QUANTUM CORP /DE/
Form 10-Q
February 05, 2016

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

Form 10-Q

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

For the quarterly period ended December 31, 2015

OR

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

For the transition period from _______ to _______
Commission File Number 1-13449

QUANTUM CORPORATION

Incorporated Pursuant to the Laws of the State of Delaware
IRS Employer Identification Number 94-2665054
224 Airport Parkway, Suite 300, San Jose, California 95110
(408) 944-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
As of the close of business on January 29, 2016, there were 264,233,646 shares of Quantum Corporation’s common stock issued and outstanding.

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PART I—FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

QUANTUM CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)
(Unaudited)

	December 31, 2015	March 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$32,919	$67,948
Restricted cash	2,763	2,621
Accounts receivable, net of allowance for doubtful accounts of $22 and $27, respectively	101,269	124,159
Manufacturing inventories	33,569	50,274
Service parts inventories	22,367	24,640
Other current assets	11,578	11,942
Total current assets	204,465	281,584
Long-term assets:		
Property and equipment, less accumulated depreciation	13,893	14,653
Intangible assets, less accumulated amortization	498	731
Goodwill	55,613	55,613
Other long-term assets	3,732	4,577
Total long-term assets	73,736	75,574
	$278,201	$357,158
Liabilities and Stockholders’ Deficit		
Current liabilities:		
Accounts payable	$41,666	$54,367
Accrued warranty	3,422	4,219
Deferred revenue, current	86,416	95,899
Accrued restructuring charges, current	1,757	3,855
Convertible subordinated debt, current, net of unamortized debt issuance costs of $390 at March 31, 2015	—	83,345
Accrued compensation	24,680	35,414
Other accrued liabilities	13,317	20,740
Total current liabilities	171,258	297,839
Long-term liabilities:		
Deferred revenue, long-term	34,182	39,532
Accrued restructuring charges, long-term	831	991
Long-term debt	68,920	—
Convertible subordinated debt, long-term, net of unamortized debt issuance costs of $862 and $1,207, respectively	69,138	68,793
Other long-term liabilities	10,738	10,441
Total long-term liabilities	183,809	119,757
Stockholders' deficit:		
Common stock, $0.01 par value; 1,000,000 shares authorized; 264,140 and 258,208	2,641	2,582

shares issued and outstanding at December 31, 2015 and March 31, 2015, respectively		
Capital in excess of par	462,351	456,411
Accumulated deficit	(545,592)	(523,311)
Accumulated other comprehensive income	3,734	3,880
Total stockholders' deficit	(76,866)	(60,438)
	$278,201	$357,158

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Product revenue	$79,672	$92,166	$213,448	$257,576
Service revenue	37,099	39,191	112,285	116,848
Royalty revenue	11,277	10,706	30,196	30,873
Total revenue	128,048	142,063	355,929	405,297
Cost of product revenue	56,323	59,772	156,360	170,273
Cost of service revenue	15,028	17,224	49,590	52,502
Total cost of revenue	71,351	76,996	205,950	222,775
Gross margin	56,697	65,067	149,979	182,522
Operating expenses:				
Research and development	11,148	13,969	37,841	43,680
Sales and marketing	28,212	27,494	83,860	83,417
General and administrative	13,488	13,815	41,610	42,271
Restructuring charges	1,895	187	2,540	1,676
Total operating expenses	54,743	55,465	165,851	171,044
Gain on sale of assets	—	—	—	462
Income (loss) from operations	1,954	9,602	(15,872)	11,940
Other income and expense	(22)	125	406	215
Interest expense	(1,406)	(2,460)	(5,304)	(7,360)
Loss on debt extinguishment	(394)	—	(394)	—
Income (loss) before income taxes	132	7,267	(21,164)	4,795
Income tax provision	431	336	1,117	940
Net income (loss)	$(299)	$6,931	$(22,281)	$3,855
Basic net income (loss) per share	$ (0.00)	$0.03	$(0.09)	$0.02
Diluted net income (loss) per share	$ (0.00)	$0.03	$(0.09)	$0.01
Weighted average shares:				
Basic	264,003	255,860	261,849	253,773
Diluted	264,003	302,855	261,849	257,807

See accompanying Notes to Condensed Consolidated Financial Statements.

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QUANTUM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Net income (loss)	$(299)	$6,931	$(22,281)	$3,855
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments	(244)	(969)	(143)	(2,061)
Net unrealized gain (loss) on revaluation of long-term intercompany balances	(124)	148	(3)	431
Total other comprehensive loss	(368)	(821)	(146)	(1,630)
Total comprehensive income (loss)	$(667)	$6,110	$(22,427)	$2,225

See accompanying Notes to Condensed Consolidated Financial Statements.

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QUANTUM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended	
	December 31, 2015	December 31, 2014
Cash flows from operating activities:		
Net income (loss)	$(22,281)	$3,855
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	4,945	6,364
Amortization of intangible assets	233	3,537
Amortization and write-off of debt issuance costs	894	1,246
Service parts lower of cost or market adjustment	4,640	2,690
Gain on sale of assets	—	(462)
Deferred income taxes	(1)	(11)
Share-based compensation	7,339	8,655
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable	22,890	(9,023)
Manufacturing inventories	13,503	(6,145)
Service parts inventories	(547)	(686)
Accounts payable	(12,708)	9,325
Accrued warranty	(797)	(1,328)
Deferred revenue	(14,833)	(8,928)
Accrued restructuring charges	(2,258)	(2,197)
Accrued compensation	(10,711)	6,774
Other assets and liabilities	(6,222)	(2,549)
Net cash provided by (used in) operating activities	(15,914)	11,117
Cash flows from investing activities:		
Purchases of property and equipment	(2,800)	(2,882)
Proceeds from sale of assets	—	462
Change in restricted cash	(142)	(139)
Purchases of other investments	—	(22)
Return of principal from other investments	—	104
Payment for business acquisition, net of cash acquired	—	(517)
Net cash used in investing activities	(2,942)	(2,994)
Cash flows from financing activities:		
Borrowings of long-term debt, net	68,920	—
Repayments of convertible subordinated debt	(83,735)	—
Payment of taxes due upon vesting of restricted stock	(3,112)	(2,212)
Proceeds from issuance of common stock	1,772	2,060
Net cash used in financing activities	(16,155)	(152)
Effect of exchange rate changes on cash and cash equivalents	(18)	(113)
Net increase (decrease) in cash and cash equivalents	(35,029)	7,858
Cash and cash equivalents at beginning of period	67,948	99,125
Cash and cash equivalents at end of period	$32,919	$106,983
Supplemental disclosure of cash flow information:		
Purchases of property and equipment included in accounts payable	$430	$90

See accompanying Notes to Condensed Consolidated Financial Statements.

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QUANTUM CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
NOTE 1: BASIS OF PRESENTATION
Quantum Corporation (“Quantum”, the “Company”, “us” or “we”) is a leading expert in scale-out storage, archive and data protection, providing solutions for capturing, sharing, transforming and preserving digital assets over the entire data lifecycle. Our customers, ranging from small businesses to large/multi-national enterprises, trust us to address their most demanding content workflow challenges. We provide solutions for storing and protecting information in physical, virtual and cloud environments that are designed to help customers Be Certain™ that they have an end-to-end storage foundation to maximize the value of their data by making it accessible whenever and wherever needed, retaining it indefinitely and reducing total cost and complexity. We work closely with a broad network of distributors, value-added resellers (“VARs”), direct marketing resellers (“DMRs”), original equipment manufacturers (“OEMs”) and other suppliers to meet customers’ evolving needs. Our stock is traded on the New York Stock Exchange under the symbol QTM.
The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of Quantum and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated. In the Condensed Consolidated Balance Sheets, prior period convertible subordinated debt, current and long-term, have been presented net of debt issuance costs to conform to current period presentation. The interim financial statements reflect all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary for a fair statement of the results for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year. The Condensed Consolidated Balance Sheet as of March 31, 2015 has been derived from the audited financial statements at that date, but it does not include all disclosures 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 Consolidated Financial Statements for the fiscal year ended March 31, 2015 included in our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on June 12, 2015.
Recently Adopted Accounting Pronouncements
In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Topic 835-30): Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by ASU 2015-03. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. We adopted ASU 2015-03 in the first quarter of fiscal 2016 and reclassified debt issuance costs from other current and long-term assets to convertible subordinated debt on the Condensed Consolidated Balance Sheets. Adoption did not otherwise impact our statements of financial position or results of operations.
In August 2015, the FASB issued ASU No. 2015-15, Interest - Imputation of Interest (Topic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements ("ASU 2015-15"). ASU 2015-15 states that given the absence of authoritative guidance within ASU 2015-03, which does not address for debt issuance costs related to line-of-credit arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred costs ratably over the term of the line-of-credit arrangement regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. We adopted ASU 2015-15 in the second quarter of fiscal 2016 and present debt issuance costs related to our line-of-credit arrangements as an asset. Adoption did not impact our statements of financial position or results of operations.
Recent Accounting Pronouncements
In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”). ASU 2014-09 requires entities to recognize revenue through the application of a five-step model, which includes identification of the contract, identification of the performance obligations, determination of the transaction

price, allocation of the transaction price to the performance obligations and recognition of revenue as the entity satisfies the performance obligations. ASU 2014-09 will become effective for us beginning April 1, 2018, or fiscal 2019. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations, cash flows and financial statement disclosures.

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In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements – Going Concern (Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (“ASU 2014-15”). ASU 2014-15 requires that management assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. We plan to adopt ASU 2014-15 as of the end of our fiscal year ending March 31, 2017 and do not anticipate adoption will impact our statements of financial position or results of operations.

In April 2015, the FASB issued ASU No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). ASU 2015-05 requires that customers apply the same criteria as vendors to determine whether a cloud computing arrangement ("CCA") contains a software license or is solely a service contract. Under ASU 2015-05, fees paid by a customer in a CCA will be within the scope of internal-use software guidance if both of the following criteria are met: 1) the customer has the contractual right to take possession of the software at any time without significant penalty, and 2) it is feasible for the customer to run the software on its own hardware (or to contract with another party to host the software). ASU 2015-05 will be effective for us beginning April 1, 2016, or fiscal 2017. We do not anticipate adoption will impact our statements of financial position or results of operations.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330) ("ASU 2015-11"). ASU 2015-11 requires that an entity measure all inventory at the lower of cost and net realizable value, except for inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. ASU 2015-11 will become effective for us beginning April 1, 2017, or fiscal 2018. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations, cash flows and financial statement disclosures.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes ("ASU 2015-17"). ASU 2015-17 requires that deferred tax liabilities and assets be classified as non-current in a classified statement of financial positions. ASU 2015-17 will become effective for us beginning April 1, 2017, or fiscal 2018. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations, cash flows and financial statement disclosures.
In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 addresses certain aspects of recognition, measurement, presentation and disclosures of financial instruments. ASU 2016-01 will become effective for us beginning April 1, 2018, or fiscal 2019. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations, cash flows and financial statement disclosures.

NOTE 2: ACQUISITION

On July 29, 2014, we acquired a majority of the assets of Symform, Inc., a Washington corporation, for cash of approximately $0.5 million. The assets, consisting primarily of Symform technology, were recorded as purchased technology and are expected to enhance our cloud software capabilities and service offerings for data protection and scale-out storage. This acquisition was recorded as a business combination and the effect was not material to our financial position, results of operations or cash flows.

NOTE 3: FAIR VALUE

Our assets measured and recorded at fair value on a recurring basis consist of money market funds, which are included in cash and cash equivalents in our Condensed Consolidated Balance Sheets and are valued using quoted market prices (level 1 fair value measurements) at the respective balance sheet dates (in thousands):

	As of December 31, 2015	March 31, 2015
Money market funds	$6,241	$34,278

We did not record impairments to any non-financial assets in the third quarter or first nine months of fiscal 2016 or 2015. We do not have any non-financial liabilities measured and recorded at fair value on a non-recurring basis.

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Our financial liabilities were comprised primarily of convertible subordinated debt and long-term debt at December 31, 2015 and convertible subordinated debt at March 31, 2015. The carrying value and fair value of our subordinated debt and our long-term debt were as follows (in thousands):

	As of			
	December 31, 2015		March 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible subordinated debt (1)	$69,138	$64,197	$152,138	$166,551
Long-term debt (2)	$68,920	$68,882	$—	$—

(1) Fair value based on quoted market prices in less active markets (level 2).
(2) Fair value based on outstanding borrowings and market interest rates (level 2)

NOTE 4: INVENTORIES
Manufacturing inventories and service parts inventories consisted of the following (in thousands):

	As of December 31, 2015	March 31, 2015
Manufacturing inventories:		
Finished goods	$18,969	$28,022
Work in process	84	58
Materials and purchased parts	14,516	22,194
	$33,569	$50,274

	As of December 31, 2015	March 31, 2015
Service parts inventories:		
Finished goods	$16,968	$18,143
Component parts	5,399	6,497
	$22,367	$24,640

NOTE 5: INTANGIBLE ASSETS AND GOODWILL
We evaluate our amortizable and indefinite-lived intangible assets ("long-lived assets") for impairment whenever indicators of impairment exist. We concluded the carrying amount of our long-lived assets was recoverable and there was no impairment in the third quarter or first nine months of fiscal 2016 or 2015. The following provides a summary of the carrying value of intangible assets (in thousands):

	As of					
	December 31, 2015			March 31, 2015		
	Gross Amount	Accumulated Amortization	Net Amount	Gross Amount	Accumulated Amortization	Net Amount
Purchased technology	$179,992	$(179,494)	$498	$179,992	$(179,261)	$731
Trademarks	3,900	(3,900)	—	3,900	(3,900)	—
Customer lists	66,219	(66,219)	—	66,219	(66,219)	—
	$250,111	$(249,613)	$498	$250,111	$(249,380)	$731

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We evaluate goodwill for impairment annually during the fourth quarter of our fiscal year, or more frequently when indicators of impairment are present. There were no changes to goodwill balances during the third quarter or first nine months of fiscal 2016. The following table provides a summary of the goodwill balance at both December 31, 2015 and March 31, 2015 (in thousands):

	Goodwill	Accumulated Impairment Losses	Net Amount
Balance	$394,613	$(339,000)	$55,613

NOTE 6: ACCRUED WARRANTY

The changes in the accrued warranty balance were (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Beginning balance	$3,473	$5,290	$4,219	$6,116
Additional warranties issued	1,550	1,596	4,680	4,843
Adjustments for warranties issued in prior fiscal years	228	(319)	159	(179)
Settlements	(1,829)	(1,779)	(5,636)	(5,992)
Ending balance	$3,422	$4,788	$3,422	$4,788

We warrant our products against certain defects for one to three years. A provision for estimated future costs and estimated returns for repair or replacement relating to warranty is recorded when products are shipped and revenue recognized. Our estimate of future costs to satisfy warranty obligations is primarily based on historical trends and, if believed to be significantly different from historical trends, estimates of future failure rates and future costs of repair. Future costs of repair include materials consumed in the repair, labor and overhead amounts necessary to perform the repair. If we determine in a future period that either actual failure rates or actual costs of repair were to differ from our estimates, we record the impact of those differences in that future period.

NOTE 7: DEBT

On October 5, 2015, we entered into a private transaction with a note holder to purchase $81.0 million of aggregate principal amount of our 3.50% convertible subordinated notes due November 15, 2015 ("3.50% notes") for $82.4 million, which included $1.1 million of accrued interest. In connection with this transaction, we recorded a loss on debt extinguishment of $0.4 million comprised of a loss of $0.3 million from the notes purchased and $0.1 million of unamortized debt issuance costs related to the purchased notes. We used a combination of $66.1 million of proceeds from our credit agreement with Wells Fargo ("WF credit agreement") and $16.3 million of restricted cash to fund the purchase and pay the accrued interest. On November 15, 2015, we paid and purchased the remaining $2.8 million 3.50% notes and funded this payment using proceeds from the WF credit agreement.

On August 7, 2015, the WF credit agreement was amended to modify the maturity date, increase the amount of foreign accounts receivable and intellectual property assets included in our borrowing base and add an additional liquidity covenant.

Under the WF credit agreement, we have the ability to borrow the lesser of $75 million or the amount of the monthly borrowing base under a senior secured revolving credit facility, which matures March 29, 2017. As of December 31, 2015, we had a $68.9 million outstanding balance on the line of credit at a weighted average interest rate of 3.24%. In addition, we have letters of credit totaling $1.0 million, reducing the amount available to borrow to $5.1 million at December 31, 2015. Quarterly, we are required to pay a 0.375% commitment fee on undrawn amounts under the revolving credit facility. As of December 31, 2015, and during the third quarter and first nine months of fiscal 2016, we were in compliance with all covenants.

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The WF credit agreement contains financial covenants and customary events of default for such securities, including cross-payment default and cross-acceleration to other material indebtedness for borrowed money which require notice from the trustee or holders of at least 25% of the notes and are subject to a cure period upon receipt of such notice. Average liquidity must exceed $15 million each month, and at all times we must maintain minimum liquidity of $10 million, at least $5 million of which must be excess availability under the WF revolving credit facility. The fixed charge coverage ratio is required to be greater than 1.2 for the 12 month period ending on the last day of any month in which the covenant is applicable. This covenant is applicable only in months in which borrowings exceed $5 million at any time during the month. To avoid triggering mandatory field audits and Wells Fargo controlling our cash receipts, we must maintain liquidity of at least $20 million at all times. The fixed charge coverage ratio, average liquidity, liquidity and excess availability are each defined in the WF credit agreement and/or amendments thereto. Certain schedules in the compliance certificate must be filed monthly if borrowings exceed $5 million; otherwise they are to be filed quarterly.

NOTE 8: RESTRUCTURING CHARGES

Fiscal 2016 Restructuring Plan

In November 2015, we approved a plan ("Fiscal 2016 Restructuring Plan") to eliminate approximately 65 positions in the U.S. and internationally, primarily in research and development and sales and marketing functions, in order to improve our cost structure and align spending with continuing operations plans. These actions are expected to be completed by March 31, 2016, with the majority having occured by December 31, 2015. The costs associated with these actions consist of restructuring charges related to severance and benefits. We expect to incur aggregate restructuring charges of approximately $2.0 million under this plan. For the third quarter and first nine months of fiscal 2016, we incurred $1.7 million of restructuring charges under this plan, of which $1.2 million was paid. The ending balance for accrued restructuring charges for the Fiscal 2016 Restructuring Plan is $0.5 million as of December 31, 2015.

Summary of Restructuring Expense

The types of restructuring expense for the three and nine months ended December 31, 2015 and December 31, 2014 were (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Severance and benefits	$1,685	$279	$1,912	$384
Facilities	210	(92)	628	1,282
Other	—	—	—	10
Total	$1,895	$187	$2,540	$1,676

For the third quarter and first nine months of fiscal 2016, restructuring charges were largely due to $1.7 million of severance and benefits costs incurred as a result of the Fiscal 2016 Restructuring Plan. Additionally, for the first nine months of fiscal 2016, we incurred restructuring charges related to facilities costs as a result of further consolidating our facilities in the U.S.

For the first nine months of fiscal 2015, restructuring charges were primarily due to facilities costs as a result of further consolidating our facilities in the U.S.

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Accrued Restructuring

The following tables show the activity and the estimated timing of future payouts for accrued restructuring (in thousands):

	Three Months Ended December 31, 2015		
	Severance and Benefits	Facilities	Total
Balance as of September 30, 2015	$257	$2,572	$2,829
Restructuring costs	1,690	210	1,900
Adjustment of prior estimates	(5)	—	(5)
Cash payments	(1,171)	(1,022)	(2,193)
Other non-cash	—	57	57
Balance as of December 31, 2015	$771	$1,817	$2,588

	Nine Months Ended December 31, 2015		
	Severance and Benefits	Facilities	Total
Balance as of March 31, 2015	$189	$4,657	$4,846
Restructuring costs	1,913	604	2,517
Adjustment of prior estimates	(1)	24	23
Cash payments	(1,330)	(3,568)	(4,898)
Other non-cash	—	100	100
Balance as of December 31, 2015	$771	$1,817	$2,588

	As of December 31, 2015		
	Severance and Benefits	Facilities	Total
Estimated timing of future payouts:			
Next twelve months	$639	$1,118	$1,757
January 2017 through December 2021	132	699	831
	$771	$1,817	$2,588

Facility restructuring accruals will be paid in accordance with the respective facility lease terms and amounts above are net of estimated sublease amounts.

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NOTE 9: STOCK INCENTIVE PLANS AND SHARE-BASED COMPENSATION

Share-Based Compensation

The following table summarizes share-based compensation (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Share-based compensation:				
Cost of revenue	$313	$362	$1,006	$1,109
Research and development	488	600	1,529	1,983
Sales and marketing	658	830	2,367	2,627
General and administrative	780	1,126	2,437	2,936
	$2,239	$2,918	$7,339	$8,655
Share-based compensation by type of award:				
Stock options	$—	$153	$2	$464
Restricted stock	1,955	2,584	6,552	7,597
Stock purchase plan	284	181	785	594
	$2,239	$2,918	$7,339	$8,655

Stock Incentive Plans - Grants and Fair Value

Stock Options

No stock options were granted during the third quarter or first nine months of fiscal 2016 or 2015. The Black-Scholes option pricing model is used to estimate the fair value of stock options.

Restricted Stock Units

The fair value of restricted stock units ("RSUs") granted is the intrinsic value as of the respective grant date since the RSUs are granted at no cost to the employee. The weighted-average grant date fair values of RSUs granted during the third quarter and first nine months of 2016 were $0.82 and $1.64 per share, respectively. The weighted-average grant date fair values of RSUs granted during the third quarter and first nine months of fiscal 2015 were $1.13 and $1.24 per share, respectively.

During the second quarter of fiscal 2015, we granted 2.4 million RSUs with performance conditions ("2015 performance RSUs") and the total fair value of 2015 performance RSUs at the grant date was $3.0 million. These RSUs became eligible for vesting based on Quantum achieving certain revenue and operating income targets through the end of fiscal 2015. During the third quarter and first nine months of fiscal 2016, shared-based compensation expense of less than $0.1 million and $0.2 million, respectively, was recognized for 2015 performance RSUs. During the third quarter and first nine months of fiscal 2015, share-based compensation expense of $0.2 million was recognized for these RSUs.

During the second quarter of fiscal 2016, we granted 1.5 million RSUs with performance conditions ("2016 performance RSUs") and the total fair value of 2016 performance RSUs at the grant date was $2.6 million. These RSUs will become eligible for vesting based on Quantum achieving certain revenue and operating income targets through the end of fiscal 2016. Share-based compensation expense for 2016 performance RSUs is recognized when it is probable that the performance conditions will be achieved. As of December 31, 2015, no share-based compensation expense was recognized for these performance RSUs.

Stock Purchase Plan

Under the Stock Purchase Plan, rights to purchase shares are typically granted during the second and fourth quarter of each fiscal year. The value of rights to purchase shares granted in the first nine months of fiscal 2016 and fiscal 2015, respectively, was estimated at the date of grant using the Black-Scholes option pricing model. The weighted-average grant date fair values and the assumptions used in calculating fair values for the nine month periods ended December 31, 2015 and 2014 were as follows:

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	Nine Months Ended December 31, 2015	December 31, 2014
Option life (in years)	0.5	0.5
Risk-free interest rate	0.09 %	0.06 %
Stock price volatility	64.61 %	32.19 %
Weighted-average grant date fair value per share	$0.38	$0.30

Stock Incentive Plans - Activity

Stock Options

A summary of activity relating to our stock options follows (options and aggregate intrinsic value in thousands):

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding as of March 31, 2015	4,944	$1.47		
Exercised	(294)	1.01		
Forfeited	(45)	0.94		
Expired	(188)	1.74		
Outstanding as of December 31, 2015	4,417	$1.49	1.04	$13
Vested and expected to vest at December 31, 2015	4,417	$1.49	1.04	$13
Exercisable as of December 31, 2015	4,417	$1.49	1.04	$13

Restricted Stock Units

A summary of activity relating to our restricted stock units follows (shares in thousands):

	Shares	Weighted-Average Grant Date Fair Value Per Share
Nonvested at March 31, 2015	13,791	$ 1.34
Granted	6,574	1.64
Vested	(6,033)	1.45
Forfeited	(983)	1.37
Nonvested at December 31, 2015	13,349	$ 1.44

NOTE 10: INCOME TAXES

Income tax provisions for the third quarter and first nine months of fiscal 2016 were $0.4 million and $1.1 million, respectively. Income tax provisions for the third quarter and first nine months of fiscal 2015 were $0.3 million and $0.9 million, respectively. Income tax provisions for each of these periods reflect expenses for foreign income taxes and state taxes. We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets. Significant management judgment is required in determining our deferred tax assets and liabilities and valuation allowances for purposes of assessing our ability to realize any future benefit from our net deferred tax assets. We intend to maintain this valuation allowance until sufficient positive evidence exists to support a reversal or decrease in this allowance. Future income tax expense will be reduced to the extent that we have sufficient positive evidence to support a reversal of, or decrease in, our valuation allowance.

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NOTE 11: NET INCOME (LOSS) PER SHARE

The following is the computation of basic and diluted income (loss) per share (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	December 31, 2015	December 31, 2014	December 31, 2015	December 31, 2014
Numerator:				
Net income (loss)	$(299)	$6,931	$(22,281)	$3,855
Adjustment for interest expense on convertible subordinated notes, net of taxes	—	902	—	—
Income (loss) for purposes of computing income (loss) per diluted share	$(299)	$7,833	$(22,281)	$3,855
Denominator:				
Weighted average shares:				
Basic	264,003	255,860	261,849	253,773
Dilutive shares from stock plans	—	4,493	—	4,034
Dilutive shares from convertible subordinated notes	—	42,502	—	—
Diluted	264,003	302,855	261,849	257,807
Basic net income (loss) per share	$ (0.00)	$0.03	$(0.09)	$0.02
Diluted net income (loss) per share	$ (0.00)	$0.03	$(0.09)	$0.01

Dilutive and potentially dilutive common shares from the Stock Incentive Plans are determined by applying the treasury stock method to the assumed exercise of outstanding options and the assumed vesting of outstanding restricted stock units. The dilutive impact related to our convertible subordinated notes is determined by applying the if-converted method, which includes adding the related weighted average shares to the denominator and the related interest expense to net income.

The computations of diluted net income (loss) per share for the periods presented exclude the following because the effect would have been anti-dilutive:

- For the third quarter of fiscal 2016 and first nine months of fiscal 2016 and 2015, 42.5 million weighted average shares related to our 4.50% convertible subordinated notes were excluded. For the third quarter of fiscal 2016, $0.9 million of related interest expense was excluded. For the first nine months of fiscal 2016 and 2015, $2.7 million of related interest expense was excluded.
- For the third quarter and first nine months of fiscal 2016, 1.3 million and 13.3 million, respectively, weighted average shares related to our 3.50% convertible subordinated notes were excluded. For the third quarter and first nine months of fiscal 2015, 30.9 million weighted average shares related to these notes were excluded. For the third quarter and first nine months of fiscal 2016, $0.1 million and $1.8 million, respectively, of related interest expense was excluded. For the third quarter and first nine months of fiscal 2015, $1.4 million and $4.3 million, respectively, of related interest expense was excluded.
- For the third quarter and first nine months of fiscal 2016, options to purchase 4.4 million and 4.6 million, respectively, weighted average shares were excluded. For the third quarter and first nine months of fiscal 2015, options to purchase 1.8 million and 2.6 million, respectively, weighted average shares were excluded.
- For the third quarter and first nine months of fiscal 2016, unvested RSUs of 12.0 million and 12.4 million, respectively, weighted average shares were excluded. For the third quarter and first nine months of fiscal 2015, unvested RSUs of 0.1 million weighted average shares were excluded.

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NOTE 12: COMMITMENTS AND CONTINGENCIES

Lease Commitments

During the second quarter of fiscal 2016, we negotiated a five year extension of an operating lease on a building in Irvine, California, which increased our future minimum lease payments under non-cancelable lease agreements by $3.7 million.

Commitments to Purchase Inventory

We use contract manufacturers for our manufacturing operations. Under these arrangements, the contract manufacturer procures inventory to manufacture products based upon our forecast of customer demand. We have similar arrangements with certain other suppliers. We are responsible for the financial impact on the supplier or contract manufacturer of any reduction or product mix shift in the forecast relative to materials that the third party had already purchased under a prior forecast. Such a variance in forecasted demand could require a cash payment for inventory in excess of current customer demand or for costs of excess or obsolete inventory. As of December 31, 2015 and March 31, 2015, we had issued non-cancelable commitments for $37.0 million and $46.0 million, respectively, to purchase inventory from our contract manufacturers and suppliers.

Legal Proceedings

On February 18, 2014, Crossroads Systems, Inc. (“Crossroads”) filed a patent infringement lawsuit against Quantum in the U.S. District Court for the Western District of Texas, alleging infringement of U.S. patents 6,425,035 and 7,934,041. An amended complaint filed on April 15, 2014 also alleged infringement of U.S. patent 7,051,147. Crossroads asserts that we have incorporated Crossroads' patented technology into our StorNext QX and Q-Series lines of disk array products and into our Scalar libraries. Crossroads seeks unspecified monetary damages and injunctive relief. Crossroads has already dismissed all claims of infringement with respect to the StorNext QX and Q-Series products. In July and September of 2014, we filed for Inter Partes Review of all three asserted Crossroads patents before the Patent Trial and Appeal Board and a review was initiated for all claims. On June 16, 2015, the U.S. District Court, Western District of Texas stayed the Crossroads trial proceedings pending resolution of the Inter Partes Review proceedings. On January 29, 2016 the Patent Trial and Appeal Board issued decisions on the Inter Partes Reviews for U.S. 6,425,035 and 7,051,147, ordering all claims of both patents to be unpatentable. The decision for U.S. 7,934,041 is expected prior to March 17, 2016. We believe the probability that this lawsuit will have a material adverse effect on our business, operating results or financial condition is remote.

On September 23, 2014, we filed a lawsuit against Crossroads in the U.S. District Court for the Northern District of California alleging patent infringement of our patent 6,766,412 by Crossroads' StrongBox VSeries Library Solution product. We are seeking injunctive relief and the recovery of monetary damages. On December 4, 2014, we amended our complaint alleging infringement of a second patent, 5,940,849, related to Crossroads' SPHiNX product line. On December 16, 2014, we withdrew the amended complaint alleging infringement of the second patent, 5,940,849. On November 23, 2015, we dismissed the lawsuit alleging patent infringement of U.S. Pat. No. 6,766,412 pursuant to a confidential settlement agreement.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENT

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," "project" or similar expressions and variations or negatives of these words. All such forward-looking statements including, but not limited to, (1) our goals, strategy and expectations for future operating performance including increasing market share and shareholder value, continuing to add customers and increasing revenue and delivering on operating profit goals; (2) our expectations and beliefs regarding the storage market and the other markets in which we compete; (3) our expectation that we will continue to derive a substantial portion of our revenue from products based on tape technology; (4) our belief that our existing cash and capital resources will be sufficient to meet all currently planned expenditures, debt service and sustain our operations for at least the next 12 months; (5) our expectations regarding our ongoing efforts to control our cost structure; (6) our expectations regarding the outcome of any litigation in which we are involved; and (7) our business goals, objectives, key focuses, opportunities and prospects, 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, about which we 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 information technology spending and the corresponding uncertainty in the demand for our products and services; (4) our ability to maintain supplier relationships; (5) general economic, political and fiscal conditions in the U.S. and internationally; (6) our ability to successfully introduce new products; (7) our ability to capitalize on market demand; (8) our ability to achieve anticipated gross margin levels and (9) those factors discussed under "Risk Factors" in Part II, Item 1A. Our forward-looking statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement.

OVERVIEW

We believe our combination of expertise, innovation and platform independence enables us to solve scale-out storage and data protection challenges more easily, cost-effectively and securely than competitive offerings. We earn our revenue from the sale of products, systems and services through an array of channel partners and our sales force. Our products are sold under both the Quantum brand name and the names of various OEM customers. Our scale-out storage solutions include StorNext® software, StorNext appliances, which include StorNext disk storage and StorNext-related tape storage, StorNext Pro™ Solutions, Lattus®™ extended online storage systems and Q-Cloud®™ Archive and are designed to help customers manage large unstructured data sets in an information workflow, encompassing high-performance ingest, real-time collaboration, scalable processing, intelligent protection and high-value monetization. Our data protection solutions include DXi® deduplication backup systems and Scalar® automated tape libraries that optimize backup and recovery, simplify management and lower cost. Our vmPRO™ virtual server backup and disaster recovery offerings protect virtual environments while minimizing the impact on servers and storage. In addition, we offer software for cloud backup and disaster recovery of physical and virtual servers. We have a full range of services and the global scale and scope to support our worldwide customer base.

Our goal for fiscal 2016 is to increase shareholder value by growing our scale-out storage revenue and investing to drive future scale-out growth while also delivering on our operating profit goals. We continue to focus on building our momentum in three main broad categories of scale-out storage: media and entertainment, intelligence and surveillance and technical applications. Outside of scale-out storage, our strategy is to continue leveraging our technology leadership, our extensive customer base and our channel and technology partnerships to generate profits and cash from our offerings.

This fiscal year, our data protection revenues have been impacted by overall weakness in general storage market, and during the third quarter of fiscal 2016, we took a series of actions to reduce our cost structure without impacting our scale-out revenue growth. During the third quarter of fiscal 2016, we added Xcellis™ workflow storage in our scale-out storage portfolio, which is a high performance storage solution engineered to optimize demanding workflows and accelerate time to insight. We also expanded Q-Cloud offerings with the launch of Q-Cloud Vault, a new service that enables users to take advantage of secure, low-cost public cloud storage for long-term retention of digital assets. We began offering LTO-7 to our tiered storage portfolio, more than doubling the capacity over previous generations and enabling low-cost, energy-efficient and secure storage for protecting and retaining data.

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On October 5, 2015, we entered into a private transaction with a note holder to purchase $81.0 million of aggregate principal amount of our 3.50% convertible subordinated notes due November 15, 2015 ("3.50% notes") for $82.4 million, which included $1.1 million of accrued interest. In connection with this transaction, we recorded a loss on debt extinguishment of $0.4 million comprised of a loss of $0.3 million from the notes purchased and $0.1 million of unamortized debt issuance costs related to the purchased notes. We used a combination of $66.1 million of proceeds from our credit agreement with Wells Fargo ("WF credit agreement") and $16.3 million of restricted cash to fund the purchase and pay the accrued interest. On November 15, 2015, we paid and purchased the remaining $2.8 million 3.50% notes and funded this payment using proceeds from the WF credit agreement.

In November 2015, we approved a plan ("Fiscal 2016 Restructuring Plan") to eliminate approximately 65 positions in the U.S. and internationally, primarily in research and development and sales and marketing functions, in order to improve our cost structure and align spending with continuing operations plans. These actions are expected to be completed by March 31, 2016, with the majority having occurred by December 31, 2015.

Results

We had total revenue of $128.0 million in the third quarter of fiscal 2016, a $14.0 million decrease from the third quarter of fiscal 2015, primarily due to decreased revenue from data protection tape automation systems, disk backup systems, media and service, partially offset by an increase in revenue from scale-out storage solutions. These factors also resulted in a net 11% decrease in our branded product and service revenue from the third quarter of fiscal 2015. Revenue from branded scale-out storage solutions increased compared to the prior year in both North America and EMEA. Our continued focus on our branded business is reflected in a greater proportion of non-royalty revenue from branded business, reaching 89% in the third quarter of fiscal 2016, compared to 88% in the third quarter of fiscal 2015.

Our gross margin percentage decreased 150 basis points from the third quarter of fiscal 2015 to 44.3% primarily due to a combination of lower revenue and a decrease in material margin related to changes in our overall revenue mix. Higher margin service revenue decreased, and lower margin products comprised a higher portion of our product revenue. In addition, we are experiencing overall pricing pressure in the storage market, which has resulted in increased discounting.

Operating expenses decreased $0.7 million, or 1%, from the third quarter of fiscal 2015 primarily due to a decrease in compensation and benefits largely attributable to recognition of a profit sharing bonus in fiscal 2015 which was not repeated in fiscal 2016 and a decrease in commission expense on lower branded revenue. These decreases were partially offset by increases in restructuring charges and advertising and marketing expense.

Our operating income declined by $7.6 million, from $9.6 million in the third quarter of fiscal 2015 to $2.0 million in the third quarter of fiscal 2016. We used $15.9 million in cash from operations in the first nine months of fiscal 2016 compared to $11.1 million of cash generated from operations in the first nine months of fiscal 2015. Interest expense decreased by $1.1 million in the third quarter of fiscal 2016 primarily as a result of payments of $50.0 million and $83.7 million, respectively, of aggregate principal amount of 3.50% notes during the fourth quarter of fiscal 2015 and third quarter of fiscal 2016, respectively. We ended the quarter with $35.7 million in cash, cash equivalents and restricted cash.

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RESULTS OF OPERATIONS

Revenue

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Product revenue	$79,672	62.2 %	$92,166	64.9 %	$(12,494)	(13.6)%
Service revenue	37,099	29.0 %	39,191	27.6 %	(2,092)	(5.3)%
Royalty revenue	11,277	8.8 %	10,706	7.5 %	571	5.3 %
Total revenue	$128,048	100.0 %	$142,063	100.0 %	$(14,015)	(9.9)%

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Product revenue	$213,448	60.0 %	$257,576	63.6 %	$(44,128)	(17.1)%
Service revenue	112,285	31.5 %	116,848	28.8 %	(4,563)	(3.9)%
Royalty revenue	30,196	8.5 %	30,873	7.6 %	(677)	(2.2)%
Total revenue	$355,929	100.0 %	$405,297	100.0 %	$(49,368)	(12.2)%

Total revenue decreased from the third quarter of fiscal 2015 primarily due to decreased revenue from branded tape automation systems, media, disk backup systems and service, partially offset by an increase in revenue from scale-out storage solutions. Total revenue decreased from the first nine months of fiscal 2015 primarily due to reduced revenue from branded and OEM tape automation systems, media, service and disk backup systems, partially offset by increased revenue from scale-out storage solutions.

We believe the changes in our product and service revenue are driven by the changing storage environment, including increased market demand for scale-out storage solutions and reduced demand for data protection tape products. Revenue from branded data protection products and services decreased $21.1 million, or 24%, from the third quarter of fiscal 2015 and $57.4 million, or 22%, from the first nine months of fiscal 2015 largely due to decreases in tape automation systems, media, service and disk backup systems revenue. Data protection products include our tape automation systems, disk backup systems and devices and media offerings. Revenue from branded scale-out storage solutions and services increased $8.6 million, or 32%, from the third quarter of fiscal 2015 and $22.8 million, or 32%, from the first nine months of fiscal 2015 largely due to increased sales of our StorNext appliances. Scale-out storage solutions include StorNext software, StorNext appliances, which include StorNext disk storage and StorNext-related tape storage, StorNext Pro Solutions, Lattus extended online storage solutions and data center archive solutions. In addition, OEM product and service revenue, which primarily is comprised of data protection tape automation systems, decreased $2.1 million from the third quarter of fiscal 2015 and $14.1 million from the first nine months of fiscal 2015. Royalty revenue increased during the third quarter of fiscal 2016 primarily due to higher software royalty revenue and higher LTO media technology royalties. Royalty revenue decreased for the first nine months of fiscal 2016 primarily due to lower LTO media technology royalties.

Product Revenue

Total product revenue, which includes sales of our hardware and software products sold through both our Quantum branded and OEM channels, decreased $12.5 million and $44.1 million, respectively, in the third quarter and first nine months of fiscal 2016 compared to the prior year periods. The decrease in product revenue for the third quarter of fiscal 2016 was primarily due to lower sales of branded tape automation systems, media and disk backup systems, partially offset by increased sales of scale-out storage solutions. The decrease in product revenue for the first nine months of fiscal 2016 was largely due to lower sales of branded and OEM tape automation systems, media and disk backup systems, partially offset by increased sales of scale-out storage solutions. Revenue from sales of branded products decreased 14% and 15%, respectively, and sales of products to our OEM customers decreased 13% and 29%, respectively, in the third quarter and first nine months of fiscal 2016 compared to the prior year periods.

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(Dollars in thousands)	Three Months Ended					
	December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Tape automation systems	$28,304	22.1 %	$40,497	28.5 %	$(12,193)	(30.1)%
Disk backup systems	11,353	8.9 %	15,396	10.8 %	(4,043)	(26.3)%
Devices and media	10,210	8.0 %	13,454	9.5 %	(3,244)	(24.1)%
Scale-out storage solutions	29,805	23.2 %	22,819	16.1 %	6,986	30.6 %
Total product revenue	$79,672	62.2 %	$92,166	64.9 %	$(12,494)	(13.6)%

(Dollars in thousands)	Nine Months Ended					
	December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Tape automation systems	$74,340	20.9 %	$116,260	28.7 %	$(41,920)	(36.1)%
Disk backup systems	29,921	8.4 %	38,067	9.4 %	(8,146)	(21.4)%
Devices and media	32,639	9.2 %	44,172	10.9 %	(11,533)	(26.1)%
Scale-out storage solutions	76,548	21.5 %	59,077	14.6 %	17,471	29.6 %
Total product revenue	$213,448	60.0 %	$257,576	63.6 %	$(44,128)	(17.1)%

Branded data protection tape automation revenue declined 41%, or $11.3 million, and 41%, or $30.9 million, respectively, compared to OEM tape automation revenue decreases of 7%, or $0.9 million, and 27%, or $11.0 million, respectively, in the third quarter and first nine months of 2016 compared to the prior year periods. The decline in branded data protection tape automation revenue for both the third quarter and first nine months of fiscal 2016 resulted from decreased sales in all product categories – enterprise, midrange, and entry-level systems – with decreases in enterprise systems accounting for the largest portion of the overall decline.

Revenue from disk backup systems decreased in the third quarter and first nine months of 2016 compared to the prior year periods. During the third quarter of fiscal 2016, the decline in disk backup systems primarily resulted from decreased sales of our midrange systems and lower OEM deduplication software revenue. During the first nine months of fiscal 2016, the decline in disk backup systems resulted from decreased sales of our midrange and enterprise systems and lower OEM deduplication software revenue.

Product revenue from devices, which includes tape drives and removable hard drives, and non-royalty media sales decreased during the third quarter and first nine months of fiscal 2016 primarily due to lower media sales.

Our scale-out storage solutions revenue increased during the third quarter and first nine months of fiscal 2016 compared to the prior year periods primarily due to increased sales of StorNext appliances, which include StorNext disk storage and StorNext-related tape storage.

Service Revenue

Service revenue is primarily comprised of hardware service contracts, which are typically purchased by our customers to extend the warranty, to provide faster service response time, or both. Service revenue decreased during the third quarter and first nine months of fiscal 2016 due to decreased service revenue for our data protection products which was partially offset by increased revenue from branded service contracts for our StorNext appliances.

Royalty Revenue

Royalty revenue increased compared to the third quarter of fiscal 2015 primarily due to increased software royalty revenue and higher media royalties from LTO 6 offset by a decrease in royalties for LTO generation 1 through 5. Royalty revenue decreased compared to the first nine months of fiscal 2015 primarily due to lower media royalties from LTO generation 1 through 5, offset by an increase in LTO 6.

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Gross Margin

	Three Months Ended					
(Dollars in thousands)	December 31, 2015	Gross margin %	December 31, 2014	Gross margin %	Change	Basis point change
Product gross margin	$23,349	29.3 %	$ 32,394	35.1 %	$(9,045)	(580)
Service gross margin	22,071	59.5 %	21,967	56.1 %	104	340
Royalty gross margin	11,277	100.0 %	10,706	100.0 %	571	—
Gross margin	$56,697	44.3 %	$ 65,067	45.8 %	$(8,370)	(150)

	Nine Months Ended					
(Dollars in thousands)	December 31, 2015	Gross margin %	December 31, 2014	Gross margin %	Change	Basis point change
Product gross margin	$57,088	26.7 %	$ 87,303	33.9 %	$(30,215)	(720)
Service gross margin	62,695	55.8 %	64,346	55.1 %	(1,651)	70
Royalty gross margin	30,196	100.0 %	30,873	100.0 %	(677)	—
Gross margin	$149,979	42.1 %	$ 182,522	45.0 %	$(32,543)	(290)

The decrease in gross margin percentage for the third quarter and first nine months of fiscal 2016 compared to the prior year periods was primarily driven by decreased product revenue and a shift in revenue mix from higher margin products to lower margin products during the third quarter and first nine months of fiscal 2016.

Product Margin

Product gross margin decreased 580 basis points and 720 basis points, respectively, during the third quarter and first nine months of fiscal 2016 compared to the prior year periods. These decreases were the result of a combination of lower revenue and a decrease in material margin. The decrease in material margin was due to both a shift in revenue mix from higher margin products to lower margin products and increased discounting from overall pricing pressure in the storage market.

Service Margin

Service gross margin increased 340 basis points and 70 basis points, respectively, in the third quarter and first nine months of 2016 compared to the prior year periods. The increased service margin percentages were primarily due to decreases in external repair expense and compensation and benefits from recognition of a profit sharing bonus in fiscal 2015 which was not repeated in fiscal 2016

Royalty Margin

Royalties typically do not have related cost of sales and have a 100% gross margin percentage. Therefore, royalty gross margin dollars vary directly with royalty revenue. Royalty revenue and related gross margin dollars increased $0.6 million in the third quarter of fiscal 2016 and decreased $0.7 million in the first nine months of fiscal 2016 compared to the prior year periods.

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Research and Development Expenses

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Research and development	$11,148	8.7 %	$13,969	9.8 %	$(2,821)	(20.2)%

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Research and development	$37,841	10.6 %	$43,680	10.8 %	$(5,839)	(13.4)%

The decrease in research and development expense in the third quarter and first nine months of fiscal 2016 compared to the prior year periods was primarily due to decreases of $2.2 million and $5.0 million, respectively, in compensation and benefits largely related to lower staffing levels and recognition of a profit sharing bonus in fiscal 2015 which was not repeated in fiscal 2016. Additionally, we had decreases of $0.3 million and $0.9 million, respectively, in depreciation expense due to lower capital purchases in fiscal 2016.

Sales and Marketing Expenses

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Sales and marketing	$28,212	22.0 %	$27,494	19.4 %	$718	2.6 %

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Sales and marketing	$83,860	23.6 %	$83,417	20.6 %	$443	0.5 %

The increase in sales and marketing expense in the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015 was primarily due to a $1.7 million increase in advertising and marketing expense, offset by a $1.1 million decrease in commission expense due to lower branded product revenue. The increase in sales and marketing expense in the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 was primarily due to net increases of $3.9 million in advertising and marketing, $0.7 million in sponsored employee activities from higher spending on sales-related meetings, $0.4 million in travel expense, $0.3 million in compensation and benefits from increased staffing levels and $0.3 million in sales demonstration unit costs. These increases were offset by decreases of $2.8 million in intangible amortization expense due to certain intangibles becoming fully amortized during fiscal 2015 and $2.5 million in commission expense due to lower branded product revenue.

General and Administrative Expenses

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
General and administrative	$13,488	10.5 %	$13,815	9.7 %	$(327)	(2.4)%

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
General and administrative	$41,610	11.7 %	$42,271	10.4 %	$(661)	(1.6)%

The decrease for the third quarter and first nine months of fiscal 2016 in general and administrative expense compared to the prior year periods was largely due to decreases of $0.9 million and $1.5 million, respectively, in compensation and benefits primarily due to recognition of a profit sharing bonus in fiscal 2015 which was not repeated in fiscal 2016, partially offset by net increases of $0.7 million and $0.9 million, respectively, in legal and advisory fees primarily from increased fees related to intellectual property matters, partially offset by decreased fees related to activities and inquiries of Starboard Value LP.

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Restructuring Charges

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Restructuring charges	$1,895	1.5 %	$187	0.1 %	$1,708	913.4 %

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Restructuring charges	$2,540	0.7 %	$1,676	0.4 %	$864	51.6 %

For the third quarter and first nine months of fiscal 2016, restructuring charges were largely due to $1.7 million of severance and benefits costs incurred as a result of our Fiscal 2016 Restructuring Plan. Additionally, for the first nine months of fiscal 2016, we incurred restructuring charges related to facilities costs as a result of further consolidating our facilities in the U.S.
For the first nine months of fiscal 2015, restructuring charges were primarily due to facilities costs as a result of further consolidating our facilities in the U.S.

For further information regarding our restructuring actions, refer to Note 8 “Restructuring Charges.”

Gain on Sale of Assets

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Gain on sale of assets	$—	— %	$462	0.1 %	$(462)	(100)%

The gain on sale of assets was primarily due to the sale of IP addresses in the first nine months of fiscal 2015.

Interest Expense

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Interest expense	$1,406	1.1 %	$2,460	1.7 %	$(1,054)	(42.8)%

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Interest expense	$5,304	1.5 %	$7,360	1.8 %	$(2,056)	(27.9)%

The decrease in interest expense in the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015 was primarily due to the payments of $50.0 million and $83.7 million, respectively, of aggregate principal amount of 3.50% notes during the fourth quarter of fiscal 2015 and third quarter of fiscal 2016, respectively. The decrease in interest expense in the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 was primarily due to the payment of $50.0 million of aggregate principal amount of 3.50% notes during the fourth quarter of fiscal 2015.

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Loss on Debt Extinguishment

(Dollars in thousands)	Three Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Loss on debt extinguishment	$394	0.3 %	$—	— %	$394	n/a

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of revenue	December 31, 2014	% of revenue	Change	% Change
Loss on debt extinguishment	$394	0.1 %	$—	— %	$394	n/a

On October 5, 2015, we entered into a private transaction with a note holder to purchase $81.0 million of aggregate principal amount of the 3.50% notes for $82.4 million, which included $1.1 million of accrued interest. In connection with this transaction, we recorded a loss on debt extinguishment of $0.4 million comprised of a loss of $0.3 million from the notes purchased and $0.1 million of unamortized debt issuance costs related to the purchased notes.

Income Taxes

(Dollars in thousands)	Three Months Ended December 31, 2015	% of pre-tax income	December 31, 2014	% of pre-tax income	Change	% Change
Income tax provision	$431	326.5 %	$336	4.6 %	$95	28.3 %

(Dollars in thousands)	Nine Months Ended December 31, 2015	% of pre-tax loss	December 31, 2014	% of pre-tax income	Change	% Change
Income tax provision	$1,117	5.3 %	$940	19.6 %	$177	18.8 %

The income tax provision for the third quarter and first nine months of both fiscal 2016 and fiscal 2015 reflects expenses for foreign income taxes and state taxes. We have provided a full valuation allowance against our U.S. net deferred tax assets due to our history of net losses, difficulty in predicting future results and our conclusion that we cannot rely on projections of future taxable income to realize the deferred tax assets.

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

Amortization of Intangible Assets

The following table details intangible asset amortization expense within our Condensed Consolidated Statements of Operations (dollars in thousands):

	Three Months Ended December 31, 2015	December 31, 2014	Change	% Change
Cost of revenue	$48	$160	$(112)	(70.0)%

	Nine Months Ended December 31, 2015	December 31, 2014	Change	% Change
Cost of revenue	$233	$753	$(520)	(69.1)%
Sales and marketing	—	2,784	(2,784)	(100.0)%
	$233	$3,537	$(3,304)	(93.4)%

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The decrease in intangible amortization in the third quarter and first nine months of fiscal 2016 compared to the prior year periods was primarily due to certain intangibles becoming fully amortized during fiscal 2015. For further information regarding amortizable intangible assets, refer to Note 5 “Intangible Assets and Goodwill.”

Share-based Compensation

The following table summarizes share-based compensation expense within our Condensed Consolidated Statements of Operations (dollars in thousands):

	Three Months Ended			
	December 31, 2015	December 31, 2014	Change	% Change
Cost of revenue	$313	$362	$(49)	(13.5)%
Research and development	488	600	(112)	(18.7)%
Sales and marketing	658	830	(172)	(20.7)%
General and administrative	780	1,126	(346)	(30.7)%
	$2,239	$2,918	$(679)	(23.3)%

	Nine Months Ended			
	December 31, 2015	December 31, 2014	Change	% Change
Cost of revenue	$1,006	$1,109	$(103)	(9.3)%
Research and development	1,529	1,983	(454)	(22.9)%
Sales and marketing	2,367	2,627	(260)	(9.9)%
General and administrative	2,437	2,936	(499)	(17.0)%
	$7,339	$8,655	$(1,316)	(15.2)%

The decrease in share-based compensation expense in the third quarter and first nine months of fiscal 2016 compared to the prior year periods was primarily due to decreases of $0.6 million and $1.0 million, respectively, in the fair value of restricted stock units and $0.2 million and $0.5 million, respectively, in stock options expense as options became fully vested early in the first quarter of fiscal 2016.

LIQUIDITY AND CAPITAL RESOURCES

Capital Resources and Financial Condition

As of December 31, 2015, we had $32.9 million of cash and cash equivalents, which is comprised of money market funds and cash deposits.

We continue to focus on improving our operating performance, including efforts to increase revenue and to control costs in order to improve margins, return to consistent profitability and generate positive cash flows from operating activities. We believe that our existing cash and capital resources will be sufficient to meet all currently planned expenditures, debt service and contractual obligations and to sustain operations for at least the next 12 months. This belief is dependent upon our ability to achieve gross margin projections and to control operating expenses in order to provide positive cash flow from operating activities. Should we be unable to meet our gross margin or expense objectives, it would likely have a material negative effect on our cash balances and capital resources.

The following is a description of our existing capital resources including outstanding balances, funds available to borrow and primary repayment terms including interest rates.

On October 5, 2015, we entered into a private transaction with a note holder to purchase $81.0 million of aggregate principal amount of the 3.50% notes for $82.4 million, which included $1.1 million of accrued interest. In connection with this transaction, we recorded a loss on debt extinguishment of $0.4 million comprised of a loss of $0.3 million from the notes purchased and $0.1 million of unamortized debt issuance costs related to the purchased notes. We used a combination of $66.1 million of proceeds from the WF credit agreement and $16.3 million of restricted cash to fund the purchase and pay the accrued interest. On November 15, 2015, we paid and purchased the remaining $2.8 million 3.50% notes and funded this payment using proceeds from the WF credit agreement.

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As of December 31, 2015, we had $70.0 million of convertible subordinated debt outstanding, excluding unamortized debt issuance costs, comprised of 4.50% convertible subordinated notes due November 15, 2017 ("4.50% notes"). The 4.50% notes require semi-annual interest payments paid on May 15 and November 15 of each year and have no early call provisions. We paid $3.2 million of interest on the 4.50% notes in the first nine months of fiscal 2016. In addition, we had a $68.9 million outstanding balance on a line of credit under the WF credit agreement at a weighted average interest rate of 3.24% as of December 31, 2015.

Under the WF credit agreement, as amended, we have the ability to borrow the lesser of $75 million or the amount of the monthly borrowing base under a senior secured revolving credit facility. We have letters of credit totaling $1.0 million, reducing the maximum amount available to $5.1 million at December 31, 2015. The WF credit agreement matures March 29, 2017. Over the course of the next year, we will explore options to refinance or extend the maturity of the WF credit agreement. If we are unable to do so, it could have a materially adverse impact on our business, financial condition and results of operations. Quarterly, we are required to pay a 0.375% commitment fee on undrawn amounts under the revolving credit facility. There is a blanket lien on all of our assets under the WF credit agreement in addition to certain financial and reporting covenants. As of December 31, 2015, and during the third quarter and first nine months of fiscal 2016, we were in compliance with all covenants.

The WF credit agreement contains financial covenants and customary events of default for such securities, including cross-payment default and cross-acceleration to other material indebtedness for borrowed money which require notice from the trustee or holders of at least 25% of the notes and are subject to a cure period upon receipt of such notice. Average liquidity must exceed $15 million each month, and at all times we must maintain minimum liquidity of $10 million, at least $5 million of which must be excess availability under the WF revolving credit facility. The fixed charge coverage ratio is required to be greater than 1.2 for the 12 month period ending on the last day of any month in which the covenant is applicable. This covenant is applicable only in months in which borrowings exceed $5 million at any time during the month. To avoid triggering mandatory field audits and Wells Fargo controlling our cash receipts, we must maintain liquidity of at least $20 million at all times. The fixed charge coverage ratio, average liquidity, liquidity and excess availability are each defined in the WF credit agreement and/or amendments. Certain schedules in the compliance certificate must be filed monthly if borrowings exceed $5 million; otherwise they are to be filed quarterly.

Generation of positive cash flow from operating activities has historically been, and will continue to be, an important source of cash to fund operating needs and meet our current and long-term obligations. We may choose to raise additional capital if strategically advantageous to the company. We can provide no assurance that such financing would be available to us on commercially acceptable terms or at all.

We have taken many actions in recent years and are continuing to take such actions to offset the negative impact of economic uncertainty and slow economic growth and their impact on the data protection and scale-out storage markets. 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 business. Certain events that are beyond our control, including prevailing economic, competitive and industry conditions, as well as various legal and other disputes, may prevent us from achieving these financial objectives. Any inability to achieve consistent and sustainable net income and cash flow could result in:

(i) Restrictions on our ability to manage or fund our existing operations, which could result in a material and adverse effect on our future results of operations and financial condition.

(ii) Unwillingness on the part of the lenders to do any of the following:

- Provide a waiver or amendment for any covenant violations we may experience in future periods, thereby triggering a default under, or termination of, the revolving credit line, or
- Approve any amendments to the credit agreement we may seek to obtain in the future.

Any lack of renewal, waiver or amendment, if needed, could result in the revolving credit line becoming unavailable to us and any amounts outstanding becoming immediately due and payable.

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

Any of the above mentioned items, individually or in combination, 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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Cash Flows

Following is a summary of cash flows from operating, investing and financing activities (in thousands):

	Nine Months Ended	
	December 31, 2015	December 31, 2014
Net income (loss)	$(22,281)	$3,855
Net cash provided by (used in) operating activities	(15,914)	11,117
Net cash used in investing activities	(2,942)	(2,994)
Net cash used in financing activities	(16,155)	(152)

Nine Months Ended December 31, 2015

The $6.4 million difference between net loss and net cash used in operating activities during the nine months ended December 31, 2015 was primarily due to a $22.9 million decrease in accounts receivable and $18.1 million in non-cash items, the largest of which were share-based compensation, depreciation and service parts lower of cost or market adjustment and a $13.5 million decrease in manufacturing inventories, partially offset by decreases of $14.8 million in deferred revenue, $12.7 million in accounts payable and $10.7 million in accrued compensation. The decrease in accounts receivable was primarily due to lower revenue in the third quarter of fiscal 2016 compared to the fourth quarter of fiscal 2015. The decrease in manufacturing inventories was largely due to a reduction in finished goods related to tape automation systems, disk backup systems and media and a reduction in raw materials from sales of consignment inventory to our contract manufacturers. The decrease in deferred revenue was largely due to a decrease in deferred service contracts revenue, primarily driven by seasonality. The majority of our service contracts renew in our third and fourth fiscal quarters. Additionally, the decrease was attributable to decreased deferred service contracts revenue for tape automation systems. The decrease in accounts payable was primarily due to the timing of invoice payments and lower inventory purchases in the third quarter of fiscal 2016 compared to the fourth quarter of fiscal 2015. The decrease in accrued compensation was primarily due to payment of a profit sharing bonus accrued in fiscal 2015 which was not repeated in fiscal 2016 and a lower commission accrual related to lower branded revenue.

Cash used in investing activities was primarily due to $2.8 million of property and equipment purchases. Equipment purchases were primarily for engineering equipment for product development, IT servers and firewall upgrades and leasehold improvements in our Colorado Springs facility.

Cash used in financing activities was primarily due to the $83.7 million payment of the 3.50% notes, partially offset by $68.9 million of borrowings under the WF credit agreement in the third quarter of fiscal 2016 .

Nine Months Ended December 31, 2014

The $7.3 million difference between net income and net cash provided by operating activities during the nine months ended December 31, 2014 was primarily due to $22.5 million in non-cash items, the largest of which were share-based compensation, depreciation, amortization of intangible assets and service parts lower of cost or market adjustment. In addition, we had a $9.3 million increase in accounts payable, offset by a $9.0 million increase in accounts receivable and an $8.9 million decrease in deferred revenue. The increase in accounts payable was due to increased purchases and timing of payments. The increase in accounts receivable was primarily due to increased revenue and increased service contract invoicing in the third quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014. The decrease in deferred revenue was largely due to a decrease in deferred service contracts revenue, primarily driven by seasonality.

Cash used in investing activities reflects $2.9 million of property and equipment purchases and $0.5 million of cash paid for our acquisition of Symform, Inc. Equipment purchases were primarily for engineering equipment for product development and permanent demo units.

Off Balance Sheet Arrangements

Lease Commitments

We lease certain facilities under non-cancelable lease agreements. Some of the leases have renewal options ranging from one to ten years and others contain escalation clauses and provisions for maintenance, taxes or insurance. We also have equipment leases for computers and other office equipment. During the second quarter of fiscal 2016, we negotiated a five year extension of an operating lease on a building in Irvine, California, which increased our future minimum lease payments under non-cancelable lease agreements by $3.7 million.

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Commitments to Purchase Inventory

We use contract manufacturers for our manufacturing operations. Under these arrangements, the contract manufacturer procures inventory to manufacture products based upon our forecast of customer demand. We have similar arrangements with certain other suppliers. We are responsible for the financial impact on the supplier or contract manufacturer of any reduction or product mix shift in the forecast relative to materials that the third party had already purchased under a prior forecast. Such a variance in forecasted demand could require a cash payment for inventory in excess of current customer demand or for costs of excess or obsolete inventory. As of December 31, 2015 and March 31, 2015, we had issued non-cancelable commitments for $37.0 million and $46.0 million, respectively, to purchase inventory from our contract manufacturers and suppliers.

Accrued restructuring

As of December 31, 2015, we had $2.6 million of accrued restructuring composed of $1.8 million in accrued facility restructuring, which is net of estimated sublease amounts, and $0.8 million in accrued severance and benefits restructuring. Payments for the accrued facility restructuring will be made monthly in accordance with the respective facility lease terms, which continue through December 2021.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

Our discussion and analysis of the financial condition and results of operations are based on the accompanying unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these statements requires us to make significant estimates and judgments about future uncertainties that affect reported assets, liabilities, revenues and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions believed to be reasonable under the circumstances. In the event that estimates or assumptions prove to be different from actual results, adjustments are made in subsequent periods to reflect more current information. The accounting estimates requiring our most difficult, subjective or complex judgments because these matters are inherently uncertain are unchanged. These critical accounting estimates and policies have been disclosed in our Annual Report on Form 10-K for the year ended March 31, 2015 filed with the Securities and Exchange Commission on June 12, 2015 except for the following:

Impairment of Long-lived Assets and Goodwill

We apply judgment when reviewing goodwill for impairment, including when evaluating potential impairment indicators. Indicators we consider include adverse changes in the economy or business climate that could affect the value of our goodwill, overall financial performance such as negative or declining cash flows or operating income, changes in our business strategy, product mix or to the long-term economic outlook, a sustained decrease in our stock price and testing long-lived assets for recoverability. In addition, we evaluate on the basis of the weight of evidence the significance of identified events and circumstances along with how they could affect the relationship between the reporting unit's fair value and carrying amount, including positive mitigating events and circumstances.

We use an undiscounted cash flow approach to evaluate our long-lived assets for recoverability when there are impairment indicators. Estimates of future cash flows require significant judgments about the future and include company forecasts and our expectations of future use of our long-lived assets, both of which may be impacted by market conditions. Other critical estimates include determining the asset group or groups within our long-lived assets, the primary asset of an asset group and the primary asset’s useful life.

In addition to comparing the carrying value of the reporting unit to its fair value, because we have negative book value, we perform a qualitative analysis to determine whether it is not more likely than not that the fair value of goodwill is less than its carrying amount. If we determine it is more likely than not that the fair value of goodwill is less than its carrying amount, then a second step must be performed to quantify the amount of goodwill impairment, if any, requiring additional assumptions and judgments.

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If the second step of a goodwill impairment test is required, the following assumptions and estimates may be used by management in an income approach analysis. We derive discounted cash flows using estimates and assumptions about the future. Other significant assumptions may include: expected future revenue growth rates, operating profit margins, working capital levels, asset lives used to generate future cash flows, a discount rate, a terminal value multiple, income tax rates and utilization of net operating loss tax carryforwards. These assumptions are developed using current market conditions as well as internal projections. Inherent in our development of cash flow projections for the income approach used in an impairment test are assumptions and estimates derived from a review of our operating results, approved business plans, expected growth, cost of capital and income tax rates. We also make certain assumptions about future economic conditions, applicable interest rates and other market data.

We performed an assessment of the carrying value of goodwill related to our single reporting unit as of December 31, 2015 and determined that it was not impaired. Subsequent to December 31, 2015, triggering events have occurred which will require us to evaluate the carrying value of our goodwill for impairment in the quarter ending March 31, 2016. These triggering events include a significant decline in the price of our common stock which, during January 2016, decreased from a closing price of $0.93 per share on December 31, 2015 to $0.48 per share on January 29, 2016. Depending on the results of our evaluation, during the fourth quarter of fiscal 2016 we may determine that some or all of our goodwill is impaired, which could result in an impairment charge that could range from $0 to $55.6 million.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Changes in interest rates affect interest income earned on our cash equivalents, which consisted solely of money market funds during the first nine months of fiscal 2016. During the first nine months of fiscal 2016, interest rates on these funds were under 1.0%, and we earned negligible amounts in interest income, thus a hypothetical 100 basis point decrease in interest rates would have an insignificant impact on interest income.

In addition, changes in interest rates affect interest expense on our borrowings under the WF credit agreement. The interest rate on amounts borrowed is based on an election by us of an annual rate equal to (1) a base rate established by Wells Fargo plus an applicable margin of 1.0% to 1.5%, based on availability levels under the WF credit agreement or (2) the LIBOR rate plus an applicable margin ranging from 2.0% and 2.5%, based on availability levels under the WF credit agreement. The base rate is defined in the WF credit agreement. We had $68.9 million outstanding borrowings under the WF credit agreement as of December 31, 2015 at a weighted average interest rate of 3.24%. A hypothetical 100 basis point increase in interest rates would increase interest expense $0.2 million for the first nine months of fiscal 2016.

Our convertible subordinated notes have a fixed interest rate, thus a hypothetical 100 basis point increase in interest rates would have no impact on interest expense in the first nine months of fiscal 2016.

For a further description of our outstanding debt, see the section captioned “Liquidity and Capital Resources” in Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Foreign Exchange Risk

We conduct business in certain international markets, primarily in the European Union. Because we operate in international markets, we have exposure to different economic climates, political arenas, tax systems and regulations that could affect foreign exchange rates. Our primary exposure to foreign currency risk relates to transacting in foreign currency and recording the activity in U.S. dollars. Changes in exchange rates between the U.S. dollar and these other currencies will result in transaction gains or losses, which we recognize in our Condensed Consolidated Statements of Operations.

To the extent practicable, we minimize our foreign currency exposures by maintaining natural hedges between our assets and liabilities and revenues and expenses denominated in foreign currencies. We have entered into foreign currency option contracts in the past and we may enter into foreign exchange derivative contracts or other economic hedges in the future. Our goal in managing our foreign exchange risk is to reduce to the extent practicable our potential exposure to the changes that exchange rates might have on our earnings. We make a number of estimates in conducting hedging. In the event those estimates differ significantly from actual results, we could experience greater volatility as a result of our hedges.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. We evaluated the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of the end of the period covered by the Quarterly Report on Form 10-Q. This control evaluation was performed under the supervision and with the participation of management, including our CEO and our CFO. Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified by the SEC. Disclosure controls are also designed to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate, to allow timely decisions regarding the required disclosure. Based on the controls evaluation, our CEO and CFO have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls were effective.

(b) Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On February 18, 2014, Crossroads Systems, Inc. (“Crossroads”) filed a patent infringement lawsuit against Quantum in the U.S. District Court for the Western District of Texas, alleging infringement of U.S. patents 6,425,035 and 7,934,041. An amended complaint filed on April 15, 2014 also alleged infringement of U.S. patent 7,051,147. Crossroads asserts that we have incorporated Crossroads' patented technology into our StorNext QX and Q-Series lines of disk array products and into our Scalar libraries. Crossroads seeks unspecified monetary damages and injunctive relief. Crossroads has already dismissed all claims of infringement with respect to the StorNext QX and Q-Series products. In July and September of 2014, we filed for Inter Partes Review of all three asserted Crossroads patents before the Patent Trial and Appeal Board and a review was initiated for all claims. On June 16, 2015, the U.S. District Court, Western District of Texas stayed the Crossroads trial proceedings pending resolution of the Inter Partes Review proceedings. On January 29, 2016 the Patent Trial and Appeal Board issued decisions on the Inter Partes Reviews for U.S. 6,425,035 and 7,051,147, ordering all claims of both patents to be unpatentable. The decision for U.S. 7,934,041 is expected prior to March 17, 2016. We believe the probability that this lawsuit will have a material adverse effect on our business, operating results or financial condition is remote.

On September 23, 2014, we filed a lawsuit against Crossroads in the U.S. District Court for the Northern District of California alleging patent infringement of our patent 6,766,412 by Crossroads' StrongBox VSeries Library Solution product. We are seeking injunctive relief and the recovery of monetary damages. On December 4, 2014, we amended our complaint alleging infringement of a second patent, 5,940,849, related to Crossroads' SPHiNX product line. On December 16, 2014, we withdrew the amended complaint alleging infringement of the second patent, 5,940,849. On November 23, 2015, we dismissed the lawsuit alleging patent infringement of U.S. Pat. No. 6,766,412 pursuant to a confidential settlement agreement.

ITEM 1A. RISK FACTORS

YOU SHOULD CAREFULLY CONSIDER THE RISKS DESCRIBED BELOW, TOGETHER WITH ALL OF THE OTHER INFORMATION INCLUDED IN THIS QUARTERLY REPORT ON FORM 10-Q. 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 “MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS” FOR ADDITIONAL DISCUSSION OF THESE FORWARD-LOOKING STATEMENTS.

We derive the majority of our revenue from products incorporating tape technology. Our future operating results depend in part on continued market acceptance and use of products employing tape technology, and decreases in the market have materially and adversely impacted our business, financial condition and operating results. In addition, if we are unable to compete with new or alternative storage technologies, our business, financial condition and operating results could be materially and adversely affected.

We currently derive the majority of our revenue from products that incorporate some form of tape technology, and we expect to continue to derive significant revenue from these products in the next several years. As a result, our future operating results depend in part on continued market acceptance and use of products employing tape technology. We believe that the storage environment is changing, including reduced demand for tape products. Decreased market acceptance or use of products employing tape technology has materially and adversely impacted our business, financial condition and operating results and we expect that our revenues from tape products will continue to decline, which could materially and adversely impact our business, financial condition and operating results in the future.

Disk products as well as various software solutions and alternative technologies continue to gain broader market acceptance. We expect that, over time, many of our tape customers will continue to migrate toward these products and solutions and that revenue from these products and solutions will generate a greater proportion of our revenue. While we are making targeted investment in software, disk backup systems and other alternative technologies, these markets are characterized by rapid innovation, evolving customer demands and strong competition, including competition with several companies who are also significant customers. If we are not successful in our efforts, our business, financial condition and operating results could be materially and adversely affected.

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We have significant indebtedness, which imposes upon us debt service obligations, and our credit facility contains various operating and financial covenants that limit our discretion in the operation of our business. If we are unable to generate sufficient cash flows from operations and overall operating results to meet these debt obligations or remain in compliance with the covenants, our business, financial condition and operating results could be materially and adversely affected.
Our level of indebtedness presents significant risks to investors, both in terms of the constraints that it places on our ability to operate our business and because of the possibility that we may not generate sufficient cash and operating results to remain in compliance with our covenants and pay the principal and interest on our indebtedness as it becomes due. For further description of our outstanding debt, see the section captioned "Liquidity and Capital Resources" in Part I, Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

As a result of our indebtedness:

- Our ability to invest in the growth areas of our business is constrained by the financial covenants contained in our credit agreement, which require us to maintain a minimum fixed charge coverage ratio and liquidity levels;
- We must dedicate a portion of our cash flow from operations and other capital resources to debt service, thereby reducing our ability to fund working capital, capital expenditures, research and development and other cash requirements;
- Our flexibility in planning for, or reacting to, changes and opportunities in the markets in which we compete may be limited, including our ability to engage in mergers and acquisitions activity, which may place us at a competitive disadvantage;
- We are subject to mandatory field audits and control of cash receipts by the lender if we do not maintain liquidity above certain thresholds;
- We may be more vulnerable to adverse economic and industry conditions;
- We may be unable to make payments on other indebtedness or obligations; and
- We may be unable to incur additional debt on acceptable terms, if at all.

Our credit facility agreement contains restrictive covenants that require us to comply with and maintain certain liquidity levels and a minimum fixed charge coverage ratio, as well as restrict our ability, subject to certain thresholds, to:

- Incur debt;
- Incur liens;
- Make acquisitions of businesses or entities or sell certain assets;
- Make investments, including loans, guarantees and advances;
- Engage in transactions with affiliates;
- Pay dividends or engage in stock repurchases; and
- Enter into certain restrictive agreements.

The recent weakness we have seen in the general storage and backup market, and the resulting underperformance of our data protection business, which is the primary driver of our overall cash flow and operating income, has placed increased pressure on our ability to meet our liquidity and fixed charge coverage ratio covenants. We have taken steps and are making changes to our business designed to ensure that our operating results are sufficient to meet these covenants, but if are not successful in implementing these changes or our results turn out to be lower than expected, we may violate a covenant, which could result in a default under our credit facility agreement.

Our credit facility agreement is collateralized by a pledge of all of our assets. If we were to default and were unable to obtain a waiver for such a default, the lender 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 lender against us could have a materially adverse impact on our business, financial condition and results of operations.

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We rely on indirect sales channels to market and sell our branded products. Therefore, the loss of or deterioration in our relationship with one or more of our resellers or distributors, or our inability to establish new indirect sales channels to drive growth of our branded revenue, especially for disk backup systems and scale-out storage solutions, could negatively affect our operating results.

We sell the majority of our branded products to distributors such as Ingram Micro, Inc. and others, VARs and to direct marketing resellers ("DMRs") such as CDW Corporation, who in turn sell our products to end users. The success of these sales channels is hard to predict, particularly over time, and we have no purchase commitments or long-term orders from them that assure us of any baseline sales through these channels. Several of our resellers carry competing product lines that they may promote over our products. A reseller might not continue to purchase our products or market them effectively, and each reseller determines the type and amount of our products that it will purchase from us and the pricing of the products that it sells to end user customers. Establishing new indirect sales channels is an important part of our strategy to drive growth of our branded revenue.

As we introduce new products and solutions, we could negatively impact our relationship with channel partners that historically have sold other products and solutions that now compete with our new offerings. For example, we introduced various StorNext appliance solutions beginning in fiscal 2012 causing us to more directly compete for hardware sales with channel partners that sold other hardware products in conjunction with our StorNext software.

Certain of our contracts with customers contain “most favored nation” pricing provisions mandating that we offer our products to these customers at the lowest price offered to other similarly situated customers. In addition, sales of our enterprise products, and the revenue associated with the on-site service of those products, are somewhat concentrated in specific customers, including government agencies and government-related companies. Any failure of such customers and agencies to continue purchasing products in the same quantities and in the same time frames as they have in the past could affect our operating results. Our operating results could be adversely affected by any number of factors including:

- A change in competitive strategy that adversely affects a reseller’s willingness or ability to distribute our products;
- The reduction, delay or cancellation of orders or the return of a significant amount of products;
- Our inability to gain traction in developing new indirect sales channels for our branded products;
- The loss of one or more of such distributors or resellers;
- Any financial difficulties of such distributors or resellers that result in their inability to pay amounts owed to us; or
- Changes in requirements or programs that allow our products to be sold by third parties to government customers.

If our products fail to meet our or our customers’ specifications for quality and reliability, we may face liability and reputational or financial harm which may adversely impact our results of operations and our competitive position may suffer.

Although we place great emphasis on product quality, we may from time to time experience problems with the performance of our products, which could result in one or more of the following:

- Increased costs related to fulfillment of our warranty obligations;
- The reduction, delay or cancellation of orders or the return of a significant amount of products;
- Focused failure analysis causing distraction of the sales, operations and management teams; or
- The loss of reputation in the market and customer goodwill.

These factors could cause our business, financial condition and results of operations to be materially and adversely affected.

In addition, we face potential liability for performance problems of our products because our end users employ our storage technologies for the storage and backup of important data and to satisfy regulatory requirements. We could potentially face claims for product liability from our customers if our products cause property damage or bodily injury. Although we maintain technology errors and omissions liability and general liability insurance, our insurance may not cover potential claims of these types or may not be adequate to indemnify us for all liability that may be imposed. Any imposition of liability or litigation costs that is not covered by insurance or is in excess of our insurance coverage could harm our business.

A large percentage of our sales are to a few customers, some of which are also competitors, and these customers generally have no minimum or long-term purchase commitments. The loss of, or a significant reduction in demand from, one or more key customers could materially and adversely affect our business, financial condition and operating results.

Our sales have been and continue to be concentrated among a few customers because under our business model, we sell to OEMs, distributors, VARs and DMRs to reach end user customers. Furthermore, customers are not obligated to purchase any minimum product volume, and our relationships with customers are terminable at will. Revenue from OEM customers has decreased in recent years. If we experience further declines in revenue from OEM customers or any of our other large customers, our business, financial condition and operating results could be materially and adversely affected. In addition, certain of our large customers are also our competitors, and such customers could decide to reduce or terminate their purchases of our products for competitive reasons.

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

A portion of our sales are to various agencies and departments of the U.S. federal government, and funding cuts to federal spending can adversely impact our revenue. The American Taxpayer Relief Act of 2012 implemented automatic spending cuts beginning March 1, 2013. Between October 1 and October 16, 2013, the U.S. government partial shutdown caused reductions, cancellations and delayed orders. Future spending cuts by the U.S. federal government could decrease revenue from sales to the federal government that could materially and adversely affect our results of operations.

Our operating results depend on a limited number of products and 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.

A limited number of products comprise a significant majority of our sales, and due to rapid technological change in the industry, our future operating results depend on our ability to develop and successfully introduce new products. To compete effectively, we must continually improve existing products and introduce new ones. We have devoted and expect to continue to devote considerable management and financial resources to these efforts. We cannot provide assurance that:

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

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

We continue to face risks related to economic uncertainty and slow economic growth.

Uncertainty about economic conditions poses a risk as businesses may further reduce or postpone spending in response to reduced budgets, tightening of credit markets, negative financial news and declines in income or asset values which could adversely affect our business, financial condition and results of operations. The slow economic growth in recent years along with periods of economic uncertainty in various countries around the world has had a material and adverse impact on our business and our financial condition.

In particular, we have experienced reduced demand for IT products and services overall and more specifically for products with tape technology in the data protection market. We continue to face risks related to economic conditions in Europe, including concerns about sovereign debt and related political matters, which could negatively impact the U.S. and global economies and adversely affect our financial results. In addition, our ability to access capital markets may be restricted, which could have an impact on our ability to react to changing economic and business conditions and could also adversely affect our results of operations and financial condition.

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Competition may intensify in the data protection market as a result of competitors introducing products based on new technology standards and merger and acquisition activity, which could materially and adversely affect our business, financial condition and results of operations.

Our competitors in the data protection market for disk backup systems and virtual machine solutions are aggressively trying to advance and develop new technologies and products to compete against our technologies and products, and we face the risk that customers could choose competitor products over ours. Competition in our markets is characterized by technological innovation and advancement. As a result of competition and new technology standards, our sales or gross margins could decline, which could materially and adversely affect our business, financial condition and results of operations.

Technological developments and competition over the years in the tape automation market and in the storage market in general has resulted in decreased prices for tape automation products and product offerings. Pricing pressure is more pronounced in the tape automation market for entry-level products and less pronounced for enterprise products. Over time, the prices of our products and competitor products have decreased, but such products often incorporate new and/or different features and technologies than in prior years. We face risks that customers could choose competitor products over ours due to these features and technologies or due to pricing differences. We have managed pricing pressure by reducing production costs and/or adding features to increase value to maintain a certain level of gross margin for our tape automation systems. However, certain of our costs are fixed in the short term, so we may not be able to offset price decreases or reductions in demand sufficiently to maintain our profitability. In addition, if competition further intensifies, or if there is additional industry consolidation, our sales and gross margins for tape automation systems could decline, which could materially and adversely affect our business, financial condition and results of operations.

Industry consolidation and competing technologies with device products, which include tape drives and removable hard drives, have resulted in decreased prices and increasingly commoditized device products. Our response has been to manage our device business at the material margin level, and we have chosen not to compete for sales in intense price-based situations or if we would be unable to maintain a certain gross margin level. Our focus has shifted to higher margin opportunities in other product lines. Although revenue from devices has decreased in recent years, our material margins have remained relatively stable over this period. We have exited certain portions of the device market and have anticipated decreased sales of devices. We face risk of reduced shipments of our devices beyond our plans and could have reduced margins on these products, which could adversely impact our business, financial condition and results of operations.

Additionally, the competitive landscape could change due to merger and acquisition activity in the data protection market. Such transactions may impact us in a number of ways. For instance, they could result in:

- Competitors decreasing in number but having greater resources and becoming more competitive with us;
- Companies that we have not historically competed against entering into one or more of our primary markets and increasing competition in such market(s);
- Customers that are also competitors becoming more competitive with us and/or reducing their purchase of our products; and
- Competitors acquiring our current suppliers or business partners and negatively impacting our business model.

These transactions also create uncertainty and disruption in the market because whether a pending transaction will be completed, the timing of such a transaction and its degree of impact are often unknown. Given these factors and others, such merger and acquisition activity may materially and adversely impact our business, financial condition and results of operations.

Competition may intensify in the scale-out storage market as a result of competitors introducing products based on new technology standards and market consolidation, which could materially and adversely affect our business, financial condition and results of operations.

Competition in the scale-out storage market is characterized by technological innovation and advancement, including performance and scale features, and our competitors are aggressively trying to advance and develop new technologies and solutions. If we are unable to compete effectively in these markets and develop solutions that have features and technologies that our customers desire, including new technology standards, our sales from software solutions and appliances could decline, which could materially and adversely affect our business, financial condition and results of operations.

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Additionally, the competitive landscape could change due to mergers and acquisitions among our competitors, customers and partners. Transactions such as these may impact us in a number of ways. For instance, they could result in:

- Competitors decreasing in number but having greater resources and becoming more competitive with us;
- Companies that we have not historically competed against entering into one or more of our primary markets and increasing competition in such market(s);
- Customers that are also competitors becoming more competitive with us and/or reducing their purchase of our products; and
- Competitors acquiring our current suppliers or business partners and negatively impacting our business model.

These transactions also create uncertainty and disruption in the market, because whether a pending transaction will be completed, the timing of such a transaction and its degree of impact are often unknown. Given these factors and others, such merger and acquisition activity may materially and adversely impact our business, financial condition and results of operations.

A significant decline in our media royalty, branded software or OEM deduplication software revenues could materially and adversely affect our business, financial condition and operating results.

Our media royalties, branded software and OEM deduplication software revenues are relatively profitable and can significantly impact total company profitability. We receive media royalty revenue based on tape media cartridges sold by various tape media manufacturers and resellers. 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. Our media royalty revenue varies depending on the level of sales of the various media cartridge offerings sold by the licensees and other factors, including:

- The size of the installed base of devices and similar products that use tape media cartridges;
- The performance of our strategic licensing partners, which sell tape media cartridges;
- The relative growth in units of newer device products, since the associated media cartridges for newer products typically sell at higher prices than the media cartridges associated with older products;
- The media consumption habits and rates of end users;
- The pattern of device retirements; and
- The level of channel inventories.

Our media royalties depend on royalty rates and the quantity of media consumed in the market. We do not control licensee sales of these tape media cartridges. Reduced royalty rates, or a reduced installed device base using tape media cartridges, would result in further reductions in our media royalty revenue and could reduce gross margins. This could materially and adversely affect our business, financial condition and results of operations.

Our branded software revenues are also dependent on many factors, including the success of competitive offerings, our ability to execute on our product roadmap and our effectiveness at marketing and selling our branded software solutions directly or through our channel partners. Disruptions to any one of these factors could reduce our branded software revenues, which could adversely affect our business, financial condition and operating results.

Our OEM deduplication software revenues also depend on many factors, including the success of competitive offerings, our ability to execute on our product roadmap with our OEM deduplication software partners, the effort of our OEM deduplication software partners in marketing and selling the resulting products, the market acceptance of the resulting products and changes in the competitive landscape, including the impact of acquisitions. At various times, we had significant revenue from OEM deduplication software revenue and at times we had negligible revenue from OEM deduplication software, which negatively impacted our results. Any further disruptions to the factors on which our OEM deduplication software revenues depend could adversely affect our business, financial condition and operating results.

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Some of our products contain licensed, third-party technology that provides important product functionality and features. The loss or inability to obtain any such license could have a material adverse effect on our business.
Our products may contain technology licensed from third parties that provides important product functionality and features. We have contractual protections within our license agreements to help mitigate against the risks of incorporating third-party technology into our products. However, there remains a risk that we may not have continued access to this technology, for instance if the licensing company ceased to exist, either from bankruptcy, dissolution or purchase by a competitor. In addition, legal actions, such as intellectual property actions, brought against the licensing company could impact our future access to the technology. We also have limited control of the technology roadmap and cannot ensure that the licensing company will advance the roadmap of the licensed technology in the manner best for Quantum. Any of these actions could negatively impact our technology licensing, thereby reducing the functionality and/or features of our products, and adversely affect our business, financial condition and operating results. We also face the risk of not being able to quickly implement a replacement technology or otherwise mitigate the risks associated with not having access to this licensed technology, which may adversely affect our business, financial condition and operating results.
We have taken considerable steps towards reducing our cost structure and may take further cost reduction actions. The steps we have taken and may take in the future may not reduce our cost structure to a level appropriate in relation to our future sales and therefore, these anticipated cost reductions may be insufficient to result in consistent profitability.
In the last several years, we have recorded significant restructuring charges and made cash payments in order to reduce our cost of sales and operating expenses to respond to adverse economic and industry conditions, from strategic management decisions and to rationalize our operations following acquisitions. In the third quarter of fiscal 2016, we implemented a restructuring plan to eliminate approximately 65 positions in the U.S. and internationally, primarily in research and development and sales and marketing functions. These restructurings may result in decreases to our revenues or adversely affect our ability to grow our business in the future. Workforce reductions may also adversely affect employee morale and our ability to retain our employees. We may take future steps to further reduce our operating costs, including future cost reduction steps or restructurings in response to strategic decisions, adverse changes in our business or industry or future acquisitions. We may be unable to reduce our cost of sales and operating expenses at a rate and to a level appropriate in relation to our future sales, which may adversely affect our business, financial condition and operating results.
In addition, our ability to achieve the anticipated cost savings and other benefits from these restructuring within the expected time frame is subject to many estimates and assumptions. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. If these estimates and assumptions are incorrect, if we experience delays, or if other unforeseen events occur, our business and financial results could be adversely affected.
If we are unable to attract and retain skilled employees, our business could be adversely impacted.
We may be subject to increased turnover in our employee base or the inability to fill open headcount requisitions due to competition, concerns about our operational performance or other factors. In addition, we may rely on the performance of employees whose skill sets are not sufficiently developed to fulfill their expected job responsibilities. Either of these situations could impair or delay our ability to realize operational and strategic objectives and cause increased expenses and lost sales opportunities.
Additionally, over the last several years, we made certain changes in our strategic direction focusing on key technology segments. As part of this change in focus, we reduced costs of revenue and other operating expenses. Executing on this new strategic direction as well as the ongoing efficiency initiatives across the company, such as the Fiscal 2016 Restructuring Plan could adversely affect our ability to retain and hire key personnel and may result in reduced productivity by our employees.
The loss of the services of any of our key employees, the inability to attract or retain qualified talent in the future, or delays in hiring required talent, particularly sales and engineering talent, could delay the development and introduction of our products or services and/or negatively affect our ability to sell our products or services.

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Economic or other business factors may lead us to write down the carrying amount of our goodwill or long-lived assets, which could have a material and adverse effect on our results of operations.

We evaluate our goodwill for impairment annually during the fourth quarter of our fiscal year, or more frequently when indicators of impairment are present. Long-lived assets are reviewed for impairment whenever events or circumstances indicate impairment might exist. We continue to monitor relevant market and economic conditions, including the price of our stock, which decreased from a closing price of $0.93 per share on December 31, 2015 to $0.48 per share on January 29, 2016, and perform appropriate impairment reviews when conditions deteriorate such that we believe the value of our goodwill could be further impaired or an impairment exists in our long-lived assets. We have been required to record material goodwill impairment charges in the past. The recent weakness we have seen in the general storage and backup market, and the resulting underperformance of our data protection business, which is the primary driver of our overall cash flow and operating income, has placed increased pressure on our financial results and stock price. We have taken steps and are making changes to our business to improve our operating results, but if we are not successful in implementing these changes or our results turn out to be lower than expected, we may be required to write down the carrying amount of our goodwill or long-lived assets to fair value at the time of such assessment. As a result of any impairment charge, our operating results could be materially and adversely affected.

Third party intellectual property 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, such as our current litigation with Crossroads Systems, Inc. described in Part II, Item 1"Legal Proceedings." While we currently believe the amount of ultimate liability, if any, with respect to any such actions will not materially affect our financial position, results of operations or liquidity, the ultimate outcome of any license discussion or litigation is uncertain. Adverse resolution of any third party infringement claim could subject us to substantial liabilities and require us to refrain from manufacturing and selling certain products. In addition, the costs incurred in intellectual property litigation can be substantial, regardless of the outcome. As a result, our business, financial condition and operating results could be materially and adversely affected.

In addition, certain products or technologies acquired or developed by us may include "open source" software. Open source software is typically licensed for use at no initial charge. Certain open source software licenses, however, require users of the open source software to license to others any software that is based on, incorporates or interacts with, the open source software under the terms of the open source license. Although we endeavor to comply fully with such requirements, third parties could claim that we are required to license larger portions of our software than we believe we are required to license under open source software licenses. If such claims were successful, they could adversely impact our competitive position and financial results by providing our competitors with access to sensitive information that may help them develop competitive products. In addition, our use of open source software may harm our business and subject us to intellectual property claims, litigation or proceedings in the future because:

- Open source license terms may be ambiguous and may subject us to unanticipated obligations regarding our products, technologies and intellectual property;
- Open source software generally cannot be protected under trade secret law; and
- It may be difficult for us to accurately determine the origin of the open source code and whether the open source software infringes, misappropriates or violates third party intellectual property or other rights.

As a result of our global manufacturing and sales operations, we are subject to a variety of risks related to our business outside of the U.S., any of which could, individually or in the aggregate, have a material adverse effect on our business.

A significant portion of our manufacturing and sales operations and supply chain occurs in countries other than the U.S. We also have sales outside the U.S. We utilize contract manufacturers to produce and fulfill orders for our products and have suppliers for various components, several of which have operations located in foreign countries including China, Hungary, Japan, Malaysia, Singapore, Mexico, the Philippines and Thailand. Because of these operations, we are subject to a number of risks including:

- Reduced or limited protection of our intellectual property;
- Compliance with multiple and potentially conflicting regulatory requirements and practices;

- Commercial laws that favor local businesses;
- Exposure to economic fluctuations including inflationary risk and continuing sovereign debt risk;
- Shortages in component parts and raw materials;
- Import, export and trade regulation changes that could erode our profit margins or restrict our ability to transport our products;

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- The burden and cost of complying with foreign and U.S. laws governing corporate conduct outside the U.S. including the Foreign Corrupt Practices Act, the United Kingdom Bribery Act and other similar regulations;
- Adverse movement of foreign currencies against the U.S. dollar (the currency in which our results are reported) and global economic conditions generally;
- Inflexible employee contracts and employment laws that may make it difficult to terminate or change the compensation structure for employees in some foreign countries in the event of business downturns;
- Recruiting employees in highly competitive markets and wage inflation in certain markets;
- Potential restrictions on the transfer of funds between countries;
- Political, military, social and infrastructure risks, especially in emerging or developing economies;
- Import and export duties and value-added taxes;
- Natural disasters, including earthquakes, flooding, typhoons and tsunamis; and
- Cultural differences that affect the way we do business.

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

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 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:

- Fluctuations in IT spending as a result of economic conditions or fluctuations in U.S. federal government spending;
- Failure by our contract manufacturers to complete shipments in the last month of a quarter during which a substantial portion of our products are typically shipped;
- Customers canceling, reducing, deferring or rescheduling significant orders as a result of excess inventory levels, weak economic conditions or other factors;
- Seasonality, including customer fiscal year-ends and budget availability impacting customer demand for our products;
- Declines in large orders defined as orders greater than $200,000;
- Declines in royalty or software revenues;
- Product development and ramp cycles and product performance or quality issues of ours or our competitors;
- Poor execution of and performance against expected sales and marketing plans and strategies;
- Reduced demand from our OEM or distribution, VAR, DMR and other large customers;
- Increased competition which may, among other things, increase pricing pressure or reduce sales;
- Failure to meet the expectations of investors or analysts;
- Restructuring actions or unexpected costs; and
- Foreign exchange fluctuations.

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

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. However, we cannot provide assurance that patents will be issued with respect to pending or future patent applications that we have filed or plan to file or that our patents will be upheld as valid or will prevent the development of competitive products or that any actions we have taken will adequately protect our intellectual property rights. We generally enter into confidentiality agreements with our employees, consultants, customers, potential customers, contract manufacturers and others as required, in which we strictly limit access to, and distribution of, our software and further limit the disclosure and use of our proprietary information.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain or use our products or technology. Enforcing our intellectual property rights can sometimes only be accomplished through the use of litigation. 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 U.S.

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Because we may order components from suppliers in advance of receipt of customer orders for our products that include these components, we could face a material inventory risk if we fail to accurately forecast demand for our products or manage production, which could have a material and adverse effect on our results of operations and cash flows.

Although we use third parties to manufacture our products, in some cases we may retain the responsibility to purchase component inventory to support third party manufacturing activities, which presents a number of risks that could materially and adversely affect our financial condition. For instance, as part of our component planning, we may place orders with or pay certain suppliers for components in advance of receipt of customer orders. We may occasionally enter into negotiated orders with vendors early in the manufacturing process of our products to ensure that we have sufficient components for our products to meet anticipated customer demand. Because the design and manufacturing process for these components can be complicated, it is possible that we could experience a design or manufacturing flaw that could delay or even prevent the production of the components for which we previously committed to pay. We also face the risk of ordering too many components, or conversely, not enough components, since supply orders are generally based on forecasts of customer orders rather than actual customer orders. In addition, in some cases, we may make non-cancelable order commitments to our suppliers for work-in-progress, supplier's finished goods, custom sub-assemblies, discontinued (end-of-life) components and Quantum-unique raw materials that are necessary to meet our lead times for finished goods. If we cannot change or be released from supply orders, we could incur costs from the purchase of unusable components, either due to a delay in the production of the components or other supplies or as a result of inaccurately predicting supply orders in advance of customer orders. These same risks exist with our third party contract manufacturing partners. Our business and operating results could be materially and adversely affected if we incur increased costs or are unable to fulfill customer orders.

Our manufacturing, component production and service repair are outsourced to third party contract manufacturers, component suppliers and service providers. If we cannot obtain products, parts and services from these third parties in a cost effective and timely manner that meets our customers' expectations, this could materially and adversely impact our business, financial condition and results of operations.

Many aspects of our supply chain and operational results are dependent on the performance of third party business partners. We increased the use of third party contract manufacturers, service providers and/or product integrators in fiscal 2014. We face a number of risks as a result of these relationships, including, among others:

- Sole source of product supply

In many cases, our business partner may be the sole source of supply for the products or parts they manufacture, or the services they provide, for us. Because we are relying on one supplier, we are at greater risk of experiencing shortages, reduced production capacity or other delays in customer deliveries that could result in customer dissatisfaction, lost sales and increased expenses, each of which could materially damage customer relationships and result in lost revenue.

- Cost and purchase commitments

We may not be able to control the costs for the products our business partners manufacture for us or the services they provide to us. They procure inventory to build our products based upon a forecast of customer demand that we provide. We could be responsible for the financial impact on the contract manufacturer, supplier or service provider of any reduction or product mix shift in the forecast relative to materials that they had already purchased under a prior forecast. Such a variance in forecasted demand could require us to pay them for finished goods in excess of current customer demand or for excess or obsolete inventory and generally incur higher costs. As a result, we could experience reduced gross margins and operating losses based on these purchase commitments. With respect to service providers, although we have contracts for most of our third party repair service vendors; the contract period may not be the same as the underlying service contract with our customer. In such cases, we face risks that the third party service provider may increase the cost of providing services over subsequent periods contracted with our customer.

- Financial condition and stability

Our third party business partners may suffer adverse financial or operational results or may be negatively impacted by global and local economic conditions. Therefore, we may face interruptions in the supply of product components or service as a result of financial or other volatility affecting our supply chain. We could suffer production downtime or increased costs to procure alternate products or services as a result of the possible inadequate financial condition of one or more of our business partners.

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• Quality and supplier conduct

We have limited control over the quality of products and components produced and services provided by our supply chain and third party contract manufacturing and service business partners. Therefore, the quality of the products, parts or services may not be acceptable to our customers and could result in customer dissatisfaction, lost revenue and increased warranty costs. In addition, we have limited control over the manner in which our business partners conduct their business. Sub-tier suppliers selected by the primary third party could have process control issues or could select components with latent defects that manifest over a longer period of time. We may face negative consequences or publicity as a result of a third party's failure to comply with applicable compliance, trade, environmental or employment regulations.

Any or all of these risks could have a material adverse effect on our business. In the past we have successfully transitioned products or component supply from one supplier or manufacturing location to another without significant financial or operational impact, but there is no guarantee of our continued ability to do so.

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

Managing change is an important focus for us. In recent years, we have implemented several significant initiatives involving our sales and marketing, engineering and operations organizations, aimed at increasing our efficiency and better aligning these groups with our corporate strategy. In addition, we have reduced headcount to streamline and consolidate our supporting functions as appropriate in response to market or competitive conditions and following past acquisitions and have increased our reliance on certain third party business relationships. Our inability to successfully manage the changes that we implement and detect and address issues as they arise could disrupt our business and adversely impact our results of operations and financial condition.

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

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

Our stock price has been volatile and such volatility could increase based on the trading activity of our institutional investors. In addition, there are other factors and events that could affect the trading prices of our common stock.

A small number of institutional investors have owned a significant portion of our common stock at various times in recent years. If any or all of these investors were to decide to purchase significant additional shares or to sell significant amounts or all of the common shares they currently own, or if there is a perception that those sales may occur, that may cause our stock price to be more volatile. For example, there have been instances in the past where a shareholder with a significant equity position began to sell shares, putting downward pressure on our stock price for the duration of their selling activity. In these situations, selling pressure outweighed buying demand and our stock price declined. This situation has occurred due to our stock price falling below institutional investors' price thresholds and our volatility increasing beyond investors' volatility parameters, causing even greater selling pressure.

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 technology companies in particular;
- Quarterly variations in our operating results;
- Failure to meet our expectations or the expectations of securities analysts and investors;

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- New products, services, innovations and strategic developments by our competitors or us, or business combinations and investments by our competitors or us;
- Changes in financial estimates by us or securities analysts and recommendations by securities analysts;
- Changes in our capital structure, including issuance of additional debt or equity to the public; and
- Strategic acquisitions.

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

Our design processes are subject to safety and environmental regulations which could lead to increased costs, or otherwise adversely affect our business, financial condition and results of operations.

We are subject to a variety of laws and regulations relating to, among other things, the use, storage, discharge and disposal of materials and substances used in our facilities as well as the safety of our employees and the public. Current regulations in the U.S. and various international jurisdictions restrict the use of certain potentially hazardous materials used in electronic products and components (including lead and some flame retardants), impose a “take back” obligation on manufacturers for the financing of the collection, recovery and disposal of electrical and electronic equipment and require extensive investigation into and disclosure regarding certain minerals used in our supply chain. We have implemented procedures and will likely continue to introduce new processes to comply with current and future safety and environmental legislation. However, measures taken now or in the future to comply with such legislation may adversely affect our costs or product sales by requiring us to acquire costly equipment or materials, redesign processes or to incur other significant expenses in adapting our waste disposal and emission management processes. Furthermore, safety or environmental claims or our failure to comply with present or future regulations could result in the assessment of damages or imposition of fines against us or the suspension of affected operations, which could have an adverse effect on our business, financial condition and results of operations.

We are subject to many laws and regulations, and violation of or changes in those requirements could materially and adversely affect our business.

We are subject to numerous U.S. and international laws regarding corporate conduct, fair competition, corruption prevention and import and export practices, and requirements including laws applicable to U.S. government contractors. In addition, the SEC has adopted disclosure rules related to the supply of certain minerals originating from the conflict zones of the Democratic Republic of Congo or adjoining countries, and we may incur costs to comply with such regulations and may realize other costs relating to the sourcing and availability of minerals used in our products. While we maintain a rigorous corporate ethics and compliance program, we may be subject to increased regulatory scrutiny, significant monetary fines or penalties, suspension of business opportunities or loss of jurisdictional operating rights as a result of any failure to comply with those requirements. If we were to be subject to a compliance investigation, we may incur increased personnel and legal costs. Our supply and distribution models may be reliant upon the actions of our third party business partners and we may also be exposed to potential liability resulting from their violation of these or other compliance requirements. Further, our U.S. and international business models are based on currently applicable regulatory requirements and exceptions. Changes in those requirements or exceptions could necessitate changes to our business model. Any of these consequences could materially and adversely impact our business and operating results.

A cybersecurity breach could adversely affect our ability to conduct our business, harm our reputation, expose us to significant liability or otherwise damage our financial results.

A cybersecurity breach could negatively affect our reputation as a trusted provider of scale-out storage, archive and data protection products by adversely affecting the market’s perception of the security or reliability of our products and services. Many of our customers and partners store sensitive data on our products, and a cybersecurity breach related to our products could harm our reputation and potentially expose us to significant liability.

We also maintain sensitive data related to our employees, strategic partners and customers, including intellectual property, proprietary business information and personally identifiable information on our own systems. We employ sophisticated security measures; however, we may face threats across our infrastructure including unauthorized access, security breaches and other system disruptions.

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It is critical to our business that our employees', strategic partners' and customers' sensitive information remains secure and that our customers perceive that this information is secure. A cybersecurity breach could result in unauthorized access to, loss of, or unauthorized disclosure of such information. A cybersecurity breach could expose us to litigation, indemnity obligations, government investigations and other possible liabilities. Additionally, a cyber-attack, whether actual or perceived, could result in negative publicity which could harm our reputation and reduce our customers' confidence in the effectiveness of our solutions, which could materially and adversely affect our business and operating results. A breach of our security systems could also expose us to increased costs including remediation costs, disruption of operations or increased cybersecurity protection costs that may have a material adverse effect on our business.

Our actual or perceived failure to adequately protect personal data could adversely affect our business, financial condition and results of operations.

A variety of state, national, foreign, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer and other processing of personal data. These privacy- and data protection-related laws and regulations are evolving, with new or modified laws and regulations proposed and implemented frequently and existing laws and regulations subject to new or different interpretations. Compliance with these laws and regulations can be costly and can delay or impede the development of new products.

For example, we historically have relied upon adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU Safe Harbor Framework agreed to by the U.S. Department of Commerce and the EU. The U.S.-EU Safe Harbor Framework, which established means for legitimizing the transfer of personal data by U.S. companies from the European Economic Area, or EEA, to the U.S., recently was invalidated by a decision of the European Court of Justice, or the ECJ. In light of the ECJ's decision, we are reviewing our business practices and may find it necessary or desirable to make changes to our personal data handling to cause our transfer and receipt of EEA residents' personal data to be legitimized under applicable European law. Additionally, the European Commission is considering adoption of a general data protection regulation that would supersede current EU data protection legislation, impose more stringent EU data protection requirements and provide for greater penalties for noncompliance. Our actual or alleged failure to comply with applicable laws and regulations, or to protect personal data, could result in enforcement actions and significant penalties against us, which could result in negative publicity, increase our operating costs, subject us to claims or other remedies and have a material adverse effect on our business, financial condition, and results of operations.

We must maintain appropriate levels of service parts inventories. If we do not have sufficient service parts inventories, we may experience increased levels of customer dissatisfaction. If we hold excessive service parts inventories, we may incur financial losses.

We maintain levels of service parts inventories to satisfy future warranty obligations and also to earn service revenue by providing enhanced and extended warranty and repair service during and beyond the warranty period. We estimate the required amount of service parts inventories based on historical usage and forecasts of future warranty and extended 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 parts inventories to satisfy customer needs and to avoid financial losses from excess service parts inventories. If we are unable to maintain appropriate levels of service parts inventories, our business, financial condition and results of operations may be materially and adversely impacted.

From time to time we have made acquisitions. The failure to successfully integrate future acquisitions could harm our business, financial condition and operating results.

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

- Failure to realize anticipated synergies from the acquisition;

- Difficulties in assimilating and retaining employees;
- Potential incompatibility of business cultures or resistance to change;
- Coordinating geographically separate organizations;
- Diversion of management's attention from ongoing business concerns;
- Coordinating infrastructure operations in a rapid and efficient manner;
- The potential inability to maximize our financial and strategic position through the successful incorporation of acquired technology and rights into our products and services;
- Failure of acquired technology or products to provide anticipated revenue or margin contribution;

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- Insufficient revenues to offset increased expenses associated with the acquisition;
- Costs and delays in implementing or integrating common systems and procedures;
- Reduction or loss of customer orders due to the potential for market confusion, hesitation and delay;
- Impairment of existing customer, supplier and strategic relationships of either company;
- Insufficient cash flows from operations to fund the working capital and investment requirements;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- The possibility that we may not receive a favorable return on our investment, the original investment may become impaired, and/or we may incur losses from these investments;
- Dissatisfaction or performance problems with the acquired company;
- The assumption of risks of the acquired company that are difficult to quantify, such as litigation;
- The cost associated with the acquisition, including restructuring actions, which may require cash payments that, if large enough, could materially and adversely affect our liquidity; and
- Assumption of unknown liabilities or other unanticipated adverse events or circumstances.

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

We were notified by the New York Stock Exchange ("NYSE") that we did not meet its continued listing requirements, and we potentially face delisting if we do not comply with NYSE standards.

We received notification from the NYSE on October 2, 2015 that we are not in compliance with the NYSE's continued listing standard requiring that our stock trade at a minimum average closing price of $1.00 for thirty consecutive trading days. Under the NYSE rules, we have until April 4, 2016 to comply with the listing standard, unless we determine that, to cure the deficiency, we must take action requiring shareholder approval, such as a reverse stock split, in which case we have until the next annual shareholder meeting which would be our annual shareholder meeting for fiscal year 2016. We have a plan in place that we believe will allow us to address the average stock price deficiency within the required period. If we are unable to regain compliance with the NYSE listing requirements, our common stock will be delisted from the NYSE, and, as a result, we would likely have our common stock quoted on the Over-the-Counter Bulletin Board, or the OTC BB. Securities that trade on the OTC BB generally have less liquidity and greater volatility than securities that trade on the NYSE. In addition, because issuers whose securities trade on the OTC BB are not subject to the corporate governance and other standards imposed by the NYSE, our reputation may suffer, which could result in a decrease in the trading price of our shares. The market price of our common stock has historically fluctuated and is likely to fluctuate in the future.

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

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

Certain changes in stock ownership could result in a limitation on the amount of net operating loss and tax credit carryovers that can be utilized each year. Should we undergo such a change in stock ownership, it would severely limit the usage of these carryover tax attributes against future income, resulting in additional tax charges, which could be material.

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 material adverse impact on our business, financial condition and results of operations.

We do not currently use derivative financial instruments for speculative purposes. We have used in the past, and may use in the future, foreign currency forward contracts and derivative instruments 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.

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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. 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.

The Company faces various risks associated with shareholder activists.

Certain shareholders have publicly advocated for certain changes at the Company. For example, in connection with a potential proxy contest related to the election of directors to the Board of Directors (“Board”) at the 2014 annual meeting of stockholders, we entered into a settlement agreement (“Settlement Agreement”) with Starboard Value LP and certain of its affiliates (“Starboard”). Pursuant to the Settlement Agreement, we agreed to, among other things, nominate candidates proposed by Starboard for election to the Board and such candidates were elected. Such activist shareholders or potential shareholders may attempt to gain additional representation on or control of our board of directors, the possibility of which may create uncertainty regarding the direction of our business. Perceived uncertainties as to our future direction may make it more difficult to attract and retain qualified personnel and business partners. In addition, a potential proxy contest would be disruptive to our operations and cause us to incur substantial costs. Future proxy contests and the presence of additional activist shareholder nominees on our board of directors could interfere with our ability to execute our strategic plan, be costly and time-consuming, disrupt our operations and divert the attention of management and our employees

Under certain circumstances, a change in a majority of the Board may result in a change of control under the severance and change of control agreements we have with our management. Pursuant to the severance and change in control agreements, certain severance payments may be triggered following a change of control, but only upon there being a qualifying termination that occurs within twelve months of any such change of control. A change in a majority of the Board may also result in a change of control under certain contracts with third parties, including our directors’ and officers’ liability insurance and our Wells Fargo credit agreement, if we are unable to secure appropriate waivers or amendments to any such contracts. The occurrence of any of the foregoing events could adversely affect our business.

ITEM 6. EXHIBITS

The Exhibit Index beginning on page 45 of this report sets forth a list of exhibits and is hereby incorporated by reference.

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SIGNATURE

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

QUANTUM CORPORATION

/s/ CHRIS S. WILLIS
Chris S. Willis
Interim Chief Financial Officer
(Principal Financial and Chief Accounting Officer)
Date: February 5, 2016

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EXHIBIT INDEX

Exhibit Number	Exhibit Description
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. †
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

‡ Filed herewith.
† Furnished herewith.
* Indicates management contract or compensatory plan, contract or arrangement.