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PRESENTATION

Operator

Good afternoon, everyone, and thank you for participating in today's conference call to discuss Quantum's financial results for the second quarter fiscal 2022. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to Brian Cabrera from Quantum. Please go ahead.

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

Good afternoon, and thank you for joining today's conference call to discuss Quantum's Second Quarter fiscal 2022 financial Results. I'm Brian Cabrera, Quantum's Chief Legal and Compliance Officer. Joining me today are Jamie Lerner, Chairman and CEO; and Mike Dodson, CFO.

This afternoon, we issued a press release, which you can access a copy of on Quantum's website at www.quantum.com under the Investor Relations section. There is also a slide presentation that we will be using in conjunction with today's call that may be accessed through the webcast link on the IR website and is also posted as a PDF in the Investor Relations section.

As a reminder, comments made during today's conference call may include forward-looking statements. All statements other than statements of historical facts could be deemed as forward looking. Quantum advises caution on reliance on forward-looking statements. These statements include, without limitation, any projections of revenue, margins, expenses, adjusted EBITDA, adjusted net income, cash flows or other financial items. Also, any statements concerning the expected development, performance and market share or competitive performance relating to products or services. All forward-looking statements are based on information available to quantum on the date hereof. These statements involve own and unknown risks, uncertainties and other factors that may cause Quantum's actual results to differ materially from those implied by the forward-looking statements. Including unexpected changes in the company's business.

More detailed information about these risk factors and additional risk factors are set forth in Quantum's periodic filings with the Securities and Exchange Commission. These risk factors include, but are not limited to, risks and uncertainties listed in the section entitled Risk Factors in Quantum's quarterly report on Form 10-Q and annual report on Form 10-K as filed with the SEC. Quantum expressly disclaims any obligation to update or alter its forward-looking statements, whether as a result of new information, future events or otherwise, except as required by footfall law.

Additionally, the company's press release and management statements during this conference call will include discussions of certain measures and financial information in GAAP and non-GAAP. Included in the company's press release are definitions and reconciliations of GAAP to non-GAAP items, which provide additional details.

For those of you unable to listen to the entire call at this time, a recording will be available for at least 90 days in the Investor Relations section of Quantum's website.

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

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

Thank you, Brian, and thank you all for joining us on today's call. Earlier today, we announced strong results for our second fiscal quarter, with revenues that exceeded the high end of our guidance. Customer demand remained robust during the quarter, demonstrated by the material increase in our backlog, which grew sequentially to $50 million from $30 million last quarter. Increased traction with our hyperscale customers continued as we delivered a third consecutive quarter of sequential order growth. We also demonstrated progress in our software businesses and saw continued momentum in our subscription and services backlog. The ongoing industry supply constraints improved during the quarter but still restricted our ability to meet all end customer demand. We anticipate supply chain will see further improvement in our third fiscal quarter, which should allow the company to see a sequential reduction in current backlog levels.

In the second quarter, we saw another quarter of revenue acceleration within our software and subscription customers, which grew 30%, albeit from a small base, but equally impressive was our bookings, which grew more than 70% sequentially. Our CaTDV product line delivered the second consecutive quarter of increased bookings with traction across sports, entertainment and enterprise markets, demonstrating our ability to cross-sell quantum solutions to customers with multiple needs and applications.

On the product and technology front, we completed the acquisition of Pivot3's video surveillance business and recently announced the acquisition of EnCloudEn, a hyper-converged start-up, which will help further establish Quantum as a leading player in the surveillance market. Also during the quarter, we announced major innovations for long-term data archiving and cyber protection, new as a service offerings and a partnership with IBM on the next-generation of LTO technology. All of these actions are strategic components to building a complete portfolio of solutions to meet customers' unstructured storage and archiving requirements across multiple end markets.

We are pleased that during the quarter, we were recognized by Gartner as a visionary in the 2021 Magic Quadrant for distributed file and object storage and recognized as the number 1 brand for secondary storage based on end user survey results published by Coldago research. We view the recognitions from third party research firms as validation of our long-term strategy with a focus on transitioning towards a higher mix of software and subscription services.

One of the key aspects of our long-term transformation is transitioning from selling mostly hardware appliances as our product mix suggests today towards selling primarily software and services in a recurring revenue model. Our portfolio of software-based offerings has come a long way in the last 2 years to 3 years. And we have built a broad portfolio of solutions, which target storing, managing, protecting and enriching data through both internal development and strategic acquisitions, our portfolio now includes software, which covers numerous aspects of the capture and storage of data, such as indexing, cataloging and tagging data, high-speed file and block software for ingesting and processing video and images files, object storage software, hyper-converged software for mission-critical surveillance workloads, deduplication software or data protection and cloud-based AIOPs software to monitor all of these operations around the world. Over the last year, we transitioned 3 of our product lines to software or subscription licensing.

In the past, quantum typically sold customers' hardware appliances, combined with software. Today, we're now transitioning away from providing appliances towards a subscription-based model in which quantum software is the key aspect of the overall solution sale. We have roughly 200 customers utilizing software and subscription services, and we anticipate future levels of adoption will continue to accelerate.

In the coming quarters, we will be transitioning more products to subscription licensing, including CaTDV, DXi deduplication software and EnCloudEn hyperconverged software. Our long-term strategic transition towards higher margin software and services is seeing strong initial uptake, and we look forward to sharing additional metrics on this business during our upcoming virtual Analyst Day on November 9.

We continue to gain both market share and customer traction within hyperscale archive infrastructure. We are now in production with multiple hyperscale and web scale companies and have secured additional design wins and use cases at 2 major hyperscalers within the last quarter, including a $5 million web scale company win, demonstrating the value quantum offers in supporting the massive archived needs of these global data behemoths.

As noted, our backlog has reached a new record level at the end of the second fiscal quarter. And while not all backlog represents potential revenues in the upcoming quarter, our end demand remains robust across hyperscaler customers. One positive that has emerged during the recent industry supply constraints is that we are seeing significantly higher levels of visibility into future revenue contribution from this vertical compared to just a year ago.

We have made a few significant announcements in October that speak to our leadership in the hyperscale space. And our strategy to offer large data archive solutions to web scale companies and enterprises. We recently announced ActiveScale cold storage, which is a new type of storage for ActiveScale based systems, which combines Quantum tape hardware with patent pending erasure coding software. In keeping with our long-term transition strategy, we can offer customers the solution-as-a-service. Thus enterprises will be able to build a large private cloud quickly and effectively in any data center they may choose with a fully managed quantum all-inclusive subscription pricing model.

The new ActiveScale cold storage solution delivers up to 80% savings relative to archiving data on disk and provides much better durability than any other tape based archiving solution, while practically eliminating the risk of data loss. Also in October, we announced a partnership with IBM on the next-generation of LTO technology. Under the terms of the agreement, Quantum will collaborate with IBM in development of LTO-10 tape drives and media to help accelerate the time to market, capacity and performance of the next-generation LTO drives.

Earlier this week, we announced our ransomware solution, which provides customers an industry first implementation, which creates a physical block between tape drives and the robotic arm of the typical tape-based system. While simplistic in its design, this additional step, which requires an individual to remove a mechanism prior to drive removal ensures data storage on tape can provide enhanced protection relative to networking cybersecurity offerings as drives remain completely offline, secure and provide the ultimate level of data security for cyber resilient archives.

For customers using Quantum based tape drives for archival storage, cyber criminals would have to physically enter the data center to gain access to any data. In total, we believe Quantum has established both the market and architectural leadership position when it comes to long-term data archiving and hyperscale customers and now broadening into the enterprise. A key element of our strategy is to expand our addressable market into the largest data storage market, video surveillance.

Today, surveillance cameras are the number 1 generator of data on the planet, and the total number of cameras as well as the resolution required of the cameras is continually increasing. Overall required retention times of video surveillance data is increasing as well. As organizations are using surveillance data for more than just loss prevention. Combined, all these trends lead to a need for more storage capacity, more infrastructure, more software and more video analytics. Over the past few months, we made 2 acquisitions to jump-start our presence in this market. We acquired the video surveillance business from Pivot3, which brought over 500 customers, including major airports, large hotels, major safe city deployments and major customers in the Energy & Utilities sector and critical infrastructure. This acquisition also brought an established sales channel, along with an expertise in the video surveillance market and key engineering and support personnel for supporting these customers.

We also acquired a small hyperconverged software start-up based in Bangalore called EnCloudEn. The company is a start-up, which has developed hyper-converged software that is both hardware and hypervisor agnostic. So, it is much easier to deploy as standalone software, running on any White Box hardware and is available today on a subscription model.

In summary, we delivered solid financial results, making tremendous progress toward our transformation agenda and remain poised for a strong second half based on customer order strength, our current backlog and anticipation that the industry supply constraints will see further improvement during the third quarter. We have clear momentum entering the second half of our fiscal year, and I'm looking forward to our virtual Analyst Day next week on Tuesday, November 9th, where our executive team can share more about the progress and outlook for our long-term strategy.

To talk more about the results, I'd like to turn the call over to Mike Dodson, our CFO, to discuss the financials. Mike?

James Michael Dodson - *Quantum Corporation - CFO*

Thank you, Jamie. Welcome to everyone that has joined our call today. Our second fiscal quarter of 2022 represented another quarter of strong customer demand. Revenue for the quarter was $93.2 million, which includes the expected $2 million from Pivot3 and is up 9% from the same period last year and 5% sequentially, exceeding the high end of our guidance range.

The second fiscal quarter revenue doesn't include just over $15 million of orders that were requested by customers in the quarter, but could not be fulfilled due to supply constraints, bringing our total backlog to $50 million as compared to $30 million last quarter.

Secondary storage revenues in the quarter were sequentially slightly down as ongoing industry supply constraints continue to restrict our ability to meet all near-term customer demand. Primary storage system saw a meaningful sequential increase in revenue due to continued recovery in our M&E and federal verticals during the second fiscal quarter. Both verticals have seen multiple headwinds over the last year driven by COVID and other impacts, and we are pleased with the improvements. The slight sequential decrease in devices and media, similar to our first fiscal quarter, were impacted by the supply constraints.

As Jamie discussed earlier on the call, we continue to transition our hardware product offerings to recurring software licensing as well as the recently announced new archive storage as a service offering. In future periods, we believe we will see an acceleration of the conversion of our existing customers as well as signing up new customers. In addition, as Jamie also highlighted, in the coming quarters, we will be transitioning more products to recurring revenue licensing, including CaTDV, DXi deduplication software and EnCloudEn hyperconverged software.

Our unprecedented backlog is a result of the strong demand we have seen across our business, but related shipments were limited by the ongoing industry supply constraints. While we remind investors that not all backlog represents potential revenue in the immediate quarter, it is indicative that the underlying business trends remains solid. The backlog also provides greatly improved visibility from our growing hyperscale business. As we noted during our last quarter earnings call, our business has historically had a relatively low level of backlog, typically comprising of less than 5% of our reported quarterly dividend.

To provide a bit more color related to the $50 million ending backlog. Just over 85% of the backlog was related to tape products, with just over 70% of the backlog, specifically related to hyperscaler customers. Approximately 2/3 of the backlog is expected to be shipped in the second half of fiscal 2022, and the remaining 1/3 of the backlog has shipped as early in fiscal year 2023.

As we mentioned in our press release today, we anticipate supply chain constraints will see further improvement in our third fiscal quarter, which should allow the company to see a sequential reduction in our current backlog levels. GAAP gross margin in the second fiscal quarter was 41%, down approximately 0.5 point from the prior quarter. The non-GAAP gross margin equaled 42% in the quarter, flat sequentially with the first quarter. Towards the back half of the quarter, we experienced higher costs incurred in the supply chain that accounted for just over 1% of gross margin pressure during the quarter, and we expect this same level of cost pressure for the entire third fiscal quarter, which is expected to impact our gross margin by as much as 2 percentage points.

GAAP operating expenses in the second quarter were $39.3 million compared to $37.3 million in the prior quarter. Non-GAAP operating expenses in the second fiscal quarter were $35.4 million, an increase of $2 million sequentially. The sequential increase in non-GAAP operating expenses was primarily due to the inclusion of operating expenses related to Pivot3 and improved sales spend to support new product introductions and long-term growth initiatives. Overall, G&A spending was down $400,000 sequentially, primarily due to lower professional fees related to the timing of audit services.

GAAP net loss in the second fiscal quarter was $9.3 million or a loss of $0.16 per share, which included debt extinguishment charge of $15 million, partially offset by the $10 million gain from the forgiveness of our prior PPP loan. This compares to a net loss of $4.2 million or a loss of $0.07 per share in the prior fiscal quarter.

Excluding stock compensation, restructuring charges and nonrecurring charges, non-GAAP adjusted net income in the second fiscal quarter was $113,000 or breakeven, exceeding the high end of our guidance range compared to adjusted net income of $125,000 or breakeven in the prior quarter.

Adjusted EBITDA during the second fiscal quarter was $5.3 million, which exceeded the high end of our guidance range and was roughly flat sequentially. There is a full reconciliation of our non-GAAP results to the most directly comparable GAAP measure in both the press release and the Form 10-Q released today.

Now turning to the balance sheet, liquidity and cash flows. Cash and cash equivalents and restricted cash were $23.2 million as of September 30, 2021, compared to $24.6 million on June 30, 2021. Adjusted working capital, excluding deferred revenue balances decreased by $2 million during the second fiscal quarter to $56 million from $58 million at the end of the prior fiscal quarter. This decrease was primarily the result of an increase in current liabilities, partially offset by higher levels of working capital assets.

Outstanding long-term debt as of September 30, 2021, which included $10 million drawn down on the revolver, was $101.4 million after netting $4.9 million in unamortized debt issuance costs, plus $3.1 million in current portion of long-term debt. This compares to $81.3 million of outstanding debt as of June 30, 2021, after netting $8.8 million in unamortized debt issuance costs and $11.9 million in current portion of long-term debt that included the $10 million PPP loan that was forgiven in the second fiscal quarter.

As a reminder, we successfully refinanced our long-term debt early in the second fiscal quarter, following a paydown of half of the term debt balance in the quarter ended March 31, 2021. Collectively, these transactions have reduced our annual interest expense by $22 million with a pretax EPS benefit of approximately $0.37 per share and a reduction of annual cash payments for interest of $15 million. Excluding the increase in the revolver balance at the end of the second quarter, the sequential increase in the net debt balance is related to incurring prepayment penalties, lender fees and legal fees to complete the refinancing. The company also paid from cash reserves, $3.7 million to cover a portion of these charges to complete the refinaning.

So taking into account the revolver balance of $10 million at the end of the second fiscal quarter, net cash decreased by $11.4 million. This decrease was primarily due to the $5 million cash payment for Pivot3, $3.7 million for refinancing costs and CapEx of $1.2 million.

Finally, turning to our financial outlook. Given the continued strength in customer demand and continued improving conditions and supply chain constraints for the third fiscal quarter of 2022, we are guiding revenues of $104 million, plus or minus $5 million. Non-GAAP adjusted net income of breakeven, plus or minus $1 million; non-GAAP adjusted net income per share of $0.00, plus or minus $0.02, and adjusted EBITDA of $5 million, plus or minus $1 million. Currently, we are maintaining our full year revenue guidance range of between $380 million to $420 million, with the range reflecting the potential timing and magnitude of the supply chain improvements.

With that, I'll turn the call back to Jamie for closing comments. Jamie?

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

Thanks, Mike. Our fiscal second quarter delivered strong financial results with both sequential and year-on-year revenue growth, exceeding our guidance on all key metrics. Our quarterly bookings have continued to see momentum, which resulted in another quarter of record backlog entering the third fiscal quarter. Our long-term transition towards a higher mix of software and service subscription revenue continues to progress, validated by another quarter of increased bookings for our CaTDV solution. We expanded our addressable market in video surveillance and large data archives, while demonstrating continued growth as we make progress in building a base of recurring revenue from software and subscription services. Combined with our view of an improving supply chain picture, we believe Quantum remains poised for a strong second half of fiscal 2022.

Please join us next week at our virtual Analyst Day event. You can register at investors.quantum.com. We appreciate your continued interest in Quantum. With that, we'll now take any questions you may have. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from Craig Ellis from B. Riley.

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

Congratulations on the financial performance in the quarter. Jamie, I wanted to start with just a high-level question. Given what you saw intra-quarter with some of the supply chain issues, is it reasonable to think that the worst of the supply chain pressures is behind quantum? Obviously, they're still out there and still out there for everybody. But do you feel like the ops team and your suppliers are in a better position than where we were 3 months ago now?

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

Yes. I mean, with the information we have in front of us, I would say it's a dramatically different situation. What I know now is for the last several weeks, we've received among the highest weekly shipments of the constrained tape component that we needed the most. So we have several weeks of evidence. I always said that in October and November, we'd see it strengthening, and we've seen that. So we are receiving much larger shipments of the tape component that we lacked. Now we are getting other surprises across our products. Sometimes it's hard drives, sometimes it's NVMe, sometimes it's just a random cable connector. We are seeing other surprises, but their magnitude is much less. So overall, the situation has improved dramatically. You see that in our guidance, and we expect to start burning down through that somewhat enormous backlog over the next 2 quarters to 3 quarters.

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

That's very helpful. And then the second question is really a multipart question on the primary storage business. So great to see it up 45% with a recovery in media and entertainment and federal government. The question is, is that recovery in those 2 segments, sustainable and Mike, given the strength in primary in the quarter, why wouldn't we have seen more improvement in primary -- or excuse me, not primary, but product gross margins in the quarter given what should have been favorable intersegment mix dynamics?

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

Yes. Craig, I'll speak really quickly to the market conditions. Media and entertainment is stronger in television and sports but I still think feature films and film in general, feature films, motion picture, things with theatrical debut is still, I would say, touch and go. It's certainly not the production -- there just aren't as many movies being filmed today as there were, and there's not as much spend on the equipment. But we are seeing strength in primary in that we're selling our products to more verticals. We had a goal to move beyond media and entertainment into genomics, life sciences, medical imagery, scientific computing. And I think we've -- we're starting to see that diversification of end markets starting to play out.

Now I will tell you, though, one of the things you may recall, though, in primary storage, it was one of the first products where we separated the hardware from the software, and we're selling the software on subscription. So our most -- our highest margin, most valuable sale of software is not recognized upfront anymore. It's recognized usually on a 3-year term. So we're starting to see the impact of moving our business model to a subscription model, where that software that we used to get paid upfront is now over typically a 3-year contract. So that deferred revenue is impacting that. And that's why there's so much pressure on us to show you the other side of the equation, which is the ARR, the TCV and the RPO that's coming from that. And we're going to start providing some insight into where we are with that at our investor conference, and we're still committed that in Q4, we're going to start showing the ARR and all the deferred revenue from our software subscription business.

James Michael Dodson - *Quantum Corporation - CFO*

Yes. And Craig, what I would add to that is, as I had mentioned in my comments, we were -- we had higher supply chain costs. We figured it impacted us about 1 percentage point across the board. So that was another factor that was weighing down on our gross margins.

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

And that's -- and there's an incremental 200 basis points, you think, in the fiscal third quarter, is that you mentioned in your remarks, Mike?

James Michael Dodson - *Quantum Corporation - CFO*

Well, yes, we expect that to be even bigger in Q3, right, up to 2 points. And we are working to add a surplus charge to our customers at 1.75%. So we're hoping to minimize that or offset that. But we do see those costs being higher going forward as well.

Operator

Our next question today is coming from Nehal Chokshi from Northland Capital Markets.

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

Congrats on the strong results. Given the supply constraint issues affecting everyone, presumably, guidance is more reflection of supply expectations rather than demand expectations. So can you share what your expectations are for bookings, any change in RPO plus revenue? That's the question there.

James Michael Dodson - *Quantum Corporation - CFO*

Well, we don't give guidance on bookings, but we still see continued demand. We do expect at the level of revenue that we have forecasted that our ending backlog next quarter will be lower than $50 million. So we will be utilizing or burning up some of that backlog, but still a very strong demand environment.

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

And is it the right way to calculate bookings to look at the change in RPO plus revenue, and that would be your bookings number? Or is there something else going on there?

James Michael Dodson - *Quantum Corporation - CFO*

Well, the RPO number that's in the 10-Q, that is that basically the deferred revenue plus our backlog. So as we burn down our backlog, that number will come down, and then it will move just as deferred revenue, which deferred revenue can be a bit lumpy, especially as we go into the December quarter because a lot of our customers sign up new contracts. So you would expect that to go up.

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

And then given that 1/3 of backlog is for early FY '23 delivery, does that mean that most of the incremental backlog that you've collected up in the current quarter was due to increased visibility that was discussed with respect to hyperscalers and thus, bookings for FY '22 relative to a quarter ago is about the same?

James Michael Dodson - *Quantum Corporation - CFO*

Yes. I mean it's fair to say that the bookings that are out in next year, FY '23 is kind of the normal run rate. We just have visibility. We just have the assurance that we've got the orders in hand.

Operator

(Operator Instructions) Our next call is coming from George Iwanyc from Oppenheimer.

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

And I'll also add my congratulations on the solid results. Jamie, I know you mentioned that you're already starting to see some cross-selling synergies with the Pivot3 acquisition. Could you give us an update on overall sales productivity, sales additions in addition to the people that you added with Pivot3?

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

Yes. So we will be adding the sales of Pivot3 to our primary storage business and not be breaking out its results separately. That being said, whenever we make an acquisition, we put a 3-year pro forma together with quarterly sales targets. And both last quarter and our projections this quarter is we'll be beating that plan. And what's happening is just as you indicated, we have the former pipeline that Pivot3 had. But now what you have is a very large installed base of stadiums, banks, local governments, federal governments, defense organizations. Our entire sales team is now compensated to cross-sell surveillance into our large and loyal installed base, and we're starting to see quite a bit of traction from that. In the pipeline as well as in quarter. So we are, right now, for last quarter and for the quarter in front of us, we're beating our internal objectives with our surveillance business.

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

And just following up on that, a couple of questions. One, you're seeing based on the segment split, very strong traction in EMEA and APAC. Can you give us a sense of some color behind that? And then just kind of a bookkeeping. I believe the $380 million to $420 million guidance previously excluded Pivot3, is that still the case? Or am I correct on that? And how should we look at the full year guidance?

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

Yes. We've put in new sales leaders in both EMEA and Asia, and they've both been on board just about a year. And so what you're seeing is the impact of the new ideas, the new energy, the new strategies they put in place. Also in EMEA, I think you're seeing a lot of strength in our data protection business because of data sovereignty issues, data export issues, laws in different countries. There's more I'd see more often people use on-premise backup strategies as well as in Europe and in Asia, we've really put a strong focus on our enterprise business. In the U.S., I think we put a lot of energy into media and entertainment, and that is weighing a little more on the historic rough results in North America, whereas in Europe and in Asia, they're more balanced across enterprise and media and entertainment. But also in Asia, when we were financially pressured, we really put very little energy into Asia. And over the last 1.5 years, because of the enormous populations in India, the enormous populations in China, we know that they're going to be media and entertainment, hotspots, we've also modified our portfolio to be more relevant in those markets, be priced more appropriately for those markets. We have ways to build in those markets. And we're seeing a lot of traction from that. And we think we're going to do a lot more across the Middle East, a lot more across Europe, beyond just the 3 large economies. And we're just pressing into more places like China, India, Brazil, and we're starting to see the results of those efforts.

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

And just on the Pivot3 inclusion and the $380 million to $420 million right in there or not?

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

I'll let Mike to address that.

James Michael Dodson - *Quantum Corporation - CFO*

Yes. When we gave the guidance last quarter, we said it was not including Pivot3. What we said about Pivot3 was it was about $2 million, and that's what we talked about in the script that this quarter included $2 million. When we look forward, it's a business unit, and we really don't break out the revenue at that level. But we also believe it's not something that's so material as to change our guidance. So that's kind of how we're treating it.

Operator

Our next question today is coming from Eric Martinuzzi from Lake Street.

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

Yes, I want to address the guidance. Just -- it seems like a pretty wide band. If I look at the back half of the year, we're talking about on the order I don't know, $200 million to $240 million, anywhere from $100 million to $120 million a quarter. Why aren't we tightening that band a little bit given the backlog that we're talking about?

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

Yes. I mean, that's a good question. Our backlog does give us more visibility and help us drive our contract manufacturers with better visibility as far as the orders. But we also still have the uncertainties of the supply chain. So just given those uncertainties, we wanted to keep it a little broader than we typically do. I mean, we usually go, say, $4 million. So it's not significantly broader, but it is a little broader than we typically do.

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

Okay. And then just following up, kind of related to gross margins, but also kind of related to the revenue. What about a price increase, you're obviously seeing price pressures, whether it's the actual cost of goods or expedite and freight fees, what about raising the price list so that we've got some relief on the revenue side or the cost of goods?

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

Yes. We're actually have instituted a series of those programs. We first instituted a 1.75% across the board, surcharge to deal with predominantly the increase in transportation fees and shipping fees. Certain of our products when we moved the StorNext product to subscription. And as we're moving DXi to subscription in that, we're instituting price increases in the 8% to 15% range based on various products. Same thing with ActiveScale cold storage with the introduction of that product, we've added price increases. We introduced the 84,000, and we'll be introducing the 84,000 to essentials. And those are both at premium pricing as well. So we are doing a combination of surcharges across the board and then product-specific price increases as well. And for our large customers who are ordering or putting purchase orders down that are very large and require us to buy a very large amount of materials. We're moving to a model where we're going to be asking for deposits to help offset the cost of the amount of materials, some of them we have to buy 6 months, 9 months and even 12 months ahead of orders. These very long lead time materials, we'll be asking for deposits for as well. So we're instituting a variety of programs to offset the inflationary environment that we're in.

James Michael Dodson - *Quantum Corporation - CFO*

And one thing¦

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

Go ahead, Mike.

James Michael Dodson - *Quantum Corporation - CFO*

Yes. Just to add on to that, understanding that anywhere where we've got orders already, you've got to honor that pricing. So it takes a little bit of time for that to work in.

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

Right. Right. The use of the word surcharge, is that to assume? Is that the same thing as saying you expect it to be temporary and that the surcharge goes away?

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

Yes. I mean, I think -- or I would expect that the amount of expediting that we're doing, the amount of -- we're paying extra to get drivers, quite frankly, to get trucks to show up on time. We're paying a premium for that. And I would expect as things settle down, that isn't a normal course of business.

Operator

Next question today is coming from David Duley from Steelhead Securities.

David Duley - *Steelhead Securities LLC - Managing Principal*

As far as the products that you plan to move to the software and service model. How far along are we that along are you with that program as far as total revenue goes? And what you expect to move to that model? How far along are you on that?

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

I think we are at the final stages. So we moved in last November, so a year ago, StorNext, ActiveScale, and the all-terrain file system to subscription. We are now this month moving DXi to subscription, and moving CaTDV to subscription. We launched ActiveScale cold storage as a service. So it's on a subscription. We have StorNext in the Amazon marketplace, which is on subscription. The only thing at this stage that is not on subscription is our surveillance business and our tape hardware business. Now the tape hardware will more increasingly sell as part of ActiveScale cold storage and we'll be moving the surveillance business to both software and the software subscription. But our traditional businesses of DXi, ActiveScale, StorNext, they're all being moved over now. And I think Q4 will be our first quarter where basically everything accepts surveillance and tape hardware will be on subscription. This in the Q3, we'll be making the final moves over. And Q4 will be a complete quarter where, again, everything except surveillance and tape hardware is going to be on subscription. And that quarter will announce the more modern metrics, if you will, for a subscription business of TCV, RPO and ARR. Well, at the Investor Day, give you what you should expect that will exit the year at in ARR and what you can expect total recurring revenue looks like at the end of our fiscal '22.

David Duley - *Steelhead Securities LLC - Managing Principal*

Okay. And a follow-up. On gross margins, I think I understood your explanation, but maybe you could just dig in a little more detail. When you move to a software and subscription model, typically, gross margins go up, yes, we're seeing them go down a little bit.

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

Sure.

David Duley - *Steelhead Securities LLC - Managing Principal*

Could you just see the math on the front room in the back end like you were talking about. So we get a clear picture as to when they're going to get better again?

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

I mean I'll walk through an example, and I think Mike will give you more color. We closed a large sports company where they bought $2 million of the StorNext software. Now in our old model, I would have recognized that $2 million of software, which is at 80 points or 90 points of margin, we would have recognized it now. But instead, we recognized probably 1 months or 2 months of that, and the other 34 months of that will be recognized over the next 34 months. So what we're doing as we rather than -- like CaTDV, if I sell $1 million of CaTDV, in the old days, we'd recognized $1 million in quarter, now I recognize $136 per month over the next 36 months. So that -- but I recognize the hardware upfront. So we're recognizing the lowest margin parts of it now while taking the highest margin pieces and spreading it over 3 years. And that's why if you just look at revenue and margin, you're not seeing the whole story, you've got to see that ARR story. And we're just in that transition. And again, this will be the last quarter -- the Q3 quarter is the last quarter where we're not going to be bringing those metrics forward. In Q4, everything is going to be based in and around subscription and the metrics of a subscription business.

James Michael Dodson - *Quantum Corporation - CFO*

Yes. And Dave, what I would add to that is we're in the early stages, right? I mean, all these products will be available, but they're building over time. And we'll give a sense of how this will look over the next 5 years on our Analyst Day as well. So I think that will be also help you understand how we transition to this recurring revenue model. At the -- when we get out 5 years, we still expect 30% of our revenue will be product-based revenue, right? So we're not moving the entire business or don't expect to move the entire business to the recurring rate.

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

And our goal is a 70-30 model, 70% recurring, 30% upfront one time.

Operator

Thank you. We've reached end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

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

Thanks, everyone. Thanks for attending today, and I invite everyone to join us on November 9 for our Investor Conference. You can sign up for that conference on our investor website at quantum.com. Thanks, everyone.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.