—	—	38,989
Operating lease-Colorado facility - contingent obligation (1)	—	—	—	50,000	50,000
Other operating leases	13,390	10,411	6,183	12,760	42,744
<b>Total Contractual Cash Obligations</b>	<b>\$ 53,355</b>	<b>\$ 10,411</b>	<b>\$ 6,183</b>	<b>\$ 222,760</b>	<b>\$ 292,709</b>

(1) Appraised value of the facility, the collateral that would be used to satisfy the contingent obligation, is \$50 million.

### General outlook

We continue to emphasize increasing revenue, reducing costs and improving margins in an effort to return to profitability and to consistently generate positive cash flows from operating activities and we believe that we are making progress.

We believe that our existing cash and capital resources, including cash we expect to generate from operations, will be sufficient to meet all currently planned expenditures and sustain operations for the next 12 months. This belief is dependent upon our ability to generate acceptable levels of revenue, maintain or improve gross margins, and reduce operating expenses in order to provide net income and positive cash flow from operating activities in the future. This belief also assumes we will not be forced to make any significant cash payments or otherwise be impacted by restrictions of available cash associated with our existing letters of credit, our credit facilities or our synthetic lease.

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 available cash and funding needs and, prospectively, will be required for us to fund our business and to meet our current and long-term obligations. We have taken many actions to offset both the negative impact of lower revenue and increased competition in our market segments as well as the negative effects of the prolonged economic downturn between 2000 and 2002. We cannot provide assurance that the actions we have taken in the past or any actions we may take in the future will ensure a consistent, sustainable and sufficient level of net income and positive cash flow from operating activities to fund, sustain or grow our businesses. Certain events that are beyond our control including prevailing economic, competitive, financial and industry conditions, as well as various legal and other disputes, may prevent us from achieving these required financial objectives. Any inability to achieve this consistent and sustainable net income and cash flow profile could result in:

- (i) Restrictions on our ability to manage or fund our existing business operations, which could result in significant deterioration in 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 either:
  - Renew the credit line facility prior to or at its June 2004 expiration;
  - Provide a waiver or amendment for any covenant violations we may experience in future periods, thereby triggering a default under both the credit line and the synthetic lease; and
  - Approve any other amendments we might seek to obtain in order to improve our business.

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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 \$40.4 million, and 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 \$50.0 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 currently appraised value. Quantum would guarantee any shortfall below the \$50.0 million stipulated sales price up to a maximum of \$43.9 million payable by us. Any requirement to pay off (or fund) either or both of these two items would substantially restrict or reduce cash available to us.

- (iii) Further loss of financial flexibility. The redemption of our existing 7% convertible notes on August 21, 2003 resulted in a reduction of available cash to Quantum of approximately \$38 million. This net cash reduction, while used to reduce our debt level, represents a significant percentage of our available cash to run our operations, thereby reducing our ability to absorb continued losses and cash flow consumption.

Consistent, continued losses would further impair our financial flexibility and could require that we raise additional funding in the capital markets sooner than we otherwise would have, and on terms less favorable to us, if available at all.

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

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## TRENDS AND UNCERTAINTIES

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 THE BEGINNING OF ITEM TWO OF THIS REPORT FOR ADDITIONAL DISCUSSION OF THESE FORWARD-LOOKING STATEMENTS.

**We are currently not profitable. If we 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, which 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 debt facilities. We cannot provide assurance that we will generate sufficient cash flow from operations, or that future borrowings 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 profitable operations, 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 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-defaults under other agreements, 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.

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**Our Storage Solutions business currently operates at a loss and may continue to operate at a loss. If we are unable to make Storage Solutions 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 Solutions revenue are comparatively high, resulting in losses and cash consumption out of proportion to the revenue generated by the group when compared to our DLT business. Therefore, we will need to generate significant revenues from Storage Solutions or significantly reduce our related operating expenses for the group in order to make Storage Solutions profitable. We cannot provide assurance that Storage Solutions 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 Solutions were reviewed for possible impairment upon the adoption on April 1, 2002 of SFAS No. 142, *Goodwill and Other Intangible Assets*, and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. The impairment test conducted relative to goodwill resulted in a \$94.3 million charge associated with 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. The goodwill and other intangible assets were determined not to be impaired in the first nine months of fiscal year 2004, based on projections of undiscounted and discounted net cash flows from Storage Solutions compared to the carrying value of the goodwill and other intangible assets. However, both tests used financial projections involving significant estimates and uncertainties regarding future revenues, expenses and cash flows. We cannot provide assurance that future net cash flows will be sufficient to avoid further impairment charges. As a result, in the future, we may incur additional impairment charges related to Storage Solutions, which would adversely affect the group's operating income, which could have a materially adverse impact on the results of our operations or our financial condition.

**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 are concentrated among a few customers. Sales to our top five customers in the first nine months of fiscal year 2004 represented 50% of total revenue. These sales concentrations do 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, or revenues from sales of our tape libraries sold to our top five customers by our customers. Furthermore, customers are not obligated to purchase any minimum product volume and our relationships with our customers are terminable at will.

The merger of Hewlett-Packard Company (or Hewlett-Packard) and Compaq Computer Corporation (or Compaq) during calendar year 2002 significantly increased the concentration of our sales and dependency on a single customer. In the first nine months of fiscal year 2004 approximately 26% of our revenue was derived from this merged entity, and, therefore, could be materially and adversely affected if Hewlett-Packard were to experience a significant decline in storage revenue whether due to customer loss or otherwise. There is an additional risk since the combined entity owns a competing linear tape open, or LTO, brand of tape drive and media. Hewlett-Packard markets both the LTO and Super DLTtape platforms, whereas Compaq had exclusively marketed Super DLTtape for tape backup and archiving. To the extent that the combined Hewlett-Packard and Compaq entity significantly reduces its purchases of DLTtape and Super DLTtape products in favor of LTO products, 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 from us, our results of operations could be materially adversely affected.

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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 competing 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 Certance (U.S.) Holdings (or Certance (formerly known as Seagate Technology (U.S.) Holdings), Exabyte Corporation (or Exabyte), Hewlett-Packard, International Business Machines Corporation (or IBM), Sony Corporation (or Sony), Advanced Digital Information Corporation, Overland Data Inc. and Storage Technology Corporation (or StorageTek). These competitors are aggressively trying to advance and develop new technologies to compete more successfully with products based on DLTape and Super DLTape technology. Hewlett-Packard, IBM and Certance formed a consortium to develop and have developed LTO products. These products target the high-capacity data backup market and compete with our products based on Super DLTape technology. This competition has resulted in a trend, which is expected to continue, toward lower prices and lower margins earned on our DLTape and Super DLTape drives and media. The lower demand resulting from the adverse economic conditions experienced over recent years has resulted in lower demand in the tape drive and tape automation markets in general, which has also resulted in increased price competition. In addition, the merger between Hewlett-Packard and Compaq has resulted in a larger competitor in the tape drive and tape automation markets with greater resources and a potentially greater market reach with a product that competes directly with our Super DLTape drives and Super DLTape media. These factors, when combined with the current environment of intense competition, which has resulted in reduced shipments of our own 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.

**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, also 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 media unit sales, and more recently, declines in 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 DLTape drives, the media cartridges for which sell at a higher price than DLTape 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. If this competition continues or intensifies, it would further erode media pricing and result in further reduced sales of Super DLTape and DLTape drives, which would lower the installed base of tape drives that utilize tape media. Since our royalty and media revenue is 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 media and royalty revenue. This would materially and adversely affect our business, financial condition and results of operations.

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**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 Photo Film Co., Ltd. (or Fuji), Hitachi Maxell, Ltd. (or Maxell), Imation Corporation (or Imation) and Sony. Under our license agreements with these companies, each of the licensees determines the pricing and number of units of tape media cartridges that it sells. To the extent that our royalty revenue is based on the prices of cartridges sold by our licensees, our royalty revenue will vary depending on the level of sales and prices set by the licensees. In addition, lower prices set by licensees could require us to lower our prices on direct sales of tape media cartridges, which would reduce our revenue and margins on this product. 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.

**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 disk-based enhanced backup solutions. 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 any of these 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, these new products;
- Our new products will achieve market acceptance and significant market share, or that the markets for these products will 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.

**We have taken considerable steps towards reducing our cost structure and anticipate taking further such 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 inadequate compared to our future sales.**

We have recognized significant restructuring charges during the past four years in order to reduce our cost of sales and operating expenses in light of adverse economic and industry conditions that occurred during this period. We anticipate taking continued steps to reduce our operating costs. These and other possible restructurings caused by changes in our business and industry will require us to make additional cash payments that can adversely affect our liquidity if large enough. 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.

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**We have and 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 these changes successfully, our business could be disrupted and that could adversely impact our results of operations and financial condition.**

In the third quarter of fiscal year 2004, we began to consolidate several of our important management and operating functions, including the sales, operations and accounting functions. In addition, we are in the process of converting the entire company to one, common enterprise software system. We expect these changes to be substantially completed by the end of the first quarter of fiscal year 2005.

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

**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.

We currently purchase the DLTtape and Super DLTtape media cartridges that we sell primarily from Imation, Fuji and Maxell. We cannot provide assurance that Imation, Fuji or Maxell will continue to supply an adequate number of high quality media cartridges in the future. 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 tape 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 \$1.8 million. 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.

**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 152 United States patents and have 137 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 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.

**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 \$50.0 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 \$50.0 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 \$50.0 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 would 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 \$50.0 million value or the \$43.9 million guaranteed value, either of which could have a material adverse effect on our financial condition and liquidity.

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**In previous quarters we violated certain financial covenants under our credit agreement and synthetic lease. If in the future we violate financial covenants, it could materially and adversely impact our financial condition and liquidity.**

In previous quarters we violated certain financial covenants under a credit agreement, which provided a \$187.5 million revolving credit line, and received waivers or amendments for such violations. In December 2002, we terminated that facility and entered into a secured senior credit agreement with a group of five banks, providing a \$100.0 million revolving credit line that expires in June 2004. As of December 28, 2003, \$90.4 million of this credit line was committed to standby letters of credit, of which \$50.0 million secures our obligation to the lessor under our synthetic lease. In December 2002, we also entered into a synthetic lease that contained the same financial covenants as our credit agreement. In July 2003, we amended our credit agreement and our synthetic lease to, among other things, change certain financial covenants and events of default and allow for redemption of our 7% Convertible Subordinated Notes due 2004. We violated the EBITDA covenant in the first quarter of fiscal year 2004, for which we obtained an amendment.

If in the future 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 \$90.4 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.

**We have engaged in and may in the future engage in acquisitions of companies, technologies or products, and the failure to integrate any such acquisitions could harm our business, financial condition and operating results.**

As a part of our business strategy, we have in the past and expect in the future to make additional acquisitions, or significant investments in, complementary companies, products or technologies. For instance, as part of this acquisition strategy, during the third quarter of fiscal year 2003, we acquired Benchmark, whose business is complementary to many Quantum products and technologies. Any future acquisitions will be accompanied by the risks commonly encountered in acquisitions of companies. These risks include, among others:

- Difficulties in assimilating its operations and personnel;
- Diversion of management's attention from ongoing business concerns;
- The potential inability to maximize our financial and strategic position through the successful incorporation of acquired technology and rights into our products and services;
- Insufficient revenues to offset increased expenses associated with the acquisition;
- Maintenance of uniform standards, controls, procedures and policies;
- Impairment of existing relationships with employees, suppliers and customers as a result of the integration of new personnel;
- 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 incur losses from these investments;
- Dissatisfaction or performance problems with an acquired company;
- The cost associated with acquisitions; and
- Assumption of unknown liabilities or other unanticipated adverse events or circumstances.

We cannot provide assurance that we will be able to successfully integrate any business, products, technologies or personnel that we may acquire in the future, and our failure to do so could harm our business, financial condition and operating results.

**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, such an inability to meet our customers' expectations would materially and adversely impact our business, financial condition and results of operations.**

We outsourced DLT and Super DLTtape drive manufacturing to Jabil during the third quarter of fiscal year 2003. 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.* Jabil is our sole source of supply for most of our DLTtape and Super DLTtape 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. 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.

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In addition to Jabil, we have outsourced a significant portion of our manufacturing to other contract manufacturers. We face similar risks in relation to these products 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.

**A significant portion of the consideration for the disposition of the material assets of our NAS business was restricted stock issued by the buyer, a privately held company.**

A portion of the consideration for the sale of the material operating assets of our NAS business was equity securities recorded with a \$3.9 million carrying value. The equity securities are "restricted securities", as defined in Rule 144 under the Securities Act and, therefore, are subject to substantial restrictions on the sale or disposition of such shares, many of which are contingent on or governed by matters solely within the control of the privately held company. Because of the nature of the privately held issuer as well as the restrictions on our ability to transfer these equity securities, there is no public market for these securities.

We generally record our investments in equity securities of early development stage companies on a cost basis, adjusted for other than temporary impairment. The restricted stock we received as a result of the NAS disposition could lose value and become worthless if the buyer fails to profitably achieve its business plans or is not able to obtain adequate funding to do so. Because there is no market in these equity securities, we would not be able to hedge or otherwise mitigate any losses on these securities. If the buyer is not successful in achieving its business plan, we could be required to write down some or all of the value of these assets, which could have a material and adverse impact on our financial condition and results of operations.

**Tax allocations under a tax sharing and indemnity agreement with Maxtor are the subject of a dispute between us and Maxtor. In the event this dispute is not resolved favorably, we could incur significant costs that could have a material adverse effect on our business, financial condition and operating results.**

The tax sharing and indemnity agreement between us and Maxtor entered into in connection with the disposition of HDD provided for the allocation of certain liabilities related to taxes. Maxtor and we presently disagree about the amounts owed by each party under that agreement. The parties are in negotiations to resolve this matter, and no litigation has been initiated to date. However, there can be no assurance that we will be successful in asserting our position. If disputes regarding contested amounts cannot be resolved favorably, we may incur significant liabilities and costs, including litigation costs, as well as costs to settle the related obligations. An unfavorable settlement or litigation outcome could have a material adverse effect on our business, financial condition and operating results.

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**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 HDD 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 HDD, Maxtor has agreed to assume responsibility for payments related to certain taxes, penalties, and interest resulting from the conduct of business by the Quantum DSS group for all periods before our issuance of tracking stock and the conduct of the Quantum HDD group for all periods before the disposition of HDD 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.

If Maxtor were unable to pay its share of any obligations, we would be required to pay and that could have a material adverse impact on our results of operations and financial position.

**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, including real estate and litigation, and Maxtor's failure to perform under these obligations could result in significant costs to us that could have a materially adverse impact on our business, financial condition and operating results.

**The disposition of HDD 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 HDD will not result in any federal income tax or state income or franchise tax to Quantum or the previous holders of HDD common stock. Instead, Maxtor and we 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 HDD 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 HDD 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;
- An acquisition representing a 50% or greater interest in Quantum which began during the one-year period before and six-month period following the disposition, whether or not approved by our board of directors; or
- An acquisition representing a 50% or greater interest in Maxtor which began during the one-year period before and six-month period following the disposition, whether or not approved by Maxtor's board of directors.

If any of these events occur, we could incur uninsured tax liability, which could materially and adversely affect our business, financial condition and results of operations.

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

If the disposition of HDD 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 the 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 HDD 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.

**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 47% 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 DSS shares they currently own, that may cause our stock price to be more volatile.

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 historical financial information may not be representative of our future results solely as a tape drive and storage solutions business.**

Our historical financial information does not necessarily reflect what our financial position, operating results, and cash flows would have been had we existed solely as a tape drive and storage solutions business prior to fiscal year 2002. In addition, the historical information is not necessarily indicative of what our operating results, financial position and cash flows will be in the future.

**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.

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**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.**

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 (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. In particular, with one of our outsourced manufacturers located in Malaysia, a significant portion of our product manufacturing may be subject to such political and climactic risks. Political instability, including the threat of terrorism, or a natural disaster in Malaysia or any other foreign market in which we operate could materially and adversely affect our business, financial condition and results of operations.

**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 speculative purposes. Our goal is to hedge our foreign currency-denominated transactions in a manner that substantially offsets the effects of changes in foreign currency exchange rates. Presently, we use foreign currency obligations to match and offset net currency exposures associated with certain assets and liabilities denominated in non-functional currencies. Corresponding gains and losses on the underlying transaction generally offset the gains and losses on these foreign currency obligations. We have used in the past, and may use in the future, foreign currency forward contracts to hedge our exposure to foreign currency exchange rates. To the extent that we have assets or liabilities denominated in a foreign currency that are inadequately hedged or not hedged at all, we may be subject to foreign currency losses, which could be significant.

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

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**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 maybe materially and adversely impacted.

**Many of our facilities are located near known earthquake fault zones, and the occurrence of an earthquake or other disasters could cause damage to our facilities and equipment, which could require us to curtail or cease operations.**

Many of our facilities are located in Northern and Southern California, near known earthquake fault zones and are, therefore, vulnerable to damage from earthquakes. In October 1989, a major earthquake that caused significant property damage and a number of fatalities struck Northern California. In addition, in 1994, a major earthquake that caused significant property damage and a number of fatalities struck Southern California. We and our suppliers are also vulnerable to damage from other types of disasters, including fire, floods, power loss, communications failures, terrorism and similar events. If any disaster were to occur, our ability to operate our business at our facilities could be seriously, or completely, impaired. The insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions.

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

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

### 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 funds and money market funds. The main objective of these investments is to maintain principal while maximizing return, without significantly increasing risk. A hypothetical 100 basis point parallel decrease in the interest rate curve would result in an approximate \$2.5 million annual decrease in interest income.

In December 2002, we entered into a secured senior credit facility with a group of five banks, providing us with a \$100.0 million revolving credit line that expires in June 2004. Our credit facilities are comprised of a \$100.0 million revolving line of credit expiring in June 2004, a synthetic lease expiring in December 2008 and \$160.0 million of 4.375% convertible subordinated notes due 2010 (refer to note 12, *Credit Agreements, Short-Term Debt and Convertible Subordinated Debt*). The borrowings under the revolving credit line and synthetic lease bear interest at either the London interbank offered rate or a base rate, plus a margin determined by a leverage ratio with option periods of one to nine months.

We do not enter into derivative transactions related to our cash equivalents or short-term investments, nor 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.

### Equity Security Risk

We hold equity investments in companies in the high-technology industry sector that are not currently publicly traded. These investments are recorded at cost, adjusted for other than temporary impairment and are included in other long-term assets. We do not attempt to reduce or eliminate exposure on these securities. At December 28, 2003, the carrying value of these investments was \$4.2 million.

A 20 percent impairment charge would result in an approximate \$0.8 million decrease in the fair value of our equity investments.

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

- (a) **Evaluation of disclosure controls and procedures.** Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.
- (b) **Changes in internal control over financial reporting.** There was no change in our internal control over financial reporting that occurred during the period 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 to the Condensed Consolidated Financial Statements is incorporated into this Part II, Item 1 by reference.

#### **Item 5. Other information**

During the quarter ended December 28, 2003, certain audit-related and tax services were performed by Ernst & Young LLP that were pre-approved by Quantum's Audit Committee.

#### **Item 6. Exhibits and reports on Form 8-K.**

(a) **Exhibits**

<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit</b>
3.1(1)	Amended and Restated Certificate of Incorporation of Registrant
3.2(6)	Certificate of Designation for the Series B Participating Junior Preferred Stock
3.3(2)	Amended and Restated By-laws of Registrant, as amended
3.4 (3)	Amendment to Amended and Restated By-laws of Registrant, effective April 23, 2003
4.1(4)	Amended and Restated Preferred Shares Rights Agreement between the Registrant and Harris Trust and Savings Bank
4.2(5)	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
4.3(5)	Stockholder Agreement, dated as of October 28, 2002, by and between Registrant and Private Capital Management
10.1	Amendment to Master Supply and Intellectual Property License Agreement
24	Power of Attorney (see signature page)
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

\*\*\*Confidential treatment has been requested for omitted portions.

1. Incorporated by reference to Registrant's Annual Report on Form 10-K for fiscal year ended March 31, 2001 filed with the Securities and Exchange Commission on June 29, 2001.
2. Incorporated by reference to Registrant's Annual Report on Form 10-K for fiscal year ended March 31, 2000 filed with the Securities and Exchange Commission on June 28, 2000.
3. Incorporated by reference to Registrant's Annual Report on Form 10-K for fiscal year ended March 31, 2003 filed with the Securities and Exchange Commission on June 30, 2003.
4. Incorporated by reference to Registrant's Registration Statement on Form S-4, Amendment No.2, filed with the Securities and Exchange Commission on June 10, 1999.
5. Incorporated by reference to Registrant's Form 10-Q for the quarterly period ended December 29, 2002 filed with the Securities and Exchange Commission on November 13, 2002.
6. Incorporated by reference to Registrant's Registration Statement on Form S-3, filed with the Securities and Exchange Commission on October 9, 2003.

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(b) **Reports on Form 8-K**

The Company filed the following Current Reports on Form 8-K during the three months ended December 28, 2003:

On October 6, 2003, Quantum Corporation filed a Current Report on Form 8-K to revise revenue and earnings expectations for the fiscal second quarter ended September 28, 2003.

On October 23, 2003, Quantum Corporation filed a Current Report on Form 8-K to report its operating results for the second quarter of fiscal year 2004.

On November 25, 2003, Quantum Corporation filed a Current Report on Form 8-K announcing that it intended to reorganize its operational structure by combining its two business groups, the DLTape business and the Storage Solutions business , into one organization with a consolidated operations function and three business units.

**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 hereunto duly authorized.

**QUANTUM CORPORATION**  
(Registrant)

Date: February 11, 2004

By: /s/ Michael J. Lambert

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Michael J. Lambert  
Executive Vice President, Finance  
and Chief Financial Officer

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subsidiaries and Affiliates (collectively +IBw-Jabil+IB0-).+ADw-o:p+AD4APA-/o:p+AD4APA-/span+AD4APA-/font+AD4APA-/p+AD4- +ADw-p align+AD0-center style+AD0-'text-align:center'+AD4APA-b+AD4APA-font size+AD0-3 face+AD0AIg-Times New Roman+ACIAPgA8-span style+AD0-'font-size:12.0pt+ADs-font-family:+ACI-Times New Roman+ACIAOw-font-weight:bold'+AD4-RECITALS+ADw-o:p+AD4APA-/o:p+AD4APA-/span+AD4APA-/font+AD4APA-/b+AD4APA-/p+AD4- +ADw-p+AD4APA-font size+AD0-3 face+AD0AIg-Times New Roman+ACIAPgA8-span style+AD0-'font-size:12.0pt+ADs- font-family:+ACI-Times New Roman+ACI-+AD4AJg-nbsp+ADsAJg-nbsp+ADsAJg-nbsp+ADsAJg-nbsp+ADsAJg-nbsp+ADsAJg-nbsp+ADs-AND NOW, THEREFORE, in consideration of the mutual promises, covenants and other terms and conditions contained in this Amendment and for other good and valuable consideration, the receipt of which is acknowledged by both parties, the parties agree as follows:+ADw-o:p+AD4APA-/o:p+AD4APA-/span+AD4APA-/font+AD4APA-/p+AD4- +ADw-p+AD4APA-font size+AD0-3 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nbsp+ADsAJg-nbsp+ADs-Jabil Parties' Workmanship Warranty:+ACY-nbsp+ADsAPA-/a+AD4- +ADw-a name+AD0AIgBf-DV+AF8-  
M278+ACIAPgA8-/a+AD4-Jabil warrants that all of the Products supplied to Quantum hereunder shall conform to all applicable Specifications,  
and that all such Products except for the SSG Products shall be free from defects in Workmanship for a period of one (1) year from the date of  
manufacture and that the SSG Products shall be free from defects in Workmanship for a period of three (3) years from the date of manufacture.  
These warranties are extended to, and may only be enforced by, Quantum.+ACY-nbsp+ADs- In addition, Jabil shall use Commercially  
Reasonable Efforts to assure that vendor warranties with respect to all materials, parts and components used in the Products extend for the  
benefit of Quantum, regardless of the length of any such warranty. For the avoidance of doubt, this warranty shall not apply to defects resulting  
from the design of the Products, or from materials, parts, or components, provided that such materials, parts or components have been purchased  
by Jabil pursuant to the AVL, or as otherwise +ADw-a name+AD0AIgBf-DV+AF8-M281+ACIAPgA8-/a+AD4APA-a name+AD0AIgBf-  
DV+AF8-M280+ACIAPgA8-/a+AD4APA-a name+AD0AIgBf-DV+AF8-M279+ACIAPgA8-/a+AD4-approved in writing by Quantum.+ADw-  
o:p+AD4APA-/span+AD4APA-/font+AD4APA-/p+AD4- +ADw-/td+AD4- +ADw-/tr+AD4- +ADw-tr+AD4- +ADw-td  
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nbsp+ADsAJg-nbsp+ADsAJg-nbsp+ADsAPA-u+AD4-Terms+ADs- No Other Changes+ADw-/u+AD4- +ACY-nbsp+ADs- Any capitalized









**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 quarterly 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 quarterly 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 quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) 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
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - 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; and

Date: February 11, 2004

/s/ Richard E. Belluzzo

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Richard E. Belluzzo  
Chief Executive Officer

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

I, Michael J. Lambert, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Quantum Corporation;
2. Based on my knowledge, this quarterly 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 quarterly 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 quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) 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
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - 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; and

Date: February 11, 2004

/s/ Michael J. Lambert

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Michael J. Lambert  
Executive Vice President, Finance  
and Chief Financial Officer

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

I, Richard 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 fiscal quarter ended December 28, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 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.

By: /s/ Richard E. Belluzzo

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Name: Richard E. Belluzzo  
Title: Chief Executive Officer

**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, Michael J. Lambert, 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 fiscal quarter ended December 28, 2003 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 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.

By: /s/ Michael J. Lambert

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Name: Michael J. Lambert  
Title: Executive Vice President, Finance  
and Chief Financial Officer