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PRESENTATION

Operator

Greetings. Welcome to the Quantum Corporation's Third Quarter Fiscal 2023 Financial Results Conference Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to your host, Brian Cabrera. You may begin.

Brian E. Cabrera - *Quantum Corporation - Senior VP, Chief Legal & Administrative Officer and Secretary*

Good afternoon, and thank you for joining today's conference call to discuss Quantum's third quarter fiscal year 2023 financial results. I'm Brian Cabrera, Quantum's Chief Administrative Officer. Joining me today are Jamie Lerner, our Chairman and CEO; and Ken Gianella, our CFO.

This afternoon, we issued a press release, which you can access under the Investor Relations section of our website at www.quantum.com. We are using a slide presentation in conjunction with today's call, also accessible under the same section of our website.

During today's call, our comments may include forward-looking statements. All statements other than statements of historical fact should be viewed as forward-looking. These statements include any projections of revenue, margins, expenses, adjusted EBITDA, adjusted net income, cash flows or other financial items. These statements may also concern the expected development, performance and market share or competitive performance of our products or services. All forward-looking statements are based on information available to Quantum as of today's date. We advise caution in relying on these statements as they involve known and unknown risks and uncertainties we refer to as risk factors. Risk factors may cause our actual results to differ materially from those implied by the forward-looking statements, including unexpected changes in our business. We include detailed information about these and additional risk factors under the sections labeled, "Risk Factors" in our quarterly report on Form 10-Q and annual report on Form 10-K, which we file with the Securities and Exchange Commission. We do not intend to update or alter our forward-looking statements, whether as a result of new information, future events or otherwise, except of course, as we are required by applicable law.

Please note that our press release and the management statements we make during today's call will include certain financial information in GAAP and non-GAAP measures. We include definitions and reconciliations of GAAP to non-GAAP items in our press release.

If you're unable to listen to the entire call at this time, we will make a recording available for at least 90 days in the Investor Relations section of our website.

Now I would like to turn the call over to our Chairman and CEO, Jamie Lerner. Jamie?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thank you, Brian, and thank you all for joining us today. Earlier today, we announced our results for our third quarter of fiscal 2023 with revenue results that exceeded the high end of guidance and a significant year-on-year improvement in our operational performance.

Turning to Slide 3. Here is a brief overview of the results from the quarter.

We finished the quarter with \$111.2 million in revenue, which is above the preliminary results we announced in January and represents an increase of 17% year-over-year and also the highest quarterly revenue results since I joined the company.

Gross margin improved sequentially to approximately 36%.

Adjusted EBITDA increased sequentially and year-over-year to \$6.3 million, driven by improved product mix and lower operating expenses.

And we exited the quarter with approximately \$15 million of shippable backlog, which is within the range we expect to maintain going forward.

Now turning to Slide 4, I would like to share some operational insights from the quarter. We delivered year-on-year revenue growth in almost all segments of our business, including another strong quarter of hyperscale tape sales. We still see several "hot pockets" of supply constraints, but see promising signs as the supply chain for tape drives and other components continues to improve. Inflationary costs remain elevated in most cases, but as lead times come down and the market improves, we are cautiously optimistic.

Next, I would like to give an update on the rest of our portfolio. We had a strong quarter in our video surveillance business. And although that market is characterized by large deals and long sales cycles, we're encouraged by the traction we have seen since we acquired the Pivot3 surveillance business last year. We continue to be recognized for our technical innovation. And in December, we were acknowledged with 3 more surveillance industry awards.

We also saw a positive year-on-year growth with our data protection business in all 3 geographies and Enterprise IT departments continue to invest in their data protection infrastructure and strengthening cybersecurity.

Turning to Slide 5, I would like to give you an update on our transformation progress. Our end-to-end portfolio is really coming together. It is resonating with customers and partners and our customers want to do more with Quantum. As we introduce new products and convert and expand our customer base, we will continue to grow recurring software revenue as we laid out during our Investor Day in November.

1 of our key strategies to drive growth is to expand our selling motion from point products to selling "end-to-end" solutions within large organizations. I'm encouraged by the evidence of early success we are seeing with this model, particularly in Europe and Asia. I would characterize those regions as being approximately a year ahead of our North American business in terms of their ability to sell the whole portfolio.

As I've stated in the past, growing our software and systems business in North America will be a key driver for both future revenue growth and improved gross margins. We have made investments in the North American sales teams to drive growth in historically strong segments for us such as media and entertainment and the U.S. Federal government. Over the past year, we have also invested in the infrastructure and tools to expand our enterprise selling capabilities and broaden our footprint in large accounts. While I anticipate this transformation to continue into fiscal 2024, we are pleased with the progress we are making.

We are also continuing to innovate at a rapid pace. We are introducing new software features across our entire portfolio. And we have begun briefing key customers and industry analysts on the next-generation storage software that we mentioned at our Investor Day. So far, the feedback has been very positive, and we expect to begin early access trials this quarter in advance of announcing publicly in the first half of next fiscal year. This new product will further strengthen and differentiate our portfolio and allow us to participate in some of the fastest-growing segments in data storage. We'll be able to talk more about this exciting new offering in the near future.

Turning to Slide 6, I would now like to introduce our new CFO, Ken Gianella. Ken joined Quantum on January 12 as our Chief Financial Officer and succeeds Mike Dodson. I'd like to take a moment to thank Mike and acknowledge the transformational work he accomplished at Quantum as well as his financial leadership through a very challenging period. Mike will remain with the company in an advisory role until August.

Ken has extensive financial and operational experience at technology companies and his background makes him well suited to help lead us through the next phase of our strategic priorities, which include driving EBITDA expansion, delivering consistent operating results and delivering improved value to our shareholders.

Ken, welcome to the team, and I'll turn it over to you to walk through the financial results.

Kenneth P. Gianella - *Quantum Corporation - CFO*

Thank you, Jamie. It's a pleasure to be on the call today, and I'm extremely excited to be here at Quantum and for the opportunity that lies ahead as we advance the strategy that you, Mike and the rest of the leadership team started.

With that, let's get into it. Please turn to Slide 7, and I'll provide an overview of the financial results for our fiscal third quarter.

As previously highlighted by Jamie, revenue increased 12% sequentially and 17% year-over-year to approximately \$111 million, which was above the preliminary results we announced in early January. This also represented the highest quarterly revenue in the last 5 years.

Earnings per share improved over 89% year-on-year to a \$0.02 per share loss on a combination of improved operational performance and lower operational expenses, which were down 9% year-on-year.

Both GAAP operating income and adjusted EBITDA were the highest since fiscal 2021.

Looking at other metrics in Q3, shippable backlog at quarter end decreased to approximately \$15 million from \$20 million last quarter as supply constraints improved. As we are cautiously optimistic about the improving supply chain situation, we expect to maintain shippable backlog in a range of \$10 million to \$15 million going forward.

Active subscription software annual recurring revenue, or ARR, increased approximately 20% sequentially and approximately 84% year-over-year to \$11.2 million on over 660 cumulative active customers as our subscription software continues to gain traction.

Now turning to Slide 8, I would like to break down this quarter's revenue results.

Primary Storage revenue was up 1% compared to prior year and up 42% sequentially to \$14 million. Contributing to the sequential growth in Primary Storage was a solid uptick in both our StorNext file storage software and Pivot3 video surveillance solutions.

As with the last few quarters, the biggest mover continues to be our Secondary Storage systems, with revenue increasing 66% year-over-year and 15% sequentially to \$50.7 million or 44% of total revenue as we saw strong orders from both our enterprise and hyperscale customers.

Next, turning to Devices and Media. While there was some sequential improvement, revenue was down approximately \$3 million or 24% year-over-year, primarily due to less global demand for tape cartridges in the period.

Turning to our Services business. The revenue was essentially flat year-over-year. The results reflect year-over-year growth in ARR, driven by new active subscriptions, offset by a continued decline in support renewal revenue due to end-of-support-life on legacy products. We anticipate services revenue will be maintained around this level in the near term.

And finally, royalties declined year-on-year as we saw less global demand for tape cartridges.

Now turning to Slide 9. Let's review our third quarter fiscal 2023 GAAP results. GAAP net loss in the third quarter was \$2.2 million or a loss of \$0.02 per share compared to a net loss of \$11.1 million or a loss of \$0.19 per share in the prior year third quarter. This improvement was driven by significantly higher revenues and lower operating expenses due to prior restructuring actions and other cost controls.

Now please turn to Slide 10 for non-GAAP metrics. Non-GAAP gross margin was 36% compared with 37.3% in the prior year and 35.4% sequentially, both driven primarily by product mix. With the significant revenue contribution from lower-margin hyperscale sales, this product mix largely offsets the cost reduction initiatives and other favorable pricing actions taken over the last year. As Jamie mentioned, sales and product mix improvements are a top priority in support of expanding gross margins and driving increased EBITDA.

On a non-GAAP basis, operating expenses decreased approximately 5% year-over-year to \$34.5 million in the third quarter due to cost controls and a traditionally lower end of calendar year costs. We expect operating expenses to be approximately \$1 million higher in the fourth quarter due to end-of-year commissions, seasonally higher payroll taxes and other inflationary pressures.

Non-GAAP adjusted net income in the third quarter was \$1.6 million or \$0.02 per diluted share compared to an adjusted net loss of \$4.6 million or a loss of \$0.08 per share in the prior year. The significant year-over-year improvement in both bottom line results reflects the company's previously implemented cost reduction actions, combined with strong top line growth.

And finally, adjusted EBITDA increased to \$6.3 million compared with \$758,000 in the prior year. The improving EBITDA for the quarter is a combination of achieving scale at higher revenue levels, improving product mix and continuing to implement cost controls.

Now please turn to Slide 11, where I'll give an overview of our debt and liquidity at the end of December.

Outstanding debt split between Term and our Revolver was \$103.6 million, slightly down from prior year levels.

Cash and equivalents at the end of the third quarter were \$26 million compared with \$4 million a year ago.

Our net debt position of \$77.6 million gives us a Street Net Leverage of 7x our trailing 12-month adjusted EBITDA. When looking at our bank calculation, there are a few adjustments to the trailing 12-month adjusted EBITDA calculation, such as FX and inventory provisions, which give us a Bank Net Leverage of 4.6x. All of these factors put us in a good place heading into the fourth quarter.

Turning to other liquidity metrics. Interest expense in the third quarter was \$2.7 million compared with \$2.4 million in the prior year. Adjusted working capital was approximately \$73 million, up year-over-year and sequentially on higher inventory receipts at the end of the quarter. And finally, we would like to work down our DIO numbers over the next few quarters, but overall, cash conversion metrics remain strong.

Now please turn to Slide 12 for a look at the company's fiscal fourth quarter guidance.

First, we anticipate total revenue in the fourth quarter to be \$102 million, plus or minus \$2 million. At a midpoint, this would equate to a year-over-year growth of approximately 7%. The expected sequential decrease from the third quarter primarily reflects seasonality experienced at the beginning of the calendar year. This is combined with the expected normalization of shippable backlog in the supply chain going forward.

We expect non-GAAP adjusted net loss per share to be \$0.04 plus or minus \$0.02 per share based on an estimated 93.3 million shares outstanding. Adjusted EBITDA for the fourth quarter is expected to be approximately \$0.5 million.

To give some color on the non-GAAP EPS and adjusted EBITDA guide, there are a few factors I would like to highlight. For the fiscal fourth quarter, we anticipate a 2 to 3-point reduction in gross margin sequentially due to product mix that will temporarily impact our performance this quarter. This is combined with the previously discussed operating expense factoring in such as end of year commissions and other inflationary increases that will have a near-term impact to our results.

Looking forward, we do anticipate margins and EBITDA to bounce back as we take actions to improve in future quarters.

Before turning the call back to Jamie, I want to emphasize that although I've been here a few weeks, I've hit the ground running. In conjunction with Jamie and our executive team, we are actively exploring ways to accelerate our operational plan with margin expansion, improving profitability with product and structural cost initiatives and looking to accelerate growth and innovation with the introduction of new software, products, and services in the coming year.

Thank you for your time, and I look forward to meeting you all soon.

With that, I'll now hand the call back to Jamie for closing remarks.

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thanks, Ken. We had a great quarter, and we're constructive on the progress we're making. While not always a straight line, I'm really encouraged by the direction and improvements to our sales model by the recovery in the supply chain and our development of an end-to-end portfolio and upcoming new product introductions.

As Ken mentioned, while we are cautiously optimistic heading into this new year, we're not standing still. We are actively working to increase margins and profitability, looking to accelerate efforts to drive cost out of our operations, and we'll continue our innovation to remain a global leader in managing and storing unstructured data.

With that, let's open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of George Iwanyc with Oppenheimer.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

Jamie, maybe starting with the progress you're seeing on the sales front. You highlighted pretty strong results in Asia and Europe. How do you see those types of patterns being replicated in North America, like what are you focusing on nearer term?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes. The model is based on deploying sales resources into our highest margin end markets. And that has traditionally been large enterprise, certain segments of media and entertainment and large federal governments. And so, what we've been doing is going into the largest geographies, going after the largest companies and also going after segments of, again, a government business, public sector business that have traditionally been very successful for us. So, it's really been about going to where the margin is.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

Okay. And maybe digging into the seasonality you're seeing, when you maybe look further in the year, what kind of patterns should we anticipate, given the visibility you have right now?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

I would expect we have a pretty well-worn pattern that's played out for quite a few years. So, I would expect us -- and some of those patterns, we came off of a little bit with upheaval from supply chain or upheaval from the pandemic, but we see ourselves returning to more of the Quantum classic seasonality with kind of a softer Q4 and then it's building up for our strongest quarter being Q3.

George Michael Iwanyc - *Oppenheimer & Co. Inc., Research Division - Associate*

And then maybe just 1 more question for you, Ken, and congratulations on joining Quantum. So, when you look at product mix, can you kind of give us a sense of how you see that progressing from a margin perspective through the year?

Kenneth P. Gianella - *Quantum Corporation - CFO*

Yes. Thank you, George. Well, 1 of the things that we wanted to focus on with this Q4 is going to be a bit of an anomaly with what we saw the growth coming back with. If you look at the work that we've done over the prior year, we had a lot of work on margin improvement and fixing that mix. But this quarter coming up, Q4, we see particularly large volume of hyperscale, coupled with a unique customer deal that we had to be a little bit aggressive on because we wanted a real good proof point in the healthcare space, particularly genomics, to be more precise.

And gaining that proof point in a sector that has a lot of unstructured data, modeling management of large quantities of that unstructured data was important for us to grab. And so, we got a little bit ahead on the pricing than where we saw our cost downs coming on that product set. But we think that's going to start normalizing heading into Q1 and into the rest of the 2024 fiscal year. So, I think you're going to start seeing that normalize. As Jamie said, we're seeing progress within -- across the geos, particularly in our primary storage space. We see that continuing into the new year and that's really where we feel more comfortable with the strength on the margins.

Operator

Our next questions come from the line of Craig Ellis with B. Riley Securities.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Jamie, congratulations on the 5-year high quarterly revenues and Ken welcome to the team. I look forward to working with you. So, I'll start with a clarification just on the quarter's revenue upside versus initial guidance. Can you give us some further color on where that came from, more on the hyperscale side, the enterprise side? And then what was the linearity of the strength to the quarter, pretty steady or was it more back-end loaded?

Kenneth P. Gianella - *Quantum Corporation - CFO*

Well, I'll start with that. It came a little bit more back end, but the first thing we saw was strength in the supply chain coming back. So having that kind of loosen up gave us the ability to fulfill more demand, particularly within the hyperscale side of things. The linearity side, it's -- we tend to be -- month 1, month 2, a little bit lighter with month 3 coming on strong, and that linearity kind of helped through to it. But we were able to fulfill a little bit more demand because of the free up of the supply chain allowed us to ship some more of that pent-up demand in backlog.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Got it. And Jamie, I think when we spoke 3 months ago, 1 of the things you were looking for is that for some of the sales changes you are making to really help accelerate primary storage. And is that what you're seeing with the strength in Europe and Asia because headline primary was pretty flattish. But just walk us through the impacts you're getting as you make some of the adjustments to the sales team?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes. I mean I wouldn't over-rotate on primary and that we can achieve the same or even stronger margins than secondary. The DXi product is our highest-margin product. ActiveScale is also often sold software only at north of 80% margins. So, there's a lot of margin in the secondary products, and there's a lot of products in secondary that are beyond just tape hardware. But what we're seeing and what we're most focused on is the ability to sell the whole portfolio. So, we have a lot of historic accounts that bought a product from us.

And what we're seeing through the new sales teams, the new sales training and the new sales incentives is going into our accounts and selling them a primary product, a StorNext or surveillance, selling them secondary products, selling the management software, selling multiple products and often those products as a solution where we combine multiple products to solve a business problem or solve a management initiative. And I think that's been going well in Europe and Asia. And the teams were set about a year behind in North America, but I'm seeing the pipeline, the initial deals, and I think that's going to flow right through North America and have a pretty -- it should have a meaningful impact on our margins as that -- as we roll through the -- predominantly the U.S. sales team.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Got it. And related to that and selling the solution subscription adds, new customers were about 100 in the quarter. It looks like that was about the third consecutive quarter getting that many new customers on subscription. What should we think through calendar '23 for new customer adds to the program? Should it click along around 100 a quarter or do you see an inflection coming? And if so, what's the catalyst?

Kenneth P. Gianella - *Quantum Corporation - CFO*

So not giving an exact number. We're really pleased about how we're seeing the active subscription sales going. I think the thing to highlight to everybody out there is that the product set that we started with for the first set really only touches about 30% of our installed base. So, focusing with these initial set of sales and these initial set of products, we're really pleased with where the product is going, and we'd expect to continue to see strong growth and momentum there because we're going to be focusing on this and trying to acquire as our customers. And more importantly, our sales channel becomes more comfortable with the selling motions around this new product set versus just a point sale.

Craig Andrew Ellis - *B. Riley Securities, Inc., Research Division - Senior MD & Director of Research*

Got it. That installed base scoping is good context. And lastly, regarding the gross margin outlook, the decline of about 250 basis points to around 33.5%. How much of that is the big healthcare deal that you flagged versus other things? And is the recovery back north of 35% and towards 40, really just working that through? Are there new initiatives that you and the team are executing. And if so, what are they and when do you expect to get a payoff from them?

Kenneth P. Gianella - *Quantum Corporation - CFO*

Predominantly, the headwind was this large deal that we were talking about. But I don't want to downplay the other work that we're doing to continue that rotation and the margin back up. There's a lot of things that we have on deck that even in my short time here, people have been really active in showing the game plan of how we get there of making sure that we're very focused on manufacturing and our services team.

As we highlighted before, there's been a pretty steady decline within the services business with our legacy side of the business as we rotate away from these end-of-life older products. That starts bleeding off, and we're really doing a job of rationalizing how that team looks to service that base, but then also leaning into the active subscriptions to continue to fill that growth. So I think you're going to start seeing that help in '24 going forward as well as some of these actions we're taking in cost downs of products and narrowing that product portfolio to be more effective and efficient. So, it's not just the one customer flushing through deal, I think there's going to be other factors involved in a lot of self-help that is going to get us to where we need to be going forward.

Operator

Our next questions come from the line of Nehal Chokshi with Northland Capital Markets.

Nehal Sushil Chokshi - Northland Capital Markets, Research Division - MD & Senior Research Analyst

Congratulations on strong results, both on the top and bottom line. Jamie, you're talking about the progress you're making with solutions selling and note that APAC is ahead of North America. Why are they ahead?

James J. Lerner - Quantum Corporation - Chairman, President & CEO

They started earlier. They were smaller geographies that were less of a risk to our business. So, we consciously said, look, let's start there. North America is such an important part of our revenue engine. It's just kind of an unsafe place to experiment with. So, Asia and parts of Europe, we could do some trials of these new models with a much lower -- it's a lower risk. And so, we started there, had some really good success in Australia, some good access across Korea and have been having a lot of success in France, Germany, England, and now we're sweeping that across North America.

Nehal Sushil Chokshi - Northland Capital Markets, Research Division - MD & Senior Research Analyst

What are the metrics that you're looking at in these smaller geos in APAC that tells you this is indeed working well?

James J. Lerner - Quantum Corporation - Chairman, President & CEO

Yes. We look for a couple signs. 1 is, are there multiple product families on a single quote versus -- instead of just selling moviemaking or just selling video surveillance, are you able to sell multiple product families, high-speed storage, archive storage, surveillance storage all part of a single deal. So multiple product families. The second thing you'd expect with multiple product families is a larger ASP. And lastly, because you're solving a business problem versus selling terabytes capacity or terabytes, you'd expect to get a higher margin when you're solving a business problem. So that's really the trifecta is multiple product families on one quote, higher ASP and higher margins.

Kenneth P. Gianella - Quantum Corporation - CFO

Which I'll just add in, Jamie, that goes to the higher contribution per rep. So, you have the body out there that is upselling multiple products and solutions, and you're getting more yield per rep.

James J. Lerner - Quantum Corporation - Chairman, President & CEO

And with that, a lot of that run rate business where we sell a single product, we're not walking away from that business. But instead of having an outside sales rep with a very high comp plan, selling a run rate product, we're pushing more of that to the channel and more of that to our inside sales organization. So, the transactional part of our business, we're doing that more cost effectively and focusing the most skilled, experienced and expensive part of our selling engine to a multiproduct family sale versus a transactional sale.

Nehal Sushil Chokshi - Northland Capital Markets, Research Division - MD & Senior Research Analyst

That's a great color. What are -- what is the actual uplift you're seeing in terms of ASP and margin in the small geos?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes. I mean we're not putting those metrics into our package of metrics at this time, but we are seeing ASPs going up. We are seeing relevance go up. And I would measure that in the number of CIOs that are meeting with us, when we're a transactional vendor versus you're helping them solve one of their top initiatives, I just think we're seeing more relevance. We're getting more time. We're getting more mind share. And I have visibility into the quotes that we're putting out in the future and I'm seeing the quotes get bigger.

And another sign of it working is when you're solving a business problem, you can't win with a quote. You have to write a proposal and describe what you're doing, describe how you're going to change their business or help their business. And it's amazing how many more proposals we're putting out than where we used to just kind of drop a quote and you're basically winning on price or winning on availability of materials. Now we're winning on the merits of the solution and the uniqueness of the solution. And that's -- it's taken a number of years to get here, but we really have the portfolio now where we can assemble highly differentiated proposals versus cost-effective quotes.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Okay. Great. And then, Ken, this is a much tighter range of revenue guidance and what I think we've typically been seeing over the past 4 or 6 quarters. Is this one of the philosophies that you're bringing to the table or is this just simply a reflection of better visibility?

Kenneth P. Gianella - *Quantum Corporation - CFO*

A little bit of both, right? I mean I think, #1, it's important to -- we want to send a signal to our investor base that as we look down the road, this is what we have a feel for. But also more importantly, we didn't want to put such a large range out there that it would skew people's thoughts because, again, great quarter we had in Q3. But the seasonality that we saw coming into this quarter, we really wanted to send a signal that we had visibility into the range, and we didn't want people to get ahead of themselves of -- on the numbers. So that's the reason why we put a little bit of a tighter range this time. As we go into the new year, we're going to be looking at as we get more visibility, some other metrics and way to give you guys a little bit more of a near-term view, not just a quarter view of what we're thinking and where we're going. And as I work with the team and Jamie, we're going to see where we can expand some of that visibility for you all in the future.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Okay. Great. And then any early thoughts on fiscal year '24? It looks like based on what you're guiding to here, you've been excluding the train of backlog you've had probably about 5% year-over-year growth in demand here. Is that how we should be thinking about for fiscal year '24 or is a different framework we should think about here?

Kenneth P. Gianella - *Quantum Corporation - CFO*

Well, I appreciate the effort, but we're not guiding '24, but we did want to give people a view on a couple of key metrics that were slightly down this quarter that we don't believe that, that is going to be a trend going forward, particularly on the margin side of it. So, I think we'll give you guys the '24 guidance in a couple of months here.

Nehal Sushil Chokshi - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Okay. And any thoughts on what the macro backdrop looks like for you guys?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes. I mean, I know a lot of my peers are signaling slowdowns and conservativeness and I don't want to second guess them. We're guiding up 7% year-on-year, right? So, we're guiding the strongest revenue quarter in quite a few years in our Q4. So, we're not guiding to signaling we're seeing a big slowdown. I mean I don't -- and that may just be a reflection of the segments we play in. I mean our biggest segment is secondary storage, which is protecting and backing up data. And I don't think that correlates to global economies, meaning if the economy is doing poorly, people don't say, well, I guess, we're not going to back up our data. You're still going to back up and protect your data.

So, the trend we're dealing with is less of a macroeconomic trend. It's a trend that the world is creating more data, regardless of what the economy does, and the data needs to be protected and backed up. I do think the moviemaking industry is seeing a recovery, and they're making just as many movies as they did in the past. I think ransomware, whether there's a good economy or a poor economy, I think people are spending money to protect against ransomware. So, the segments that we play in predominantly do not seem to be negatively affected the way laptops and other parts of -- other segments are being impacted. So right now, our guide does not guide to seeing major negative macroeconomic trends.

Operator

Our next questions comes from the line of Eric Martinuzzi with Lake Street Capital Markets.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Yes, I had a question regarding the guidance. If I go back the past couple of years, the sequential revenue Q3 to Q4 last year, we were flat. The year prior to that, we were down about \$6 million sequentially. I understand there's seasonality, but it seems like a pretty dramatic step down Q3 to Q4. Would you care to comment on that?

Kenneth P. Gianella - *Quantum Corporation - CFO*

So I think the prior flat, I'll start with was more supply chain driven than anything. I think the other step down, if you will, going back to what this current quarter looked at, the supply chain loosening back up allowed us to fulfill a little bit more of that hyperscale demand, which had a little bit of elevation in the quarter. I go back to what Jamie said, though, a 7% year-on-year number. And if you look, it's the strongest Q4 that we've had in several years, even before the supply chain impacting it, that we think it's a strong indication heading into '24.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

So really, the supply -- the outperformance in Q3, you're saying that supply chain loosening helps or created kind of a bigger starting point. Okay.

Kenneth P. Gianella - *Quantum Corporation - CFO*

Yes it does.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

And then -- just again, the sequential guide on the adjusted EBITDA also seems -- I know we're talking about the product mix, taking roughly 2.5% out of that \$102 million midpoint guide another \$1 million for the OpEx higher, but that still seems -- the \$0.5 million of adjusted EBITDA seems like a pretty dramatic step down. Is that conservatism that you're kind of baking in there just from the \$6.3 million and the \$0.5 million seems dramatic?

Kenneth P. Gianella - *Quantum Corporation - CFO*

I think mix has a lot to do with it. So if you start with your top line and looking at what you're shipping out there, the mix with the hyperscale plus this 1 customer, that's a lot of fall-through to EBITDA that was an impact. We were purposely mindful to also point out the OpEx increase with the commissions and the other end of year elements. We are seeing some inflationary pieces where the OpEx run rate will probably be more around that 35%, 36% range going forward with some of that inflationary and merit pressures going forward. So, you take the \$1 million from the OpEx piece that we called out, give or take, and then you call out the points of margin, that's about 2 to 3 plus of EBITDA that fell off.

Eric Martinuzzi - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Okay. And then royalty continues to dwindle here. I think on a year-on-year basis, I'm looking at -- if I just replicate what you did in Q3 into Q4 would be off about 20%. I know you're not guiding at the product line, but just at a high level, is this the new normal? Should we anticipate continued erosion on the royalty?

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Yes. I think it's probably safe to say, I think we were at \$2.8 million. I think \$2.8 million is the new normal. And none of us have a crystal ball, but I'd say unless something changes, I think running around \$2.8 million is about right for your model.

Operator

There are no further questions at this time. I would now like to hand the call back over to Jamie Lerner for any closing comments.

James J. Lerner - *Quantum Corporation - Chairman, President & CEO*

Thanks, everyone, for joining us today. We're pleased with the results and have a lot of work in front of us, but it's great to have Ken on board and have some fresh legs here, and we're excited about Q4 and entering the new year. So, thanks, everyone. Thanks for joining.

Operator

Thank you. This does conclude today's teleconference. We appreciate your participation. You may disconnect your lines at this time. Enjoy the rest of your day.

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