

3COM CORP  
Form 10-Q  
April 06, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

☐ **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
For the quarterly period ended February 26, 2010

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 No. 0-12867

**3COM CORPORATION**  
(Exact name of registrant as specified in its charter)

**Delaware**

**94-2605794**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

**350 Campus Drive**  
**Marlborough, Massachusetts**

**01752**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(508) 323-1000**

Former name, former address and former fiscal year, if changed since last report: **N/A**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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. (Check one):

Large accelerated  
filer ☐

Accelerated filer ☐

Non-accelerated filer ☐  
(Do not check if a smaller reporting  
company)

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 ☐

As of March 26, 2010, 398,163,780 shares of the registrant's common stock were outstanding.



**3COM CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED FEBRUARY 28, 2010**  
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We use a 52 or 53 week fiscal year ending on the Friday nearest to May 31, with each fiscal quarter ending on the Friday generally nearest August 31, November 30 and February 28. For presentation purposes, the periods are shown as ending on August 31, November 30, February 28 and May 31, as applicable. The entities comprising our H3C business follow a calendar year basis of reporting and therefore results for our China-based sales segment are consolidated on a two-month time lag.

3Com, the 3Com logo, H3C, Digital Vaccine, NBX, OfficeConnect, Comware, IRF, TippingPoint, TippingPoint Technologies and VCX are registered trademarks or trademarks of 3Com Corporation or one of its wholly owned subsidiaries. Other product and brand names may be trademarks or registered trademarks of their respective owners. This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements regarding the following aspects of our business: global economic slowdown, nascent economic recovery and effects and strategy; core business strategy to leverage China and emphasize larger enterprise business; China-based sales region strategy, growth, dependence, expected benefits, tax rate, sales from China and expected decline in sales to Huawei; impact of recent accounting regulations; expected annual amortization expense; environment for enterprise networking equipment; challenges relating to sales growth; trends and goals for segments and regions; pursuit of termination fee in connection with now-terminated proposed acquisition by affiliates of Bain Capital; supply of components; research and development focus; execution of our strategy; strategic product and technology development plans; goal of sustaining profitability; short-term management of cash during economic

slowdown and nascent recovery; intercompany dividends from China; ability to satisfy cash requirements for at least the next twelve months; restructuring activities and expected charges to be incurred; expected cost savings from restructuring activities and integration; potential acquisitions and strategic relationships; future contractual obligations; recovery of deferred tax assets and balance of unrecognized tax benefits; reserves; market risk; outsourcing; competition; expectation regarding base interest rates; impact of foreign currency fluctuations; belief regarding meritorious defenses to litigation claims and effects of litigation; the ability of our company and Hewlett-Packard Company ( HP ) to consummate the announced acquisition of our company by HP (the Merger ); satisfaction of closing conditions precedent to the consummation of the proposed Merger, including obtaining antitrust approvals in China; the affect on our business,

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operations and financial results of the announcement, the pendency, and activities relating to the Merger; and the affect of certain restrictions on our ability to conduct our business under the acquisition agreement with HP. In some cases, you can identify these and other forward-looking statements by the use of words such as may, can, should, expects, plans, anticipates, believes, estimates, predicts, intends, continue, or the negative of such terms and comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any forward-looking statements.

Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including, without limitation, those set forth under Part II Item 1A Risk Factors. All forward-looking statements included in this document are based on our assessment of information available to us at the time this report is filed. We have no intent, and disclaim any obligation, to update any forward-looking statements.

In this Form 10-Q we refer to the People's Republic of China as China or the PRC.

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****3COM CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

|   | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |              |
|---|--|-------------|---|--------------|
| (In thousands, except per share data)       | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b>  |
| Sales                                       | \$ 345,880                                 | \$ 324,707  | \$ 958,546                                | \$ 1,021,919 |
| Cost of sales                               | 137,086                                    | 138,878     | 389,559                                   | 446,671      |
| Gross profit                                | 208,794                                    | 185,829     | 568,987                                   | 575,248      |
| Operating expenses (income):                |  |             |   |              |
| Sales and marketing                         | 100,543                                    | 85,541      | 279,085                                   | 262,943      |
| Research and development                    | 47,997                                     | 45,229      | 128,365                                   | 141,630      |
| General and administrative                  | 21,323                                     | 27,593      | 68,479                                    | 80,699       |
| Amortization                                | 16,506                                     | 23,106      | 50,332                                    | 73,330       |
| Patent dispute resolution                   |  |             |   | (70,000)     |
| Restructuring charges                       | 47   | 2,860       | 2,732                                     | 7,361        |
| Operating expenses, net                     | 186,416                                    | 184,329     | 528,993                                   | 495,963      |
| Operating income                            | 22,378                                     | 1,500       | 39,994                                    | 79,285       |
| Interest income (expense), net              | 683  | (3,333)     | (2,327)                                   | (5,131)      |
| Other income, net                           | 19,676                                     | 16,528      | 37,143                                    | 45,298       |
| Income before income taxes                  | 42,737                                     | 14,695      | 74,810                                    | 119,452      |
| Income tax provision                        | (1,346)                                    | (12,828)    | (5,966)                                   | (24,878)     |
| Net income                                  | \$ 41,391                                  | \$ 1,867    | \$ 68,844                                 | \$ 94,574    |
| Basic net income per share                  | \$ 0.10                                    | \$ 0.00     | \$ 0.17                                   | \$ 0.24      |
| Diluted net income per share                | \$ 0.10                                    | \$ 0.00     | \$ 0.17                                   | \$ 0.24      |
| Shares used in computing per share amounts: |  |             |   |              |
| Basic                                       | 396,253                                    | 384,679     | 392,905                                   | 393,868      |
| Diluted                                     | 411,546                                    | 386,377     | 403,771                                   | 395,232      |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**3COM CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Unaudited)

| (In thousands, except per share data)   |    | February 28,<br>2010 | May 31,<br>2009 |
|---|----|----------------------|-----------------|
| <b>ASSETS</b>   |    |                      |                 |
| Current assets:   |    |                      |                 |
| Cash and equivalents  | \$ | 795,014              | \$ 545,818      |
| Short-term investments  |    |                      | 98,357          |
| Notes receivable  |    | 26,688               | 40,590          |
| Accounts receivable, less allowance for doubtful accounts of \$9,019 and \$9,645, respectively              |    | 129,998              | 112,771         |
| Inventories   |    | 114,972              | 90,395          |
| Other current assets  |    | 48,977               | 56,982          |
| Total current assets  |    | 1,115,649            | 944,913         |
| Property and equipment, less accumulated depreciation of \$176,652 and \$172,717, respectively              |    | 36,747               | 40,012          |
| Goodwill  |    | 609,297              | 609,297         |
| Intangible assets, net  |    | 148,432              | 198,624         |
| Deposits and other assets   |    | 22,823               | 22,511          |
| Total assets  | \$ | 1,932,948            | \$ 1,815,357    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |    |                      |                 |
| Current liabilities:  |    |                      |                 |
| Accounts payable  | \$ | 74,907               | \$ 68,350       |
| Current portion of long-term debt   |    | 48,000               | 48,000          |
| Accrued liabilities and other   |    | 484,388              | 394,103         |
| Total current liabilities   |    | 607,295              | 510,453         |
| Deferred taxes and long-term obligations  |    | 37,218               | 40,729          |
| Long-term debt  |    | 64,000               | 152,000         |
| Stockholders' equity:   |    |                      |                 |
| Preferred stock, \$0.01 par value, 10,000 shares authorized; none outstanding                               |    |                      |                 |
| Common stock, \$0.01 par value, 990,000 shares authorized; shares issued: 398,088 and 389,284, respectively |    | 2,378,781            | 2,336,961       |
| Retained deficit  |    | (1,221,678)          | (1,290,522)     |
| Accumulated other comprehensive income  |    | 67,332               | 65,736          |
| Total stockholders' equity  |    | 1,224,435            | 1,112,175       |
| Total liabilities and stockholders' equity  | \$ | 1,932,948            | \$ 1,815,357    |

The accompanying notes are an integral part of these condensed consolidated financial statements.



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**3COM CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

|   | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|---|-------------|
|   | <b>2010</b>                               | <b>2009</b> |
| (In thousands)  |   |             |
| Cash flows from operating activities:   |   |             |
| Net income  | \$ 68,844                                 | \$ 94,574   |
| Adjustments to reconcile net income to cash provided by operating activities: |   |             |
| Depreciation and amortization   | 66,467                                    | 97,156      |
| Stock-based compensation expense  | 17,579                                    | 18,187      |
| Impairment of property and equipment  |   | 1,150       |
| Loss on property and equipment disposals                                      | 288                                       | 581         |
| Deferred income taxes   | (12,123)                                  | (7,466)     |
| Changes in assets and liabilities:  |   |             |
| Accounts and notes receivable   | (3,243)                                   | (13,560)    |
| Inventories   | (23,319)                                  | (22,006)    |
| Other assets  | 15,667                                    | 6,771       |
| Accounts payable  | 6,247                                     | (20,929)    |
| Other liabilities   | 88,393                                    | 41,874      |
| Net cash provided by operating activities                                     | 224,800                                   | 196,332     |
| Cash flows from investing activities:   |   |             |
| Proceeds from maturities and sales of investments                             | 98,661                                    |             |
| Purchases of property and equipment   | (11,170)                                  | (12,778)    |
| Proceeds from sale of property and equipment                                  | 40  | 223         |
| Net cash provided by (used in) investing activities                           | 87,531                                    | (12,555)    |
| Cash flows from financing activities:   |   |             |
| Issuances of common stock   | 28,480                                    | 3,022       |
| Repurchases of common stock   | (4,158)                                   | (51,383)    |
| Repayment of long term debt   | (88,000)                                  | (88,000)    |
| Net cash used in financing activities   | (63,678)                                  | (136,361)   |
| Effect of exchange rate changes on cash and equivalents                       | 543                                       | 8,901       |
| Net change in cash and equivalents during period                              | 249,196                                   | 56,317      |
| Cash and equivalents, beginning of period                                     | 545,818                                   | 503,644     |
| Cash and equivalents, end of period   | \$ 795,014                                | \$ 559,961  |

The accompanying notes are an integral part of these condensed consolidated financial statements.



**Table of Contents****3COM CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**NOTE 1. BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of our financial position as of February 26, 2010 and May 29, 2009, our results of operations for the three and nine months ended February 26, 2010 and February 27, 2009 and our cash flows for the nine months ended February 26, 2010 and February 27, 2009.

We use a 52 or 53 week fiscal year ending on the Friday nearest to May 31. For convenience, the condensed consolidated financial statements have been shown as ending on the last day of the calendar month. Accordingly, the three and nine months shown as ended February 28, 2010 actually ended on February 26, 2010, the three and nine months shown as ended February 28, 2009 ended on February 27, 2009, and the balance sheet presented as of February 28, 2010 and May 31, 2009 actually was as of February 26, 2010 and May 29, 2009, respectively. The results of operations for the three and nine months ended February 28, 2010 may not be indicative of the results to be expected for the fiscal year ending May 28, 2010 or any other future periods. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended May 29, 2009.

Certain prior period amounts have been reclassified to conform to the current year presentation. Specifically, in the condensed consolidated statements of operations we have reclassified \$2.8 million from general and administrative expenses to sales and marketing, and to research and development expenses, in the amounts of \$1.3 million and \$1.5 million, respectively, for the three months ended February 28, 2009, and \$8.1 million from general and administrative expenses to sales and marketing, and to research and development expenses, in the amounts of \$3.8 million and \$4.3 million, respectively, for the nine months ended February 28, 2009.

*Accounting Pronouncements* The Financial Accounting Standards Board ( FASB ) is the authoritative body for financial accounting and reporting in the United States. On July 31, 2009, the FASB Accounting Standards Codification ( the Codification ) became the authoritative source of accounting principles to be applied to the financial statements of nongovernmental entities prepared in accordance with GAAP. The following is a list of recent pronouncements issued by the FASB:

**Recently Issued and Adopted Accounting Pronouncements**

*Business Combinations:* Effective in the first quarter of fiscal 2010, the Company adopted the revised accounting guidance for business combinations. The more significant changes include an expanded definition of a business and a business combination; recognition of assets acquired, liabilities assumed and noncontrolling interests (including goodwill) measured at fair value at the acquisition date; recognition of acquisition-related expenses and restructuring costs separately from the business combination; recognition of assets acquired and liabilities assumed at their acquisition-date fair values with subsequent changes recognized in earnings; and capitalization of in-process research and development at fair value as an indefinite-lived intangible asset. The guidance also amends and clarifies the application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The impact of this accounting guidance and its relevant updates on the Company's results of operations or financial position will vary depending on each specific business combination or asset purchase. The Company has not had any business combinations or asset purchases since the adoption of this pronouncement.

*Noncontrolling Interests in Consolidated Financial Statements:* The pronouncement requires the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment and presentation of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary, and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. The Company adopted the pronouncement in the first quarter of fiscal 2010. The adoption did not have any impact on the Company's Condensed Consolidated Financial Statements.



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*Fair Value Measurements and Disclosures:* The pronouncements define fair value, establish guidelines for measuring fair value, and expand disclosures regarding fair value measurements. In the first quarter of fiscal 2010, the Company adopted the fair value measurements guidance for all nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The adoption did not have a material impact on the Company's Condensed Consolidated Financial Statements. See Note 3 of Notes to Condensed Consolidated Financial Statements for additional information. The Company did not choose the fair value option which allows entities to choose to measure many financial instruments and certain other items at fair value that previously were not required to be measured at fair value.

In the second quarter of fiscal 2010, the Company adopted the fair value disclosure provision that requires the reporting of interim disclosures about the fair value of financial instruments previously only disclosed on an annual basis. The adoption did not have any impact on the Company's Condensed Consolidated Financial Statements as it relates only to disclosures. The required disclosures are included in Note 3 of Notes to Condensed Consolidated Financial Statements.

*Impairments of Debt Securities:* The pronouncement changed the impairment recognition and presentation model for debt securities. An other-than-temporary impairment is now triggered when there is intent to sell the security, it is more likely than not that the security will be required to be sold before recovery in value, or the security is not expected to recover its entire amortized cost basis (credit related loss). Credit related losses on debt securities will be considered an other-than-temporary impairment recognized in earnings, and any other losses due to a decline in fair value relative to the amortized cost deemed not to be other-than-temporary will be recorded in other comprehensive income. The Company adopted the pronouncement in the second quarter of fiscal 2010. The adoption did not have a material impact on the Company's Condensed Consolidated Financial Statements.

*Earnings Per Share:* The pronouncement provided guidance on determining whether instruments granted in share-based payment transactions are participating securities. Non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The company adopted this pronouncement in the first quarter of fiscal 2010. The adoption had no material effect on basic or diluted EPS for any of the periods presented in these Condensed Consolidated Financial Statements.

### **Recently Issued but Not Yet Adopted Accounting Pronouncements**

*Revenue Arrangements with Multiple Deliverables:* The guidance amends the current revenue recognition guidance for multiple deliverable arrangements. It allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence, vendor objective evidence, or third-party evidence is unavailable. Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The guidance is effective for fiscal years beginning on or after June 15, 2010 (the Company's fiscal 2012), but early adoption is permitted. The Company is currently evaluating the impact that adoption of this pronouncement will have on the Company's Financial Statements.

*Revenue Arrangements with Software Elements:* The pronouncement modifies the scope of the software revenue recognition guidance to exclude tangible products that contain both software and non-software components that function together to deliver the product's essential functionality. The pronouncement is effective for fiscal years beginning on or after June 15, 2010 (the Company's fiscal 2012), but early adoption is permitted. This guidance must be adopted in the same period an entity adopts the amended revenue arrangements with multiple deliverables guidance described above. The Company is currently evaluating the impact that adoption of this pronouncement will have on the Company's Financial Statements.

*Variable Interest Entities and Transfers of Financial Assets and Extinguishments of Liabilities:* The pronouncement on transfers of financial assets and extinguishments of liabilities removes the concept of a qualifying special-purpose entity and removes the exception from applying variable interest entity accounting to qualifying special-purpose entities. The new guidance on variable interest entities requires an entity to perform an ongoing analysis to determine whether the entity's variable interest or interests give it a controlling financial interest in a variable interest entity. The

pronouncements are effective for fiscal years beginning after November 15, 2009. The Company will adopt the pronouncements for interim and annual reporting periods beginning in the first quarter of fiscal 2011. The Company expects that adoption of this pronouncement will not have an impact on the Company's financial statements.

**Table of Contents****NOTE 2. STOCK-BASED COMPENSATION**

In order to determine the fair value of stock options and employee stock purchase plan shares, we use the Black-Scholes option pricing model and apply the single-option valuation approach to the stock option valuation. In order to determine the fair value of restricted stock awards and restricted stock units we use the closing market price of 3Com common stock on the date of grant. We recognize stock-based compensation expense on a straight-line basis over the requisite service period for time-based vesting awards of stock options, restricted stock awards, restricted stock units, and the employee stock purchase plan. Certain of the stock options may vest on an accelerated basis and certain restricted stock units are earned contingent upon the future achievement of financial performance metrics. Performance metrics for the performance period are determined by the Compensation Committee of the Board of Directors in its sole discretion. For unvested stock options outstanding as of May 31, 2006, we continue to recognize stock-based compensation expense using the accelerated attribution method.

As of February 28, 2010, total unrecognized stock-based compensation expense relating to unvested employee stock options, restricted stock awards, restricted stock units, and the employee stock purchase plan, as adjusted for estimated forfeitures, was \$5.2 million, \$1.5 million, \$18.0 million and \$0.2 million, respectively. These amounts are expected to be recognized over a weighted-average period of 2.0 years for stock options, 1.2 years for restricted stock awards, 2.0 years for restricted stock units and 0.1 years for employee stock purchase plan. If actual forfeitures differ from current estimates, total unrecognized stock-based compensation expense will be adjusted for future changes in estimated forfeitures.

Stock-based compensation recognized and disclosed is based on the Black-Scholes option pricing model for estimating the fair value of options granted under the company's equity incentive plans. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The underlying weighted-average assumptions used in the Black-Scholes model and the resulting estimates of fair value per share were as follows for options granted during the three and nine months ended February 28, 2010 and February 28, 2009:

|   | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| <b><i>Employee stock options:</i></b>       |  |             |   |             |
| Volatility                                  | *  | 51.3%       | 57.0%                                     | 51.3%       |
| Risk-free interest rate                     | *  | 1.9%        | 2.1%                                      | 2.6%        |
| Dividend yield                              | *  | 0.0%        | 0.0%                                      | 0.0%        |
| Expected life (years)                       | *  | 6.0         | 4.1                                       | 4.7         |
| Weighted average grant date fair value      | *  | \$ 1.28     | \$ 1.83                                   | \$ 1.04     |
| <b><i>Restricted stock awards:</i></b>      |  |             |   |             |
| Weighted average grant date fair value      | *  | \$ *        | *   | \$ 2.28     |
| <b><i>Restricted stock units:</i></b>       |  |             |   |             |
| Weighted average grant date fair value      | \$ 7.49                                    | \$ 2.51     | \$ 4.20                                   | \$ 2.35     |
| <b><i>Employee Stock Purchase Plan:</i></b> |  |             |   |             |
| Volatility                                  | */%  | */%         | 64.8%                                     | 77.7%       |
| Risk-free interest rate                     | */%  | */%         | 0.2%                                      | 1.2%        |
| Dividend yield                              | */%  | */%         | 0.0%                                      | 0.0%        |
| Expected life (years)                       | *  | *           | 0.5                                       | 0.5         |

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|  |    |   |    |   |         |         |
|--|----|---|----|---|---------|---------|
| Weighted average grant date fair value | \$ | * | \$ | * | \$ 1.70 | \$ 0.90 |
|--|----|---|----|---|---------|---------|

\* No grants  
during the  
period

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The following table presents stock-based compensation expense included in the accompanying Condensed Consolidated Statements of Operations (in thousands):

|   | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| Cost of sales                               | \$ 557                                     | \$ 596      | \$ 1,688                                  | \$ 1,916    |
| Sales and marketing                         | 2,147                                      | 1,371       | 5,818                                     | 4,742       |
| Research and development                    | 538  | 552         | 1,437                                     | 2,329       |
| General and administrative                  | 3,219                                      | 3,144       | 8,636                                     | 8,756       |
| Restructuring charges                       |  | 444         |   | 444         |
| Stock-based compensation expense before tax | \$ 6,461                                   | \$ 6,107    | \$ 17,579                                 | \$ 18,187   |

*Stock Options.* Stock option activity for the nine months ended February 28, 2010 and 2009, was as follows (shares in thousands):

|  | <b>Nine Months Ended February 28,</b> |  | <b>Nine Months Ended February 28,</b> |  |
|--|---------------------------------------|--|---------------------------------------|--|
|  | <b>2010</b>                           |  | <b>2009</b>                           |  |
|  | <b>Number<br/>of<br/>shares</b>       | <b>Weighted<br/>average<br/>exercise<br/>price</b> | <b>Number<br/>of<br/>shares</b>       | <b>Weighted<br/>average<br/>exercise<br/>price</b> |
| Outstanding May 31, 2009 and 2008      | 28,361                                | \$ 4.92  | 43,925                                | \$ 4.98  |
| Granted                                | 2,419                                 | 4.00   | 1,403                                 | 2.30   |
| Exercised                              | (6,590)                               | 3.99   | (979)                                 | 1.48   |
| Forfeited                              | (326)                                 | 4.01   | (3,239)                               | 4.34   |
| Expired                                | (2,526)                               | 6.12   | (11,342)                              | 5.39   |
| Outstanding February 28, 2010 and 2009 | 21,338                                | \$ 4.97  | 29,768                                | \$ 4.88  |

As of February 28, 2010, there were approximately 13.3 million options exercisable with a weighted-average exercise price of \$5.95 per share. By comparison, there were approximately 20.0 million options exercisable as of February 28, 2009 with a weighted-average price of \$5.69 per share.

During the nine months ended February 28, 2010 and 2009 approximately 6.6 million and 1.0 million options were exercised at an aggregate intrinsic value of \$13.7 million and \$0.7 million, respectively. The exercise intrinsic value is calculated as the difference between the market value on the exercise date and the exercise price of the options. The closing market value as of February 26, 2010 was \$7.63 per share as reported by the NASDAQ Global Select Market. The aggregate intrinsic value of options outstanding and options exercisable as of February 28, 2010 was \$72.8 million and \$38.4 million, respectively. The weighted-average remaining contractual life of options outstanding and options exercisable were 3.6 years and 2.6 years, respectively. The aggregate options outstanding and options exercisable intrinsic value is calculated for options that are in-the-money as the difference between the market value as of February 28, 2010 and the exercise price of the options.

Options outstanding that are vested and expected to vest as of February 28, 2010 are as follows:

|                 |                 |
|-----------------|-----------------|
| <b>Weighted</b> | <b>Weighted</b> |
|                 | <b>Average</b>  |

|   | <b>Number of</b>  | <b>average</b>    | <b>Remaining</b>   | <b>Aggregate</b>  |
|---|-------------------|-------------------|--------------------|-------------------|
|   | <b>Shares</b>     | <b>Grant-Date</b> | <b>Contractual</b> | <b>Intrinsic</b>  |
|   | <b>(in</b>        | <b>Fair</b>       | <b>Life (in</b>    | <b>Value</b>      |
|   | <b>thousands)</b> | <b>Value</b>      | <b>years)</b>      | <b>(in</b>        |
|   |                   |                   |                    | <b>thousands)</b> |
| Vested and expected to vest at February 28,<br>2010 | 18,992            | \$ 5.16           | 3.3                | \$ 62,927         |
|   | 7                 |                   |                    |                   |

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*Restricted Stock Awards.* Restricted stock award activity during the nine months ended February 28, 2010 and 2009 was as follows (shares in thousands):

|  | Nine Months Ended February 28,<br>2010 |   | 2009                                 |   |
|--|--|---|--------------------------------------|---|
|  | Number<br>of<br>Shares<br>(unvested)   | Weighted<br>average<br>Grant-Date<br>Fair Value | Number<br>of<br>Shares<br>(unvested) | Weighted<br>average<br>Grant-Date<br>Fair Value |
| Outstanding May 31, 2009 and 2008      | 1,459                                  | \$ 2.94   | 3,095                                | \$ 3.43   |
| Granted                                |  |   | 325                                  | 2.28  |
| Vested                                 | (337)                                  | 3.27  | (734)                                | 3.94  |
| Forfeited                              | (17)                                   | 4.64  | (745)                                | 3.75  |
| Outstanding February 28, 2010 and 2009 | 1,105                                  | \$ 2.82   | 1,941                                | \$ 2.92   |

During the nine months ended February 28, 2010 and 2009 approximately 0.3 million and 0.7 million restricted stock awards with an aggregate fair value of \$1.7 million and \$1.6 million, respectively, became vested. Total aggregate intrinsic value of restricted stock awards outstanding as of February 28, 2010 was \$8.4 million.

*Restricted Stock Units.* Restricted stock unit activity during the nine months ended February 28, 2010 and 2009 was as follows (shares in thousands):

|  | Nine Months Ended February 28,<br>2010 |   | 2009                                 |   |
|--|--|---|--------------------------------------|---|
|  | Number<br>of<br>Shares<br>(unvested)   | Weighted<br>average<br>Grant-Date<br>Fair Value | Number<br>of<br>Shares<br>(unvested) | Weighted<br>average<br>Grant-Date<br>Fair Value |
| Outstanding May 31, 2009 and 2008      | 6,161                                  | \$ 2.78   | 5,744                                | \$ 3.59   |
| Granted                                | 6,062                                  | 4.20  | 5,071                                | 2.35  |
| Vested                                 | (2,192)                                | 3.01  | (2,445)                              | 3.51  |
| Forfeited                              | (536)                                  | 3.40  | (1,246)                              | 3.16  |
| Outstanding February 28, 2010 and 2009 | 9,495                                  | \$ 3.60   | 7,124                                | \$ 2.81   |

During the nine months ended February 28, 2010 and 2009 approximately 2.2 million and 2.4 million restricted units with an aggregate fair value of \$12.2 million and \$5.4 million, respectively, became vested. Total aggregate intrinsic value of restricted stock units outstanding at February 28, 2010 was \$72.4 million. Restricted stock units outstanding at February 28, 2010 had a weighted-average remaining contractual life of 1.3 years. Total aggregate intrinsic value of restricted stock units outstanding and expected to vest at February 28, 2010 was \$53.6 million. Restricted stock units outstanding and expected to vest at February 28, 2010 had a weighted-average remaining contractual life of 1.1 years.

*Employee Stock Purchase Plan.* We have an employee stock purchase plan ( ESPP ) under which eligible employees may authorize payroll deductions of up to ten percent of their compensation, as defined, to purchase common stock at a price of 85 percent of the lower of the fair market value as of the beginning or the end of the six-month offering period. In September 2008, our stockholders approved an increase of eight million shares available for issuance under the ESPP. We recognized \$1.4 million and \$1.0 million of stock-based compensation expense in the nine months ended February 28, 2010 and 2009, respectively, associated with the ESPP. Employee stock purchases generally occur

only in the quarters ending November 30 and May 31.

**Table of Contents****NOTE 3: FAIR VALUE***Fair Value Hierarchy*

The Company's financial instruments consist primarily of cash and cash equivalents, short-term investments, accounts receivable, notes receivable, accounts payable, and long-term debt. The carrying value of cash, short-term investments, accounts receivable, notes receivable and accounts payable approximates their fair market values due to their short-term nature. The Company believes that the carrying value of its outstanding debt approximates fair value, because the debt bears interest at variable rates.

The accounting pronouncements establish a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The accounting pronouncements establish three levels of inputs that may be used to measure fair value:

*Level 1* Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

*Level 2* Include other inputs that are directly or indirectly observable in the marketplace.

*Level 3* Unobservable inputs which are supported by little or no market activity.

In accordance with the accounting pronouncements, we measure our cash equivalents at fair value and classify them within Level 1 or Level 2 of the fair value hierarchy. The classification has been determined based on the manner in which we value our cash equivalents, primarily using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

***Assets Measured at Fair Value on a Recurring Basis***

Assets measured at fair value on a recurring basis consisted of the following types of instruments and were reported as cash and equivalents as of February 28, 2010:

|   | Fair Value Measurements at Reporting Date Using  |   |  | Total<br>Balance |
|---|--|---|--|------------------|
|   | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                  |
|   | (In thousands)   |   |  |                  |
| <b>Assets</b>   |  |   |  |                  |
| Cash and equivalents:   |  |   |  |                  |
| Time deposits and bank deposits with a maturity less than 3 months          | \$   | \$ 441,138  | \$   | \$ 441,138       |
| Money market fund deposits  | 248,776  |   |  | 248,776          |
| China government bonds and bank bills with a maturity of less than 3 months | 105,100  |   |  | 105,100          |
| Total assets measured at fair value   | \$ 353,876   | \$ 441,138  | \$   | \$ 795,014       |

Money market funds, China government bonds and bank bills are measured based on quoted market prices. Time deposits and bank deposits are measured based on similar assets and/or subsequent transactions.

**NOTE 4. REALTEK PATENT DISPUTE RESOLUTION**

On July 11, 2008, 3Com Corporation and Realtek Semiconductor Corp. (the Realtek Group ) entered into three agreements which document the resolution of a several-year-long patent litigation between the parties and provide for the non-exclusive license by 3Com to the Realtek Group of certain patents and related network interface technology for license fees totaling \$70.0 million, all of which was received in the three months ended August 31, 2008.

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The basic agreement between 3Com and the Realtek Group documents the resolution of the litigation between the parties and provides for the dismissal of the lawsuit and mutual releases between the parties.

Under the terms of the agreements, the payments are non-refundable and the Company has no future performance obligations, apart from certain customary covenants not to sue Realtek, its customers or its suppliers on the licensed technology, and non-material notice and tax assistance obligations. Accordingly the \$70.0 million was recognized as income in the first quarter of fiscal 2009 in the operating expense (income) section of the Consolidated Statement of Operations.

**NOTE 5. RESTRUCTURING CHARGES**

In recent fiscal years, we have undertaken several initiatives involving significant changes in our business strategy and cost structure.

We continued a restructuring of our business to enhance the focus and cost effectiveness of our businesses in serving their respective markets. These restructuring efforts continued into fiscal 2010. We took the following specific actions in fiscal 2007 through 2010 (the Fiscal 2007 2010 Actions ):

reduced our workforce;

continued efforts to consolidate and dispose of excess facilities; and

shifting the focus of our direct-touch sales force to accommodate our shift to the enterprise market

Restructuring charges related to these various initiatives were \$0.05 million in the three months ended February 28, 2010 and \$2.9 million in the three months ended February 28, 2009. Primarily all of the \$0.05 million of net expense in the third quarter of fiscal 2010 consists of severance and outplacement costs. The severance and outplacement costs primarily relate to severance for certain of our sales and marketing employees as the Company continues to shift our focus increasingly on the larger enterprise market. Primarily all of the \$2.9 million of net expense in the third quarter of fiscal 2009 resulted from severance and outplacement costs. The severance and outplacement costs in the third quarter of fiscal 2009 primarily relate to the integration of our TippingPoint segment. Restructuring charges for the nine months ended February 28, 2010 were \$2.7 million, and restructuring charges for the first nine months of fiscal 2009 were \$7.4 million.

Restructuring charges of \$0.1 million for the three months ended February 28, 2010 related to our TippingPoint segment, while our Networking segment had a net credit of \$0.02 million. Restructuring charges of \$1.7 million and \$1.0 million for the nine months ended February 28, 2010 related to our Rest of World sales region in our Networking business and TippingPoint segment, respectively. Restructuring charges of \$0.9 million and \$2.0 million for the three months ended February 28, 2009 related to our Networking business and TippingPoint segment, respectively. Restructuring charges of \$5.4 million and \$2.0 million for the nine months ended February 28, 2009 related to our Networking business and our TippingPoint segment, respectively.

Accrued liabilities associated with restructuring charges total \$0.1 million as of February 28, 2010 and are included in the caption Accrued liabilities and other in the accompanying consolidated balance sheets. These liabilities are classified as current because we expect to satisfy such liabilities in cash within the next 12 months.

***Fiscal 2010 Actions***

Activity and liability balances related to the fiscal 2010 restructuring actions, are as follows (in thousands):

|                               | <b>Employee<br/>Separation<br/>Expense</b> | <b>Other<br/>Restructuring<br/>Costs</b> | <b>Total</b> |
|-------------------------------|--|--|--------------|
| Balance as of May 31, 2009    | \$   | \$                                       | \$           |
| Provisions                    | 2,528                                      | 150                                      | 2,678        |
| Payments and non-cash charges | (2,416)                                    | (150)                                    | (2,566)      |

|                                 |    |     |    |    |     |
|---------------------------------|----|-----|----|----|-----|
| Balance as of February 28, 2010 | \$ | 112 | \$ | \$ | 112 |
|---------------------------------|----|-----|----|----|-----|



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Employee separation expenses include severance pay, outplacement services, medical and other related benefits. The reduction in workforce affected employees involved in research and development, sales and marketing, customer support, and general and administrative functions. Non-cash charges include stock-based compensation charges as applicable.

We expect to complete any remaining activities related to actions initiated in fiscal 2010 during fiscal 2010.

***Fiscal 2007 through 2009 Actions***

Activity and liability balances related to the fiscal 2007 through 2009 restructuring actions are as follows (in thousands):

|                                 | <b>Employee<br/>Separation<br/>Expense</b> | <b>Facilities-related<br/>Charges</b> | <b>Total</b> |
|---------------------------------|--|---------------------------------------|--------------|
| Balance as of May 31, 2009      | \$ 1,477                                   | \$ 47                                 | \$ 1,524     |
| Provisions                      | 52   | 2                                     | 54           |
| Payments and non-cash charges   | (1,529)                                    | (12)                                  | (1,541)      |
| Balance as of February 28, 2010 | \$   | \$ 37                                 | \$ 37        |

Employee separation expense includes severance pay, outplacement services, medical and other related benefits.

Facilities-related charges related to revised future lease obligations.

We expect to complete any remaining activities related to actions initiated through fiscal 2009 during fiscal 2010.

**NOTE 6. INCOME TAXES**

The Company provides for income taxes during interim periods based on our estimate of the effective tax rate for the year. Discrete items and changes in our estimate of the annual effective tax rate are recorded in the period in which they occur. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. During the three and nine months ended February 28, 2010, the balance of unrecognized tax benefits decreased by \$1.0 million and increased by \$1.6 million, respectively. As of February 28, 2010, we had unrecognized tax benefits, including interest and penalties, of \$23.5 million, all of which, if recognized, would impact our effective tax rate. As of February 28, 2010, the accrued interest and penalties related to uncertain tax positions were \$3.6 million and \$0, respectively, which has been recorded within the balance of unrecognized tax benefits.

As of February 28, 2010 we estimate that the balance of unrecognized tax benefits will decrease by approximately \$5.4 million over the next twelve months as a result of the expiration of various statutes of limitations on the assessment of income tax.

Under special agreement with the tax authorities certain of our annual Chinese income tax filings for the calendar year ended December 31, 2008 were not filed until August 14, 2009, pending the resolution of an uncertainty over the applicable 2008 income tax rate in China. Calendar year 2008 was the final year during which our main operating company in China, Hangzhou H3C Technologies Co. Ltd ( HH3C ), was entitled to certain tax concessions under a tax holiday agreement. The Company provided for income taxes in China for calendar 2008 at 15 percent. In July 2009, the Tax Bureau of Hangzhou Binjiang District notified the Company that it could enjoy the reduced rate of 9 percent for the 2008 calendar year. The impact of this discrete income tax item was a benefit of \$10.8 million which has been reflected in our fiscal second quarter results as a reduction to income tax provision.

On December 31, 2009, HH3C was granted Key Software Development Enterprise ( KSDE ) status by the Hangzhou Tax Bureau. Status as a KSDE allows the Company to enjoy a 10 percent income tax rate retroactively applied for all of calendar year 2009. The impact of this discrete income tax item is a benefit of \$9.9 million for the three months ended February 28, 2010. Status as a KSDE needs to be applied for and granted annually. There can be no assurance that the KSDE status will be granted in future years. Accordingly, the tax rate for calculating HH3C's deferred tax assets and liabilities as of December 31, 2009 remains at the 15 percent income tax rate applicable to New and High

Technology companies.

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Income tax payments, net of refunds, were \$41.0 million and \$9.9 million for the nine months ended February 28, 2010 and 2009, respectively.

**NOTE 7. COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive income (loss), net of tax, are as follows (in thousands):

|   | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| Net income                                    | \$ 41,391                                  | \$ 1,867    | \$ 68,844                                 | \$ 94,574   |
| Other comprehensive income:                   |  |             |   |             |
| Change in accumulated translation adjustments | (1,212)                                    | (2,307)     | 1,596                                     | 2,194       |
| Total comprehensive income (loss)             | \$ 40,179                                  | \$ (440)    | \$ 70,440                                 | \$ 96,768   |

**NOTE 8. NET INCOME PER SHARE**

The following represents a reconciliation from basic earnings per common share to diluted earnings per common share. Stock options and restricted stock (awards and units) of 12.9 million and 3.8 million, respectively, were outstanding at February 28, 2010 but were not included in the computation of diluted earnings per share because they were antidilutive. Stock options and restricted stock (awards and units) of 29.0 million and 8.2 million, respectively, were outstanding at February 28, 2009, but were not included in the computation of diluted earnings per share because they were antidilutive.

|   | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|--|-------------|---|-------------|
| (in thousands except per share data)                      | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| Determination of shares:                                  |  |             |   |             |
| Weighted average shares outstanding                       | 396,253                                    | 384,679     | 392,905                                   | 393,868     |
| Assumed conversion of dilutive stock options              | 8,460                                      | 789         | 5,694                                     | 873         |
| Assumed conversion of restricted stock (awards and units) | 6,833                                      | 909         | 5,172                                     | 491         |
| Diluted weighted average shares outstanding               | 411,546                                    | 386,377     | 403,771                                   | 395,232     |
| Basic earnings per share                                  | \$ 0.10                                    | \$ 0.00     | \$ 0.17                                   | \$ 0.24     |
| Diluted earnings per share                                | \$ 0.10                                    | \$ 0.00     | \$ 0.17                                   | \$ 0.24     |

We have consistently applied the two class earnings per share methodology in all periods reported. Earnings per share has been the same under both methods except the nine months ended February 28, 2010. In the nine months ended February 28, 2010 the two class method changes the basic earnings per share from \$0.18 per share to \$0.17 per share.

**NOTE 9. INVENTORIES**

The components of inventories are as follows (in thousands):

|                 | <b>February 28,<br/>2010</b> | <b>May 31,<br/>2009</b> |
|-----------------|------------------------------|-------------------------|
| Finished goods  | \$ 93,658                    | \$ 69,860               |
| Work-in-process | 4,287                        | 3,420                   |
| Raw materials   | 17,027                       | 17,115                  |
| Total           | \$ 114,972                   | \$ 90,395               |



**Table of Contents****NOTE 10. INTANGIBLE ASSETS, NET**

Intangible assets consist of (in thousands, except for weighted average remaining life):

|                        | February 28, 2010  |           |                             |           | May 31, 2009   |           |                             |           |
|------------------------|--|-----------|-----------------------------|-----------|--|-----------|-----------------------------|-----------|
|                        | Weighted<br>Average<br>Remaining<br>Amortization<br>Period | Gross     | Accumulated<br>Amortization | Net       | Weighted<br>Average<br>Remaining<br>Amortization<br>Period | Gross     | Accumulated<br>Amortization | Net       |
| Existing technology    | 2.8  | \$398,454 | \$(312,636)                 | \$ 85,818 | 3.6  | \$398,178 | \$(272,460)                 | \$125,718 |
| Trademark              | NA   | 55,502    |                             | 55,502    | NA   | 55,502    |                             | 55,502    |
| OEM agreement          | 0.3  | 26,883    | (24,668)                    | 2,215     | 1.0  | 23,777    | (14,852)                    | 8,925     |
| Maintenance agreements | 1.0  | 19,000    | (16,100)                    | 2,900     | 1.7  | 19,000    | (13,724)                    | 5,276     |
| Other                  | 1.3  | 22,706    | (20,709)                    | 1,997     | 2.0  | 22,697    | (19,494)                    | 3,203     |
|                        |  | \$522,545 | \$(374,113)                 | \$148,432 |  | \$519,154 | \$(320,530)                 | \$198,624 |

During the nine months ended February 28, 2010 our gross intangible assets increased by \$3.4 million due to the appreciation on the Renminbi affecting the value of certain intangible assets related to our H3C subsidiary. Net intangible assets at February 28, 2010 in our China-based sales region were \$139.5 million and in our TippingPoint segment were \$8.9 million.

Annual amortization expense related to intangible assets is expected to be as follows for each of the following five succeeding fiscal years (in thousands):

|                      | Remainder<br>of 2010 | 2011     | 2012     | 2013     | 2014 | 2015 |
|----------------------|----------------------|----------|----------|----------|------|------|
| Amortization expense | \$16,451             | \$42,242 | \$17,144 | \$17,093 |      |      |

We apply the provisions of ASC 350 Goodwill and Other Intangible Assets to goodwill and intangible assets with indefinite lives (our trademark) which are not amortized but are reviewed annually for impairment or more frequently if impairment indicators arise. We performed our annual goodwill impairment review as of February 26, 2010 for our TippingPoint segment and December 31, 2009 for our China-based region (as our China-based region reports on a two month lag), and noted no impairment of goodwill or intangible assets with indefinite lives. In making this assessment, we rely on a number of factors including operating results, business plans, economic projections, anticipated future cash flows, and transactions and marketplace data. There are inherent uncertainties related to these factors and our judgment in applying them to the analysis of goodwill impairment. Reporting unit valuations have been calculated using a combination of an income approach based on the present value of future cash flows of each reporting unit and a market approach. The income approach incorporates many assumptions including future growth rates, discount factors, expected capital expenditures and income tax cash flows. Changes in economic and operating conditions impacting these assumptions could result in a goodwill impairment in future periods. In conjunction with our annual goodwill impairment tests, we reconcile the sum of the valuations of all of our reporting units to our market capitalization as of such dates.

Goodwill as of February 28, 2010 and May 31, 2009 was \$609.3 million. Goodwill in our Networking business was \$455.9 million for both periods and goodwill in our TippingPoint segment was \$153.4 million (net of accumulated impairments of \$158.0 million) for both periods.

**NOTE 11. ACCRUED WARRANTY**

Most products are sold with varying lengths of limited warranty ranging from 90 days to limited lifetime. Allowances for estimated warranty obligations are recorded as part of cost of sales in the period of sale, and are based on historical experience related to product failure rates and actual warranty costs incurred during the applicable warranty period. Also, on an ongoing basis, we assess the adequacy of our allowances related to warranty obligations recorded in previous periods and may adjust the balances to reflect actual experience or changes in future expectations.

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The following table summarizes the activity in the allowance for estimated warranty costs for the nine months ended February 28, 2010 and 2009 (in thousands):

|   | <b>Nine Months Ended<br/>February 28,</b> |             |
|---|---|-------------|
|   | <b>2010</b>                               | <b>2009</b> |
| Accrued warranty, beginning of period                               | \$ 29,587                                 | \$ 36,897   |
| Cost of warranty claims processed during the period                 | (18,596)                                  | (23,613)    |
| Provision for warranties related to products sold during the period | 14,994                                    | 19,308      |
| Accrued warranty, end of period                                     | \$ 25,985                                 | \$ 32,592   |

**NOTE 12. LONG-TERM DEBT AND OTHER BANK OBLIGATIONS***Senior Secured Credit Agreement H3C Holdings Limited*

On May 25, 2007, our subsidiary H3C Holdings Limited (the Borrower) entered into an amended and restated credit agreement with various lenders, including Goldman Sachs Credit Partners L.P., as Mandated Lead Arranger, Bookrunner, Administrative Agent and Syndication Agent, and Industrial and Commercial Bank of China (Asia) Limited, as Collateral Agent (the Credit Agreement). Under the Credit Agreement, the Borrower borrowed \$430 million in the form of a senior secured term loan in two tranches (Tranche A and Tranche B) to finance a portion of the purchase price for 3Com's acquisition of 49 percent of H3C Technologies Co., Limited, or H3C (a Hong Kong entity). The Borrower and its subsidiaries are referred to collectively as the H3C Group.

Interest on borrowings is payable semi-annually on March 28 and September 28, and commenced on September 28, 2007. All amounts outstanding under the Tranche A Term Facility will bear interest, at the Borrower's option, at the (i) LIBOR, or (ii) Base Rate (i.e., prime rate), in each case plus the applicable margin percentage set forth in the table below, which is based on a leverage ratio of consolidated indebtedness of the Borrower and its subsidiaries to EBITDA (as defined in the Credit Agreement) for the relevant twelve-month period:

| <b>Leverage Ratio</b>  | <b>LIBOR +</b> | <b>Base Rate +</b> |
|------------------------|----------------|--------------------|
| >3.0:1.0               | 2.25%          | 1.25%              |
| ≤3.0:1.0 but > 2.0:1.0 | 2.00%          | 1.00%              |
| ≤2.0:1.0 but > 1.0:1.0 | 1.75%          | 0.75%              |
| ≤1.0:1.0               | 1.50%          | 0.50%              |

All amounts outstanding under the Tranche B Term Facility will bear interest, at the Borrower's option, at the (i) LIBOR plus 3 percent or (ii) Base Rate (i.e., prime rate) plus 2 percent. We have elected to use LIBOR as the reference rate for borrowings to date. Applicable LIBOR rates, which were established on September 28, 2009, at February 28, 2010 were 0.64 percent and the effective interest rate at February 28, 2010 was 2.14 percent for the Tranche A Term Facility and 3.64 percent for the Tranche B Term Facility. On March 29, 2010 the LIBOR rates reset to 0.44 percent and the effective interest rate will be 1.94 percent for the Tranche A Term Facility and 3.44 percent for the Tranche B Term Facility and will remain the rates until September 28, 2010.

Required payments under the loan are generally expected to be serviced by cash flows from the H3C Group. Borrowings under the Credit Agreement may be prepaid in whole or in part without premium or penalty if paid at the time of making a semi-annual interest payment. The Borrower will be required to make mandatory prepayments using net proceeds from H3C Group (i) asset sales, (ii) insurance proceeds and (iii) equity offerings or debt incurrence. In addition, to the extent there exists excess cash flow as defined under the Credit Agreement, the Borrower will be required to make annual prepayments. Any excess cash flow amounts not required to prepay the loan may be distributed to and used by the Company outside of the H3C Group, provided certain conditions are met.

H3C and all other existing and future subsidiaries of the Borrower (other than PRC subsidiaries or small excluded subsidiaries) will guarantee all obligations under the loans and are referred to as Guarantors. The loan obligations are secured by (1) first priority security interests in all assets of the Borrower and the Guarantors, including their bank

accounts, and (2) a first priority security interest in 100 percent of the capital stock of the Borrower and H3C and the PRC subsidiaries of H3C. The debt bears interest at floating rates therefore the carrying value approximates fair value.



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The Borrower must maintain a minimum debt service coverage, minimum interest coverage, maximum capital expenditures and a maximum total leverage ratio. Negative covenants restrict, among other things, (i) the incurrence of indebtedness by the Borrower and its subsidiaries, (ii) the making of dividends and distributions to the Company outside of the H3C Group, (iii) the ability to make investments including in new subsidiaries, (iv) the ability to undertake mergers and acquisitions and (v) sales of assets. As of February 28, 2010, the H3C Group's net assets were \$877.3 million and are subject to these dividend restrictions. Also, cash dividends from the PRC subsidiaries to H3C, and H3C to the Borrower, will be subject to restricted use pending payment of principal, interest and excess cash flow prepayments. Standard events of default apply.

Remaining payments of the \$112 million principal are due on September 28, of each year as follows, (in thousands):

| <b>Calendar Year</b> | <b>3Com Fiscal Year</b> | <b>Tranche A</b> | <b>Tranche B</b> |
|----------------------|-------------------------|------------------|------------------|
| 2010                 | 2011                    | 46,000           | 2,000            |
| 2011                 | 2012                    |                  | 20,000           |
| 2012                 | 2013                    |                  | 44,000           |

On September 28, 2009, in addition to our regular principal payment of \$48.0 million, the Company made a voluntary prepayment of \$40.0 million of principal, for which the Company did not incur a penalty and all of which was applied to reduce our fiscal year 2013 Tranche B principal balance. We recorded accelerated amortization of deferred financing fees \$0.9 million in our second fiscal quarter related to the voluntary prepayment. The Company also made interest payments of \$4.1 million on September 28, 2009 and \$1.7 million on March 29, 2010.

In the three and nine months ended February 28, 2010 we recorded interest expense of \$1.6 million and \$8.0 million, respectively, compared to \$6.6 million and \$15.3 million in the same period of the prior fiscal year. In the three and nine months ended February 28, 2010 we recorded interest income of \$2.2 million and \$5.7 million, respectively, compared to \$3.2 million and \$10.2 million in the same period of the prior fiscal year.

***Other Bank Obligations***

As of February 28, 2010, bank-issued standby letters of credit and guarantees totaled \$7.0 million, including \$6.0 million relating to potential foreign tax, custom, and duty assessments. These instruments are entered into in support of our commercial operations. We provide the bank with cash collateral for 100 percent of these amounts. Restricted cash held as collateral was \$7.0 million and is included in deposits and other assets on the Condensed Consolidated Balance Sheet.

**NOTE 13. SEGMENT INFORMATION**

In the first quarter of fiscal 2010, we changed the measures of segment contribution profit (loss) and segment income to align with how we currently manage our business and report internally. Accordingly, our previously reported segment information has been revised to reflect our new measure of segment contribution profit (loss) and segment income. Based on the information provided to our chief operating decision-maker ( CODM ) for purposes of making decisions about allocating resources and assessing performance, we have two primary businesses, our Networking Business and TippingPoint Security Business. Our Networking Business consists of the following sales regions as operating segments: China-based (including Japan and Hong Kong SAR), Asia Pacific Region excluding China-based sales region ( APR ), Europe Middle East and Africa ( EMEA ), Latin America ( LAT ), and North America ( NA ) regions. The APR, EMEA, LAT and NA operating segments have been aggregated given their similar economic characteristics, products, customers and processes, and have been consolidated as one reportable segment called, Rest of World . The China-based sales region does not meet the aggregation criteria at this time.

The China-based and Rest of World reporting segments benefit from shared support services on a world-wide basis. The costs associated with providing these shared central functions are not allocated to the China-based and Rest of World reporting segments and instead are reported and disclosed under the caption Central Functions . Central Function costs include research and development expenses and other operating expenses . Other operating expenses in both our Central Function costs and TippingPoint Security business include other costs of sales, such as supply chain operations, indirect sales and marketing, and general and administrative support costs.

Management evaluates the China-based sales region and the Rest of World sales region performance based on segment contribution profit. Segment contribution profit is standard margin less segment direct sales and marketing

expenses. Standard margin for these regions is sales less standard costs of sales. Our TippingPoint Security business segment is measured on segment income. Segment income is segment contribution profit less research and development expenses.

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Eliminations and other include intercompany sales eliminations, stock-based compensation expense, amortization of intangible assets and restructuring in all periods as well as proceeds from the Realtek patent dispute resolution in the first quarter of fiscal 2009, as these costs are not included in the Company's segment contribution profit and segment income.

Summarized financial information of our results of operations by segment for the three and nine months ended February 28, 2010 and 2009 is as follows.

|                                    | Three Months Ended February 28, 2010 |  |                      |   |                     | Total      |
|------------------------------------|--------------------------------------|--|----------------------|---|---------------------|------------|
|                                    | China-based sales region             | Networking Business Rest of World Sales Region | Central Functions(a) | TippingPoint Security Business Tipping Point(b) | Eliminations/ Other |            |
| (in thousands)                     |                                      |  |                      |   |                     |            |
| Sales                              | \$ 187,963                           | \$ 123,401                                     | \$                   | \$ 37,868                                       | \$ (3,352) <i>c</i> | \$ 345,880 |
| Standard margin                    | 133,300                              | 79,033   |                      | 32,076  | (557) <i>d</i>      | 243,852    |
| Direct sales & marketing expenses  | 43,109                               | 26,354   |                      | 13,543  | 2,147 <i>d</i>      | 85,153     |
| Segment contribution profit (loss) | 90,191                               | 52,679   |                      | 18,533  | (2,704)             | 158,699    |
| Research & development expenses    |                                      |  | 40,409               | 7,050   | 538 <i>d</i>        | 47,997     |
| Segment income                     | \$                                   | \$   | \$                   | \$ 11,483                                       | \$                  |            |
| Other operating expenses           |                                      |  | 61,567               | 4,183   | 22,574 <i>e</i>     | 88,324     |
| Operating income                   |                                      |  |                      |   |                     | \$ 22,378  |

|                | Three Months Ended February 28, 2009 |  |                      |   |                     | Total      |
|----------------|--------------------------------------|--|----------------------|---|---------------------|------------|
|                | China-based sales region             | Networking Business Rest of World Sales Region | Central Functions(a) | TippingPoint Security Business Tipping Point(b) | Eliminations/ Other |            |
| (in thousands) |                                      |  |                      |   |                     |            |
| Sales          | \$ 190,385                           | \$ 102,836                                     | \$                   | \$ 33,284                                       | \$ (1,798) <i>c</i> | \$ 324,707 |

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|                                    |         |        |        |           |                 |          |
|------------------------------------|---------|--------|--------|-----------|-----------------|----------|
| Standard margin                    | 128,160 | 61,365 |        | 28,288    | (596) <i>d</i>  | 217,217  |
| Direct sales & marketing expenses  | 36,581  | 23,360 |        | 10,882    | 1,371 <i>d</i>  | 72,194   |
| Segment contribution profit (loss) | 91,579  | 38,005 |        | 17,406    | (1,967)         | 145,023  |
| Research & development expenses    |         |        | 37,574 | 7,103     | 552 <i>d</i>    | 45,229   |
| Segment income                     | \$      | \$     | \$     | \$ 10,303 | \$              |          |
| Other operating expenses           |         |        | 56,146 | 9,488     | 32,660 <i>e</i> | 98,294   |
| Operating income                   |         |        |        |           |                 | \$ 1,500 |

**Table of Contents****Nine Months Ended February 28, 2010**

|                                    | <b>Networking Business</b>      |                                   | <b>TippingPoint Security Business</b> |                         |                            |              |
|------------------------------------|---------------------------------|-----------------------------------|---------------------------------------|-------------------------|----------------------------|--------------|
|                                    | <b>China-based sales region</b> | <b>Rest of World Sales Region</b> | <b>Central Functions(a)</b>           | <b>Tipping Point(b)</b> | <b>Eliminations/ Other</b> | <b>Total</b> |
| (in thousands)                     |                                 |                                   |                                       |                         |                            |              |
| Sales                              | \$ 509,273                      | \$ 349,862                        | \$                                    | \$ 106,334              | \$ (6,923) <i>c</i>        | \$ 958,546   |
| Standard margin                    | 353,397                         | 215,553                           |                                       | 89,960                  | (1,688) <i>d</i>           | 657,222      |
| Direct sales & marketing expenses  | 117,520                         | 75,663                            |                                       | 37,325                  | 5,818 <i>d</i>             | 236,326      |
| Segment contribution profit (loss) | 235,877                         | 139,890                           |                                       | 52,635                  | (7,506)                    | 420,896      |
| Research & development expenses    |                                 |                                   | 107,429                               | 19,499                  | 1,437 <i>d</i>             | 128,365      |
| Segment income                     | \$                              | \$                                | \$                                    | \$ 33,136               | \$                         |              |
| Other operating expenses           |                                 |                                   | 170,062                               | 13,421                  | 69,054 <i>e</i>            | 252,537      |
| Operating income                   |                                 |                                   |                                       |                         |                            | \$ 39,994    |

**Nine Months Ended February 28, 2009**

|                                   | <b>Networking Business</b>      |                                   | <b>TippingPoint Security Business</b> |                         |                            |              |
|-----------------------------------|---------------------------------|-----------------------------------|---------------------------------------|-------------------------|----------------------------|--------------|
|                                   | <b>China-based sales region</b> | <b>Rest of World Sales Region</b> | <b>Central Functions(a)</b>           | <b>Tipping Point(b)</b> | <b>Eliminations/ Other</b> | <b>Total</b> |
| (in thousands)                    |                                 |                                   |                                       |                         |                            |              |
| Sales                             | \$ 565,597                      | \$ 368,838                        | \$                                    | \$ 92,499               | \$ (5,015) <i>c</i>        | \$ 1,021,919 |
| Standard margin                   | 375,588                         | 215,479                           |                                       | 76,962                  | (1,916) <i>d</i>           | 666,113      |
| Direct sales & marketing expenses | 106,194                         | 77,254                            |                                       | 32,873                  | 4,742 <i>d</i>             | 221,063      |
|                                   | 269,394                         | 138,225                           |                                       | 44,089                  | (6,658)                    | 445,050      |

Segment contribution  
profit (loss)

Research &  
development expenses

118,603      20,698      2,329<sup>d</sup>      141,630

Segment income

\$      \$      \$      \$ 23,391      \$

Other operating  
expenses

177,697      22,641      23,797<sup>e</sup>      224,135

Operating income

\$ 79,285

*a Included in our  
Central  
Function results  
were  
depreciation  
expenses of  
\$4.4 million and  
\$8.1 million for  
the three months  
ended  
February 28,  
2010 and 2009,  
respectively,  
and  
\$14.2 million  
and  
\$21.1 million  
for the nine  
months ended  
February 28,  
2010 and 2009,  
respectively.*

*b Included in our  
TippingPoint  
segment profit  
were  
depreciation  
expenses of  
\$0.8 million and  
\$0.8 million for  
the three months  
ended  
February 28,*

*2010 and 2009,  
respectively,  
and \$2.8 million  
and \$2.8 million  
for the nine  
months ended  
February 28,  
2010 and 2009,  
respectively.*

- c Represents  
eliminations for  
inter-company  
revenue between  
Networking and  
TippingPoint  
during the  
respective  
periods.*
- d Represents  
stock-based  
compensation in  
all periods.*
- e Includes  
stock-based  
compensation,  
amortization,  
and  
restructuring in  
all periods plus  
acquisition  
related costs,  
proceeds from  
the Realtek  
patent dispute  
resolution,  
property and  
equipment  
impairment and  
legal settlement  
accruals where  
applicable.*

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| <b>Identifiable assets (in thousands)</b> | <b>February 28,<br/>2010</b> | <b>May 31,<br/>2009</b> |
|---|------------------------------|-------------------------|
| China-based sales region(1)(2)            | \$ 1,371,856                 | \$ 1,378,059            |
| Rest of World sales region(1)             | 1,029,098                    | 875,788                 |
| TippingPoint                              | 245,708                      | 228,440                 |
| Eliminations(3)                           | (713,714)                    | (666,930)               |
| Total                                     | \$ 1,932,948                 | \$ 1,815,357            |

(1) Included in our identifiable assets for both our China-based sales region and Rest of World sales region are Central Function assets. We do not segregate these assets as the CODM does not review the segment assets in that manner.

(2) Our China-based sales region identifiable assets are the same as those held by our H3C subsidiary.

(3) The eliminations primarily relate to the Rest of World sales region investment in subsidiaries and intercompany transactions.



| <b>Total Expenditures for Additions to Property and Equipment (in thousands)</b> | <b>Nine Months Ended<br/>February 28,</b> |             |
|--|---|-------------|
|  | <b>2010</b>                               | <b>2009</b> |
| China-based sales region(1)  | \$ 3,301                                  | \$ 4,934    |
| Rest of World sales region(1)  | 6,652                                     | 5,585       |
| TippingPoint   | 1,217                                     | 2,259       |
| Total  | \$ 11,170                                 | \$ 12,778   |

(1) Included in our capital expenditures for both our China-based sales region and Rest of World sales region are Central Function expenditures for additions to property and equipment. We do not segregate these expenditures as the CODM does not review the segment in that manner.

Certain product groups account for a significant portion of our sales. In the first quarter of fiscal 2010 we expanded the number of individually reported networking equipment products. We have expanded our networking equipment into two categories: switches and routers, and other networking equipment. Other networking equipment revenue includes sales of our VCX and NBX voice-over-internet protocol, or VoIP, IP storage, IP surveillance and our wireless LAN ( WLAN ) products. We have also consolidated voice into other networking equipment. Prior year disclosures have been revised to be comparable with our current year groupings. Security revenue includes our TippingPoint products and services, as well as other security products, such as our embedded firewall, or EFW and virtual private network, or VPN, products. Services revenue includes professional services and maintenance contracts, excluding TippingPoint maintenance which is included in security revenue. Sales from these product groups as a percentage of total sales for the respective periods are as follows (in thousands, except percentages):

|                            | <b>Three Months Ended February 28,</b> |       |             |       | <b>Nine Months Ended February 28,</b> |       |             |       |
|----------------------------|--|-------|-------------|-------|---------------------------------------|-------|-------------|-------|
|                            | <b>2010</b>                            |       | <b>2009</b> |       | <b>2010</b>                           |       | <b>2009</b> |       |
| Switches and routers       | \$ 234,433                             | 67.8% | \$ 227,583  | 70.1% | \$ 643,194                            | 67.1% | \$ 738,343  | 72.3% |
| Other networking equipment | 48,521                                 | 14.0% | 41,679      | 12.8% | 141,344                               | 14.7% | 126,311     | 12.4% |
| Security                   | 48,286                                 | 14.0% | 43,553      | 13.4% | 135,387                               | 14.1% | 122,682     | 12.0% |

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|          |            |      |            |      |            |      |              |      |
|----------|------------|------|------------|------|------------|------|--------------|------|
| Services | 14,640     | 4.2% | 11,892     | 3.7% | 38,621     | 4.1% | 34,583       | 3.3% |
| Total    | \$ 345,880 | 100% | \$ 324,707 | 100% | \$ 958,546 | 100% | \$ 1,021,919 | 100% |

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**Table of Contents****NOTE 14. GEOGRAPHIC INFORMATION**

Sales by geographic region are as follows (in thousands):

|                                 | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended February<br/>28,</b> |              |
|---------------------------------|--|-------------|---|--------------|
|                                 | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b>  |
| China                           | \$ 187,963                                 | \$ 183,758  | \$ 503,274                                | \$ 544,136   |
| Europe, Middle East, and Africa | 59,134                                     | 52,982      | 161,037                                   | 181,348      |
| North America                   | 45,839                                     | 43,300      | 151,278                                   | 144,461      |
| Asia Pacific (except China)     | 24,049                                     | 23,850      | 71,738                                    | 81,147       |
| Latin and South America         | 28,895                                     | 20,817      | 71,219                                    | 70,827       |
| Total                           | \$ 345,880                                 | \$ 324,707  | \$ 958,546                                | \$ 1,021,919 |

All sales (other than sales to Original Equipment Manufacturer (OEM) partners) are reported in geographic categories based on the location of the end customer. Sales to OEM partners are included in the geographic categories based upon the hub locations of the OEM partners.

**NOTE 15. LITIGATION**

We are a party to lawsuits in the normal course of our business. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict and the outcome of claims against the Company described below are uncertain. We believe that we have meritorious defenses in the matters set forth below in which we are named as a defendant. An unfavorable resolution of the lawsuit in which we are a defendant as described below, could adversely affect our business, financial position, results of operations, or cash flow. The Company does not believe that the ultimate disposition of these matters will have a material adverse effect on the Company's financial position.

On December 5, 2001, TippingPoint and two of its current and former officers and directors, as well as the managing underwriters in TippingPoint's initial public offering, were named as defendants in a purported class action lawsuit filed in the United States District Court for the Southern District of New York. The lawsuit, which is part of a consolidated action that includes over 300 similar actions, is captioned *In re Initial Public Offering Securities Litigation, Brian Levey vs. TippingPoint Technologies, Inc., et al.* (Civil Action Number 01-CV-10976). The principal allegation in the lawsuit is that the defendants participated in a scheme to manipulate the initial public offering and subsequent market price of TippingPoint's stock (and the stock of other public companies) by knowingly assisting the underwriters' requirement that certain of their customers had to purchase stock in a specific initial public offering as a condition to being allocated shares in the initial public offerings of other companies. In relation to TippingPoint, the purported plaintiff class for the lawsuit is comprised of all persons who purchased TippingPoint stock from March 17, 2000 through December 6, 2000. The suit seeks rescission of the purchase prices paid by purchasers of shares of TippingPoint common stock. On September 10, 2002, TippingPoint's counsel and counsel for the plaintiffs entered into an agreement pursuant to which the plaintiffs dismissed, without prejudice, TippingPoint's former and current officers and directors from the lawsuit. In March 2009, TippingPoint signed a settlement agreement with the plaintiffs. On April 2, 2009, all the parties to the lawsuit (including all plaintiffs, issuers, and underwriters) filed settlement documents with the District Court. On June 10, 2009 the District Court issued its preliminary approval of the settlement. From June 2009 to September 2009, the plaintiffs sent notifications to approximately 7 million potential class members, 140 of whom objected and approximately 350 of whom opted out. The judge conducted the final approval hearing on September 10, 2009, and thereafter, on October 5, 2009, issued an order approving the settlement. Several objectors have filed an appeal of this Order with the Court of Appeals for the Second Circuit. These appeals are currently pending. The settlement, if approved by the Court of Appeals, will fully dispose of this lawsuit. Any direct financial impact of the settlement is expected to be borne by TippingPoint's insurers. If the Court of Appeals does not approve the settlement for any reason and the litigation against TippingPoint continues, we intend to defend this action vigorously, but cannot make any predictions about the outcome. To the extent necessary, we will seek

indemnification and/or contribution from the underwriters in TippingPoint's initial public offering pursuant to its underwriting agreement with the underwriters. However, there can be no assurance that indemnification or contribution will be available to TippingPoint or enforceable against the underwriters.

On July 31, 2008, the Company filed a lawsuit in the Delaware Chancery Court against Diamond II Holdings, Inc., an entity controlled by affiliates of Bain Capital Partners, LLC. The lawsuit seeks interpretation and enforcement of the provisions of the Merger Agreement and Plan of Merger by among 3Com, Diamond II Holdings, Inc., and Diamond II Acquisition Corp., dated as of September 28, 2007. The litigation is in furtherance of our efforts to enforce the provisions of the now-terminated Merger Agreement related to the termination fee. There can be no assurance that 3Com will be able to collect this fee.

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Between November 12, 2009 and November 24, 2009, eight purported class action complaints were filed in the Court of Chancery of the State of Delaware against 3Com and all of the current members of 3Com's board of directors. Seven of the complaints name Hewlett-Packard Company ( HP ) as a defendant. Four of the complaints also name Merger Sub as a defendant. The plaintiffs, David Shaev, Leonard Ahern, Richard Hall, Larry McIntyre, Alan Kahn, Ashok Madan, County of York Employees Retirement Plan, and Pipefitters Local No. 636 Defined Benefit Plan, all claim that they were stockholders of 3Com and that they filed their lawsuits on behalf of themselves and a class consisting of all public stockholders of 3Com. Among other things, the complaints, captioned Shaev v. 3Com Corporation, et al., Civil Action No. 5067, Ahern v. Cote, et al., Civil Action No. 5068, Hall v. 3Com Corporation, et al., Civil Action No. 5073, McIntyre v. 3Com Corporation, et al., Civil Action No. 5080, Kahn v. 3Com Corporation, et al., Civil Action No. 5087, Madan v. 3Com Corporation, et al., Civil Action No. 5092, County of York Employees Retirement Plan v. 3Com Corporation, et al., Civil Action No. 5098, and Pipefitters Local No. 636 Defined Benefit Plan v. Cote, et al., Civil Action No. 5103, generally allege that the members of 3Com's board of directors breached their fiduciary duties by failing to maximize shareholder value in negotiating and approving the Merger. Seven of the complaints also generally allege that HP and, in four of the complaints, Merger Sub, aided and abetted these alleged breaches of fiduciary duties. The complaints seek class certification, certain forms of injunctive relief, including enjoining the consummation of the Merger and rescission of the Merger Agreement, as well as unspecified damages. On December 2, 2009, the Chancery Court consolidated the actions for all purposes under the caption In re 3Com Shareholders Litigation, Case No. C.A. No. 5067-CC. On December 11, 2009, the plaintiffs filed their Consolidated Amended Complaint. The Consolidated Amended Complaint includes the allegations, defendants, and requested relief described above, but does not name 3Com as a defendant and adds allegations that the preliminary proxy statement failed to provide information necessary for 3Com's shareholders to vote on the Merger, including details of the financial analysis conducted by 3Com's financial advisor, Goldman Sachs, and the Management Plan. On December 11, 2009, the plaintiffs moved for a preliminary injunction and for expedited proceedings. On December 15, 2009, 3Com and the members of its board filed an opposition to plaintiffs' motion for expedited proceedings. On December 18, 2009, the Chancery Court issued an order denying plaintiffs' motion for expedited proceedings on the ground that, among other things, plaintiffs had failed to state a colorable claim for relief. On December 28, 2009, 3Com and the members of the board moved to dismiss the Consolidated Amended Complaint for, among other things, failure to state a claim upon which relief may be granted. On January 6, 2010, the Chancery Court denied plaintiffs' request for a hearing on their motion for a preliminary injunction. On March 22, 2010, the Chancery Court so ordered the parties' stipulation to dismiss the consolidated action without prejudice.

On November 12, 2009 and November 25, 2009, two separate purported class action complaints were filed in the United States District Court for the District of Massachusetts, by, respectively, plaintiffs Edward Tansey and Robert Levine, et al., against 3Com and all of the current members of 3Com's board of directors. Like the plaintiffs in the Delaware actions, the plaintiffs in these actions have asserted that they were stockholders of 3Com and filed the lawsuit purportedly on behalf of themselves and a class consisting of all other stockholders of 3Com. Among other things, the complaints, captioned Tansey v. 3Com Corporation, et al., Case No. 09-cv-11941, and Levine and Duncan v. 3Com Corporation, et al., Case No. 09-cv-12027, generally allege that the members of 3Com's board of directors breached their fiduciary duties by failing to maximize shareholder value in negotiating and approving the Merger, and that 3Com aided and abetted these alleged breaches of fiduciary duties. The complaints seek class certification and certain forms of injunctive relief, including enjoining the consummation of the Merger and rescission of the acquisition. On December 7, 2009, pursuant to the parties' stipulation, the Court adjourned *sine die* defendants' deadline for responding to the Tansey complaint and administratively closed that action until a response is filed. On December 15, 2009, pursuant to the parties' stipulation, the Court adjourned *sine die* defendants' deadline for responding to the Levine and Duncan complaint and, on December 16, 2009, administratively closed that action until a response is filed.

On November 16, 2009, two other purported class action complaints were filed in the Superior Court for the Commonwealth of Massachusetts against 3Com, all of the current members of 3Com's board of directors, HP, and Merger Sub. Like the plaintiffs in the Delaware actions and the federal actions in Massachusetts, the plaintiffs in these actions, Dean Davenport and Stanley Tanzer, both claim that they were stockholders of 3Com and that they filed their

lawsuits on behalf of themselves and a class consisting of all public stockholders of 3Com. Among other things, the complaints, captioned Davenport v. Benhamou, et al., Case No. 09-4886, and Tanzer v. Benhamou, et al., Case No. 09-4887, generally allege that the members of 3Com's board of directors breached their fiduciary duties by failing to maximize shareholder value in negotiating and approving the Merger, and that 3Com, HP and Merger Sub aided and abetted these alleged breaches of fiduciary duties. On November 25, 2009, 3Com and its board served a motion to dismiss or stay the action on plaintiffs in both the Davenport and Tanzer cases. On December 1, 2009, the plaintiffs in both Davenport and Tanzer moved for expedited proceedings. 3Com and its board filed oppositions to those motions on December 3, 2009. On December 7, 2009, the plaintiffs in both actions moved for consolidation. On December 17, 2009, 3Com and its board filed an opposition to that motion. On or about December 24, 2009, the Court denied plaintiffs' motions for expedited proceedings in both the Davenport and Tanzer cases. On January 4, 2010, 3Com and its board moved for a protective order to stay discovery in both actions until the Court rules

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on the pending motions to dismiss or stay. On January 12, 2010, in return for withdrawal of the motion for a protective order, plaintiffs agreed to stay discovery pending decision on the motions to dismiss or stay. On January 7, 2010, Parallel Technology, LLC sued 3Com in the Court of Chancery of the State of Delaware. The complaint, filed under seal, alleges that 3Com had breached, and (upon the Merger's closing) would breach, the confidentiality and cooperation provisions of a patent sale agreement between Parallel and 3Com. Parallel claims breach of contract and breach of the duty of good faith and fair dealing. On January 18, 2010, Parallel moved for a temporary restraining order, expedited proceedings, and a preliminary injunction against 3Com's consummation of the then-proposed Merger with HP. On January 19, 2010, 3Com filed an opposition to Parallel's motion for a temporary restraining order and expedited proceedings. That same day, the Chancery Court denied Parallel's motion for a temporary restraining order and expedited proceedings, and declined to schedule a hearing on the preliminary injunction motion. On January 22, 2010, 3Com moved to dismiss the complaint. On January 26, 2010, Parallel moved to certify interlocutory appeal from the Chancery Court's January 19 order. 3Com filed an opposition to the certification motion on February 4, 2010. On February 12, 2010, the Chancery Court issued an order denying the certification motion. On February 16, 2010, Parallel petitioned the Supreme Court of the State of Delaware for interlocutory appeal of the Chancery Court's January 19 order. The Supreme Court of the State of Delaware issued an order denying the petition on February 18, 2010. On March 9, 2010, Parallel filed its first amended complaint. On March 12, 2010, 3Com moved to dismiss the first amended complaint and to stay discovery.

**NOTE 16. PROPOSED ACQUISITION OF THE COMPANY**

On November 11, 2009, 3Com Corporation, a Delaware corporation ( "3Com" ), entered into an Agreement and Plan of Merger (the "Merger Agreement" ) by and among 3Com, Hewlett-Packard Company, a Delaware corporation ( "HP" ), and Colorado Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of HP ( "Merger Sub" ). Upon the terms of the Merger Agreement and subject to the terms set forth therein, Merger Sub will be merged with and into 3Com, and as a result 3Com will continue as the surviving corporation and a wholly owned subsidiary of HP (the "Merger" ).

Pursuant to the Merger Agreement, at the closing of the Merger, each issued and outstanding share of common stock of 3Com, other than shares owned by 3Com, HP or Merger Sub, or by any stockholders who are entitled to and who properly exercise appraisal rights under Delaware law, will be cancelled and will be automatically converted into the right to receive \$7.90 in cash, without interest.

Vesting of all outstanding 3Com equity based awards under 3Com equity plans will continue until the closing of the Merger in accordance with their respective terms. At the closing of the Merger, outstanding stock options issued under 3Com equity plans that are (i) not yet vested or exercisable, and/or (ii) have an exercise price greater than or equal to \$7.90 per share will be assumed by HP and automatically converted into an option with respect to shares of HP common stock based on an exchange ratio described in the Merger Agreement. In addition, outstanding stock options issued under 3Com equity plans that are vested and have an exercise price less than \$7.90 per share, will be cancelled and cashed out at the difference between \$7.90 and the exercise price per share less applicable tax withholdings. Additionally, all restricted stock units and shares of restricted stock issued under 3Com equity plans that are outstanding immediately prior to the closing of the Merger will be assumed by HP and automatically converted into awards based upon HP common stock as described in the Merger Agreement.

On November 11, 2009, 3Com and the American Stock Transfer & Trust Company, a New York state trust company (the "Rights Agent" ) entered into Amendment No. 2 (the "Amendment" ) to the Third Amended and Restated Preferred Shares Rights Agreement between 3Com and the Rights Agent as amended and restated as of November 4, 2002, as amended to date (the "Rights Agreement" ). The Amendment permits the execution of the Merger Agreement and the performance and consummation of the transactions contemplated by the Merger Agreement, including the Merger, without triggering the provisions of the Rights Agreement.

The Merger Agreement contains a non-solicitation or "no shop" provision restricting 3Com from soliciting alternative acquisition proposals from third parties and from furnishing non-public information to and engaging in discussions with third parties regarding alternative acquisition proposals. The no-shop provision was subject to a customary "fiduciary-out" provision, which would have allowed 3Com under certain circumstances prior to the approval of the Merger Agreement by our stockholders to furnish non-public information to and participate in discussions with third

parties with respect to a bona fide unsolicited written alternative acquisition proposal that constituted or was reasonably likely to lead to a superior proposal and under certain circumstances, coupled with the payment of a termination fee of \$99,000,000, to terminate the Merger Agreement.



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We believe that our future cash requirements will likely include an aggregate of \$2 million to \$5 million for professional and other fees related to our proposed acquisition by HP that are not contingent on the closing of the deal. Pursuant to an engagement letter between Goldman Sachs and us, we agreed to pay Goldman Sachs a transaction fee of approximately \$41 million, approximately \$38 million of which is payable upon consummation of the Merger. The closing of the Merger is subject to the satisfaction or waiver of specified closing conditions, including, without limitation, (i) the adoption of the Merger Agreement by 3Com's stockholders and (ii) the expiration or termination of waiting periods, and obtaining of requisite approvals or clearances, under specified antitrust and competition laws (including, without limitation, in China, the European Union and the United States, among others). On December 22, 2009, the relevant U.S. antitrust authorities granted early termination of the waiting period under the U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. On February 12, 2010, the European Commission cleared the Merger under the EU Merger Regulation. In addition, on January 26, 2010, 3Com's stockholders adopted the Merger Agreement at a special meeting of stockholders.

Several purported class action lawsuits have been filed against 3Com and all of the current members of 3Com's board of directors in connection with the proposed Merger. See Note 15 "Litigation" for a further discussion of these actions.

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

### **INTRODUCTION**

The following discussion should be read in conjunction with the condensed consolidated financial statements and the related notes that appear elsewhere in this document.

### **BUSINESS OVERVIEW**

We are a global enterprise networking solutions provider incorporated in Delaware. A pioneer in the computer networking industry, we have three global product and solutions brands—H3C, 3Com, and TippingPoint—that offer high-performance networking and security solutions to enterprises large and small. These organizations range across a number of vertical industries, including education, finance, government, healthcare, insurance, manufacturing and real estate. The H3C® enterprise networking portfolio—one of the leading large enterprise networking equipment brands in China—includes products that span from the data center to the edge of the network and is targeted at large enterprises. The 3Com® family of products offers a strong price/performance value proposition for small and medium businesses. Our TippingPoint® security brand features network-based intrusion prevention systems (IPS) and network access control (NAC) solutions, which deliver in-depth, application, infrastructure and performance protection.

We believe our portfolio of products and services enables customers to deploy and manage business-critical voice, video, data and other advanced networking technologies in a secure, scalable, reliable and efficient network environment. We believe we offer customer-driven technology solutions that help enterprises optimize their budgets and resources, increase productivity, and realize their business goals. 3Com designs its solutions to offer customers a unique value proposition: lower total cost of ownership (TCO) and expert, responsive service. Our data center-to-edge enterprise networking solutions offer a common operating system to streamline system management, and are based on open standards to enable the use of best-of-breed applications from other vendors. We believe we offer a broad, fresh portfolio of products and solutions that disrupt the industry status quo.

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We believe we deliver high-quality, high-performance converged networking solutions that provide exceptional business value and help customers address the following fundamental challenges:

**Performance** Bandwidth demands have increased along with the number of users and applications IP telephony, videoconferencing, streaming multimedia and others on enterprise networks, yet performance requirements never abate. 3Com routers, switches and security devices provide robust throughput and traffic optimization applications to ensure high-quality networking even in the most challenging enterprise network environments.

**Cost effectiveness** Today's enterprise customers are seeking cost-effective solutions that optimize the value of their network infrastructure investment. 3Com products are designed to be cost-effective, competitively priced and energy efficient. 3Com's single-pane, intuitive network management platform minimizes time spent training IT staff and network administrators, helping to further reduce overall TCO.

**Security** Today's enterprises need to protect themselves from a constantly evolving spectrum of internal and external threats to ensure the safety of their mission-critical information. 3Com's pervasive network solutions provide granular oversight, control access, quarantine malicious programs and files, and restore data.

We focus on delivering superior networking solutions that offer a cost advantage to our customers through solutions that are less expensive to acquire, power and operationally manage. Our products are designed to provide superior value through capability design as well as other cost conscious features such as lower power requirements, and inter-operability in multi-vendor networks.

We believe that our global presence, brand identity, strong development organization and intellectual property portfolio provide a solid foundation for achieving our objectives.

Our products are sold on a worldwide basis through a combination of value added resellers, distributors and direct-touch sales representatives. We also work with service providers to deliver managed networking solutions for enterprise customers.

Headquartered in Marlborough, Massachusetts, we have worldwide operations, including sales, marketing, research and development, and customer service and support capabilities.

Our products and services can generally be classified in the following categories:

Switches and routers;

Other networking equipment;

Security; and

Services.

We have introduced multiple new products targeted at the small, medium and large enterprise markets, including a data center switch; modular and multi-service switches and routers; converged IP solutions such as voice; video and surveillance; security; and unified switching solutions. Our recent product introductions and future product strategy are designed to offer a compelling value proposition to our customers, by leveraging open platform technology with options to integrate best-of-breed application solutions directly into their networks.

### *Business Environment and Future Trends*

We operate today in a rapidly changing business environment due to the recent global economic slowdown and the current slow economic recovery. The last several years have been challenging due to the global economic recession, and we have experienced reduced demand, delayed or cancelled purchases and longer sales cycles. More recently, many regions in which we operate have stabilized and we have experienced the beginnings of a slow economic recovery. More specifically by region, our business is highly dependent on the Chinese economy, which has experienced strong growth in recent years. Our success in China has been due to the success of the direct-touch enterprise model, a mixture of core and new products and solution selling, and value creation for customers. While we believe that China may have been less affected than other regions by the global economic slowdown, it has

experienced the effects of the downturn and our growth has slowed in China. While China's growth rates have recently stabilized, it is unclear whether this stabilization will result in increased growth rates in the future. Additionally, we have seen and expect a continued significant reduction in sales to Huawei Technologies throughout fiscal year 2010. Outside of China, which we call our "Rest of World" business, while our operations have been adversely impacted by the global economic slowdown, we have recently witnessed a slow recovery in many regions, although the increase in economic activity remains modest and it is not clear whether economic conditions in

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any particular jurisdiction will continue to improve or will experience a return to recessionary conditions. The slow recovery is evidenced by customers exercising restraint when considering IT-related capital spending. The above factors make it more challenging to predict our future performance.

Our strategy to address these business conditions is to market our solutions as providing exceptional quality for a good value and to remain competitive in the enterprise market. At the same time, we recognize that global spending on networking products and solutions is likely to continue to be under pressure for the foreseeable future. While the timing of a more robust recovery is unclear, we strive to be well positioned when it occurs.

Networking industry analysts and participants differ widely in their assessments concerning the prospects for mid to long-term industry growth, especially in light of the current weakness in many of the major global economies.

Industry factors and trends also present significant challenges in the medium-term. Such factors and trends include intense competition in the market for higher end, enterprise core routing and switching products and aggressive product pricing by competitors targeted at gaining share in the small to medium-sized business market.

We believe that long-term success in this environment requires us to (1) be a global technology leader, (2) increase our revenue and take market share from competitors outside of China, (3) increase and sustain our profitability and (4) increase our generation of cash from operations.

### Technology Strategy

We believe our principal research and development base in China provides a strong foundation for our global product development. Our strategy involves continuing to innovate, using China as a principal market in which to introduce new products and provide leading solutions for global markets. Our approach is to focus on activities that deliver differentiated products and solutions and drive reductions in product costs. Our current areas of focus include data center solutions, security, convergence of applications over IP, advanced switching, routing solutions and other advanced technologies.

### Revenue and Market Share Goals

We believe that our differentiated, comprehensive product portfolio which provides end-to-end IP solutions based on open standards offers a compelling value proposition for customers, particularly in the current economic environment. Our intention is to leverage our global footprint to more effectively sell these products. A key element of our strategy is to increasingly focus on sales to larger enterprise and government accounts in all of our regions.

We intend to execute on three regional strategies as follows:

*China* In China, we have been successful in direct-touch sales to enterprise and government customers. To maintain a leadership position in China, we intend to increase our focus on direct-touch sales as well as pursue other distribution channels. We believe that growing market share in China will be more challenging than in the past given that we already have a significant enterprise networking market share in China. We also intend to continue to introduce innovative new product offerings in the China market, such as IP video surveillance and IP storage, which may offer additional growth opportunities.

Our strategy involves leveraging our significant China-based engineering team and strong brand of networking solutions designed for enterprise and government accounts into greater success in markets outside of China, as further described below.

*Emerging markets outside of China* We expect to target growth opportunities outside of China in other developing markets. We believe that our successful penetration of the Chinese market has provided experience that is transferable to many emerging markets. We believe this experience will position us to gain market share in developing markets.

*Developed global markets* Our goal in developed markets is to increase our market share. Our strategy is to focus on large enterprise and government accounts and to implement this strategy we intend to increase go to market resources. We intend to offer these customers our comprehensive end to end solutions and highlight our products price to performance value proposition and energy efficiency. Our goal is to be well positioned for a more robust economic recovery and in fact we have started to see some stabilization in recent months.

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### **Profitability and Cash Generation Objectives**

We believe that our long-term success is also dependent on our ability to increase our overall profit and cash generation. We believe that by continuing to integrate our worldwide operations we can achieve further operational efficiencies to support continued investment in sales and marketing to grow our business. We may also continue to require targeted investments in infrastructure designed to meet our market share growth objectives.

For our TippingPoint business we plan to focus on growing its top line and continuing to improve operational efficiency and segment profitability. We also plan to leverage our existing sales channels and global footprint to more effectively sell TippingPoint products and services. The Company is also integrating our TippingPoint® IPS technology into our Networking products to deliver a unified product line that combines security, network infrastructure and policy management.

### **Significant Event**

On November 11, 2009, 3Com Corporation, a Delaware corporation ( 3Com ), entered into an Agreement and Plan of Merger (the Merger Agreement ) by and among 3Com, Hewlett-Packard Company, a Delaware corporation ( HP ), and Colorado Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of HP ( Merger Sub ). Upon the terms of the Merger Agreement and subject to the terms set forth therein, Merger Sub will be merged with and into 3Com, and as a result 3Com will continue as the surviving corporation and a wholly owned subsidiary of HP (the

Merger ). Pursuant to the Merger Agreement, at the closing of the Merger, each issued and outstanding share of common stock of 3Com, other than shares owned by 3Com, HP or Merger Sub, or by any stockholders who are entitled to and who properly exercise appraisal rights under Delaware law, will be canceled and will be automatically converted into the right to receive \$7.90 in cash, without interest.

The parties are currently targeting completion of the merger by the end of April 2010, however the exact timing cannot be predicted. The closing of the Merger is subject to the satisfaction or waiver of specified closing conditions, including, without limitation, (i) the adoption of the Merger Agreement by 3Com's stockholders and (ii) the expiration or termination of waiting periods, and obtaining of requisite approvals or clearances, under specified antitrust and competition laws (including, without limitation in China). On December 22, 2009, the relevant U.S. antitrust authorities granted early termination of the waiting period under the U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. On February 12, 2010, the European Commission cleared the Merger under the EU Merger Regulation. In addition, on January 26, 2010, 3Com's stockholders adopted the Merger Agreement at a special meeting of stockholders. For a further discussion of risks associated with the proposed acquisition, please refer to Risk Factors in Part II, Item 1A in this Form 10-Q.

### **Segment Reporting**

In the first quarter of fiscal 2010, we changed the measures of segment profit and segment income to align to how we currently manage our business and report internally. Accordingly, our previously reported segment information has been revised to reflect our new measure of segment profit and segment income. Based on the information provided to our chief operating decision-maker ( CODM ) for purposes of making decisions about allocating resources and assessing performance, we have two primary businesses, our Networking Business and TippingPoint Security Business. Our Networking Business consists of the following sales regions as operating segments: China-based (including Japan and Hong Kong SAR), Asia Pacific Region excluding China-based sales region ( APR ), Europe Middle East and Africa ( EMEA ), Latin America ( LAT ), and North America ( NA ) regions. The APR, EMEA, LAT and NA operating segments have been aggregated given their similar economic characteristics, products, customers and processes, and have been consolidated as one reportable segment called, Rest of World . The China-based sales region does not meet the aggregation criteria at this time.

The China-based and Rest of World reporting segments benefit from shared support services on a world-wide basis. The costs associated with providing these shared central functions are not allocated to the China-based and Rest of World reporting segments and instead are reported and disclosed under the caption Central Functions . Central Function costs include research and development expenses and other operating expenses . Other operating expenses in both our Central Function costs and TippingPoint Security Business include indirect cost of sales, such as supply chain operations expenses, indirect sales and marketing, and general and administrative support costs.



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*Summary of Three Months Ended February 28, 2010 Financial Performance*

Our sales in the three months ended February 28, 2010 were \$345.9 million, compared to sales of \$324.7 million in the three months ended February 28, 2009, an increase of \$21.2 million, or 6.5 percent.

Our gross margin improved to 60.4 percent in the three months ended February 28, 2010 from 57.2 percent in the three months ended February 28, 2009.

Our operating expenses (income) in the three months ended February 28, 2010 were \$186.4 million, compared to \$184.3 million in the three months ended February 28, 2009, a net increase of \$2.1 million, or 1.1 percent.

Our net income in the three months ended February 28, 2010 was \$41.4 million, compared to net income of \$1.9 million in the three months ended February 28, 2009. Included in net income in the three months ended February 28, 2009 was a benefit of approximately \$9.9 million as a result of a decision by the Chinese tax authorities to grant the Company key software developer status which entitles the Company to a 10 percent tax rate in China for the calendar year ended December 31, 2009.

Our balance sheet contains cash and equivalents and short term investments of \$795.0 million as of February 28, 2010, compared to cash and equivalents and short term investments of \$644.2 million at the end of fiscal 2009. The balance sheet also includes long-term debt of \$112 million with \$48 million classified as a current liability as of February 28, 2010, compared to long-term debt of \$200 million with \$48 million classified as a current liability as of May 31, 2009.

*Summary of Nine Months Ended February 28, 2010 Financial Performance*

Our sales in the nine months ended February 28, 2010 were \$958.5 million, compared to sales of \$1,021.9 million in the nine months ended February 28, 2009, a decrease of \$63.4 million, or 6.2 percent.

Our gross margin improved to 59.4 percent in the nine months ended February 28, 2010 from 56.3 percent in the nine months ended February 28, 2009.

Our operating expenses (income) in the nine months ended February 28, 2010 were \$529.0 million, compared to \$496.0 million in the nine months ended February 28, 2009, a net increase of \$33.0 million, or 6.7 percent. Included in the nine months ended February 28, 2009 operating expenses (income) is \$70.0 million of income related to the Realtek patent dispute resolution.

Our net income in the nine months ended February 28, 2010 was \$68.8 million, compared to net income of \$94.6 million in the nine months ended February 28, 2009. Included in the nine months ended February 28, 2010, is a \$10.8 million income tax benefit due to the favorable determination of our calendar 2008 China tax rate and a benefit of approximately \$9.9 million as a result of a decision by the Chinese tax authorities to grant the Company key software developer status which entitles the Company to a 10 percent tax rate in China for the calendar year ended December 31, 2009. Included in the nine months ended February 28, 2009 net income is \$70.0 million of income related to the Realtek patent dispute resolution.

**CRITICAL ACCOUNTING POLICIES**

Our critical accounting policies are described in the Annual Report on Form 10-K for the fiscal year ended May 31, 2009. There have been no significant changes to these policies during the nine months ended February 28, 2010. These policies continue to be those that we feel are most important to a reader's ability to understand our financial results.

**Table of Contents****RESULTS OF OPERATIONS****THREE AND NINE MONTHS ENDED FEBRUARY 28, 2010 AND 2009**

The following table sets forth, for the periods indicated, the percentage of total sales represented by the line items reflected in our condensed consolidated statements of operations:

|                                | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|--------------------------------|--|-------------|---|-------------|
|                                | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| Sales                          | 100.0%                                     | 100.0%      | 100.0%                                    | 100.0%      |
| Cost of sales                  | 39.6                                       | 42.8        | 40.6                                      | 43.7        |
| Gross profit margin            | 60.4                                       | 57.2        | 59.4                                      | 56.3        |
| Operating expenses (income):   |  |             |   |             |
| Sales and marketing            | 29.1                                       | 26.3        | 29.1                                      | 25.7        |
| Research and development       | 13.9                                       | 13.9        | 13.4                                      | 13.8        |
| General and administrative     | 6.1  | 8.5         | 7.1                                       | 7.9         |
| Amortization                   | 4.8  | 7.1         | 5.3                                       | 7.2         |
| Realtek patent resolution      |  |             |   | (6.8)       |
| Restructuring charges          | 0.0  | 0.9         | 0.3                                       | 0.7         |
| Operating expenses, net        | 53.9                                       | 56.7        | 55.2                                      | 48.5        |
| Operating income               | 6.5  | 0.5         | 4.2                                       | 7.8         |
| Interest income (expense), net | 0.2  | (1.0)       | (0.2)                                     | (0.5)       |
| Other income, net              | 5.7  | 5.1         | 3.8                                       | 4.4         |
| Income before income taxes     | 12.4                                       | 4.6         | 7.8                                       | 11.7        |
| Income tax provision           | (0.4)                                      | (4.0)       | (0.6)                                     | (2.4)       |
| Net income                     | 12.0%                                      | 0.6%        | 7.2%                                      | 9.3%        |

**Sales**

Consolidated sales for the three and nine months ended February 28, 2010 and 2009 by segment were as follows (dollars in millions):

|                                | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|--------------------------------|--|-------------|---|-------------|
|                                | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| China-based sales region       | \$ 188.0                                   | \$ 190.4    | \$ 509.3                                  | \$ 565.6    |
| Rest of World sales region     | 123.4                                      | 102.8       | 349.8                                     | 368.8       |
| TippingPoint security business | 37.9                                       | 33.3        | 106.3                                     | 92.5        |
| Eliminations and other         | (3.4)                                      | (1.8)       | (6.9)                                     | (5.0)       |
| Consolidated sales             | \$ 345.9                                   | \$ 324.7    | \$ 958.5                                  | \$ 1,021.9  |

Sales in our China-based sales region decreased \$2.4 million, or 1.3 percent, in the three months ended February 28, 2010 and decreased \$56.3 million, or 10.0 percent in the nine months ended February 28, 2010 compared to the same periods in the previous fiscal year. The decrease in sales in the three and nine months ended February 28, 2010 is primarily attributable to decreased sales to Huawei. Huawei sales decreased \$43.5 million in the three months ended



February 28, 2010 as compared to the same quarter in the prior fiscal year, mostly offset by an increase of \$38.0 million of China direct-touch sales. Huawei sales decreased \$126.8 million in the nine months ended February 28, 2010 as compared to the same period in the prior fiscal year, partially offset by an increase of \$69.4 million of China direct-touch sales. The increase in China direct-touch sales in the three months ended February 28, 2010 primarily relates to increased sales of \$21.8 million and \$6.7 million, respectively, of our switches and WLAN products. The increase in China direct-touch sales in the nine months ended February 28, 2010 primarily relates to increased sales of \$28.5 million and \$27.7 million, respectively, of our switches and WLAN . When compared to our first and second quarters of fiscal 2010, however, our China-based sales region's revenues for the three months ended February 28, 2010 increased by \$36.0 million and \$18.7 million, respectively, reflecting the traction we have made with our China-direct touch sales force.

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Sales in our Rest of World sales region increased \$20.6 million, or 20.0 percent, in the three months ended February 28, 2010 but decreased \$19.0 million, or 5.2 percent in the nine months ended February 28, 2010 compared to the same periods in the previous fiscal year. The increase in sales in the three months ended February 28, 2010 is primarily attributable to increased sales volume in all of regions reflecting the slow economic recovery and market stabilization and increased demand for our H3C products in our rest of world sales regions. The decrease in sales in the nine months February 28, 2010 is primarily attributable to decreased sales volume in all of our regions in the first half of fiscal 2010 as compared to the first half of fiscal 2009 as we experienced longer sales cycles, delayed or cancelled purchases and reduced incoming orders because of the global economic downturn that began in fiscal 2009. In our fiscal third quarter of 2010, we saw year over increased sales volume and new product sales reflecting the slow economic recovery and market stabilization we have recently experienced as compared to the same period of the prior fiscal year. When compared to our first and second quarters of fiscal 2010, our Rest of World revenues for the three months ended February 28, 2010 increased by \$16.2 million and \$4.1 million, respectively, reflecting the slow economic recovery and market stabilization we have recently experienced.

Sales in our TippingPoint security business increased \$4.6 million, or 13.8 percent, in the three months ended February 28, 2010 and increased \$13.8 million, or 14.9 percent in the nine months ended February 28, 2010 compared to the same periods in the previous fiscal year. The increase in sales in both the three and nine months ended February 28, 2010 is driven both by our hardware and maintenance business. Product sales increased \$2.1 million and \$5.0 million, respectively, due in large part to introduction of new products and increased investment in selling and marketing expenses. Higher maintenance renewal rates coupled with increased contracts drove an increase in maintenance revenue \$2.5 million and \$8.8 million, respectively.

Consolidated sales increased by \$21.2 million, or 6.5 percent, in the three months ended February 28, 2010 but decreased by \$63.4 million, or 6.2 percent, in the nine months ended February 28, 2010 compared to the same period in the previous fiscal year. The increase in the three months ended February 28, 2010 compared to the same periods in the prior fiscal year is primarily due to increased China direct-touch sales and increased sales in our Rest of World sales region due to the slow economic recovery and market stabilization and increased demand for our H3C products, partially offset by decreased sales to Huawei. The decrease in the nine months ended February 28, 2010 compared to the same periods in the prior fiscal year is primarily due to a decrease of \$126.8 million in sales to Huawei, partially offset by increased China direct-touch sales. When compared to our first and second quarters of fiscal 2010, our consolidated sales for the three months ended February 28, 2010 increased by \$55.4 million and \$23.7 million, respectively, reflecting the slow economic recovery and market stabilization we have recently experienced.

Sales by major product categories are as follows (dollars in millions):

|                            | Three Months Ended February 28, |      |         |      | Nine Months Ended February 28, |      |           |      |
|----------------------------|---------------------------------|------|---------|------|--------------------------------|------|-----------|------|
|                            | 2010                            |      | 2009    |      | 2010                           |      | 2009      |      |
| Switches and routers       | \$234.4                         | 68%  | \$227.6 | 70%  | \$643.2                        | 67%  | \$ 738.3  | 72%  |
| Other networking equipment | 48.5                            | 14%  | 41.7    | 13%  | 141.3                          | 15%  | 126.3     | 13%  |
| Security                   | 48.3                            | 14%  | 43.5    | 13%  | 135.4                          | 14%  | 122.7     | 12%  |
| Services                   | 14.7                            | 4%   | 11.9    | 4%   | 38.6                           | 4%   | 34.6      | 3%   |
| Total                      | \$345.9                         | 100% | \$324.7 | 100% | \$958.5                        | 100% | \$1,021.9 | 100% |

Switches and routers revenue includes sales of our Layer 2 and Layer 3 stackable 10/100/1000 managed switching lines, our modular switching lines and routers. Sales of these products increased \$6.8 million or 2.9 percent in the three months ended February 28, 2010 but decreased \$95.1 million or 12.9 percent in the nine months ended February 28, 2010 compared to the same periods in the previous fiscal year. The increase in sales in the three months ended February 28, 2010 was primarily driven by increased sales in our Rest of World sales region of our H3C

sourced products as well as increased China direct touch sales, partially offset by decreased volume to Huawei when compared with corresponding periods in the prior fiscal year. The decrease in sales in the nine months ended February 28, 2010 was primarily driven by decreased sales volume to Huawei when compared with corresponding periods in the prior fiscal year.

Other networking equipment revenue includes sales of our VCX and NBX® voice-over-internet protocol, or VoIP, IP storage, IP surveillance and our WLAN products. Sales of our other networking equipment products increased \$6.8 million or 16.3 percent in the three months ended February 28, 2010 and \$15.0 million, or 11.9 percent, in the nine months ended February 28, 2010 compared to the same period in the previous fiscal year. The increase in sales of our other networking products in the three months ended February 28, 2010 was primarily due to increased WLAN sales of \$6.6 million. The increase in sales of our other networking products in the nine months ended February 28, 2010 was primarily due to increased WLAN sales of \$27.8 million, partially offset by decreased voice sales of \$9.9 million.

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Security revenue includes our TippingPoint products and services, as well as other security products, such as our embedded firewall, or EFW and virtual private network, or VPN, products. Sales of our security products increased \$4.8 million or 11.0 percent in the three months ended February 28, 2010 and \$12.7 million, or 10.4 percent for the nine months ended February 28, 2010 compared to the same periods in the previous fiscal year. The increase in the three and nine months ended February 29, 2010 is primarily driven by the combined factors of new product introductions due to increased selling and marketing investments as well as our maintenance renewal business which saw higher renewal rates and an increase in the number of maintenance contracts.

Services revenue includes professional services and maintenance contracts, excluding TippingPoint maintenance which is included in security revenue. Services revenue increased \$2.8 million or 23.5 percent in the three months ended February 28, 2010 and \$4.0 million, or 11.6 percent, in the nine months ended February 28, 2010 compared to the same period in the previous fiscal year. The increase in sales in the three and nine months ended February 28, 2010 was driven primarily by increased service sales tied to growth in our China direct-touch sales.

**Gross Margin Percentage**

Gross margin for the three and nine months ended February 28, 2010 and 2009 by segment was as follows:

|                                | <b>Three Months Ended<br/>February 28,</b> |             | <b>Nine Months Ended<br/>February 28,</b> |             |
|--------------------------------|--|-------------|---|-------------|
|                                | <b>2010</b>                                | <b>2009</b> | <b>2010</b>                               | <b>2009</b> |
| Networking business            | 57.6%                                      | 55.8%       | 56.8%                                     | 54.9%       |
| TippingPoint security business | 78.0%                                      | 66.6%       | 76.0%                                     | 67.7%       |
| Consolidated margin            | 60.4%                                      | 57.2%       | 59.4%                                     | 56.3%       |

Gross margin in our Networking business improved 1.8 points to 57.6 percent in the three months ended February 28, 2010 from 55.8 percent, and 1.9 points to 56.8 percent in the nine months ended February 28, 2010 from 54.9 percent in the same periods in the previous fiscal year. The improvement in gross profit margin for the three and nine months ended February 28, 2010 is primarily explained by higher standard margins in our China-based sales region driven by customer mix as our sales to Huawei continue to decrease and higher standard margins in our Rest of World sales region driven by product mix due to a higher proportion of sales of our H3C sourced products.

Gross margin in our TippingPoint security business increased 11.4 points to 78.0 percent in the three months ended February 28, 2010 from 66.6 percent in the same period of the previous fiscal year. In the nine months ended February 28, 2010 gross margin increased 8.3 points to 76.0 percent from 67.7 percent in the same period of the previous fiscal year.

The improvement in gross profit margin in the three months ended February 28, 2010 is primarily due to the inclusion in the three months ended February 28, 2009 of a reserve for excess and obsolete inventory of approximately \$3.5 million which did not recur in the three months ended February 28, 2010.

The improvement in gross profit margin in the nine months ended February 28, 2010 is primarily due to the nine months ended February 28, 2009 an increase in standard margins of 2 percent, increased sales as well as the nine months ended February 28, 2009 having included a reserve for excess and obsolete inventory of approximately \$3.5 million which did not recur in the nine months ended February 28, 2010.

Gross margin on a consolidated basis increased 3.2 points to 60.4 percent in the three months ended February 28, 2010 from 57.2 percent, and 3.0 percent to 59.4 percent in the nine months ended February 28, 2010 from 56.3 in the same period in the previous fiscal year. This increase in the three and nine months ended February 28, 2010 is due principally to the segment specific items discussed above.

**Table of Contents****Operating Expenses (Income)**

| (dollars in millions)      | <b>Three Months<br/>Ended<br/>February 28,</b> |             | <b>Change</b> |          | <b>Nine Months<br/>Ended<br/>February 28,</b> |             | <b>Change</b> |          |
|----------------------------|--|-------------|---------------|----------|---|-------------|---------------|----------|
|                            | <b>2010</b>                                    | <b>2009</b> | <b>\$</b>     | <b>%</b> | <b>2010</b>                                   | <b>2009</b> | <b>\$</b>     | <b>%</b> |
| Sales and marketing        | \$ 100.5                                       | \$ 85.5     | \$ 15.0       | 18%      | \$ 279.1                                      | \$ 262.9    | \$ 16.2       | 6%       |
| Research and development   | 48.0   | 45.2        | 2.8           | 6%       | 128.4   | 141.6       | (13.2)        | (9)%     |
| General and administrative | 21.3   | 27.6        | (6.3)         | (23)%    | 68.5  | 80.7        | (12.2)        | (15)%    |
| Amortization               | 16.5   | 23.1        | (6.6)         | (29)%    | 50.3  | 73.4        | (23.1)        | (31)%    |
| Patent dispute resolution  |  |             |               | *        |   | (70.0)      | 70.0          | *        |
| Restructuring charges      | 0.1  | 2.9         | (2.8)         | (97)%    | 2.7   | 7.4         | (4.7)         | (64)%    |
| Operating expenses, net    | \$ 186.4                                       | \$ 184.3    | \$ 2.1        | 1%       | \$ 529.0                                      | \$ 496.0    | \$ 33.0       | 7%       |

\* - *percentage calculation not meaningful.*

***Sales and Marketing***

The most significant factors in the increase in the three months ended February 28, 2010 compared to the same period in fiscal 2009 was increased agent commissions on China direct-touch sales, increased commissions on higher sales in our Rest of World sales region and increased headcount as we transition to an enterprise sales model. The most significant factor in the increase in the nine months ended February 28, 2010 compared to the same period in fiscal 2009 was increased agent commissions on China direct-touch sales.

***Research and Development***

The most significant factor contributing to the increase in the three months ended February 28, 2010 compared to the same period in fiscal 2009 was increased research and development activities as well as increased incentive based compensation in the period. The most significant factor contributing to the decrease in the nine months ended February 28, 2010 compared to the same period in fiscal 2009 was savings from integration and consolidation of our Networking research and development to China.

***General and Administrative***

The most significant factor in the decrease in the three months ended February 28, 2010 compared to the same period in fiscal 2009 was the recognition of \$4.0 million of non-recurring gains in the current quarter, more specifically, a \$2.3 million gain related to a class action lawsuit, a \$1.1 million sale of a state tax receivable, a \$0.4 million legal settlement and a \$0.2 million VAT recovery. Additionally, in the prior quarter we experienced legal fees of \$2.4 million related to patent settlements and a \$1.2 million property impairment, and in the current period we incurred \$2.8 million of HP acquisition-related expenses.

The most significant factor in the decrease in the nine months ended February 28, 2010 compared to the same period in fiscal 2009 was the absence of certain non-recurring expenses in the current period that were present in fiscal 2009. More specifically, in the prior period we experienced legal fees of \$7.3 million related to patent settlements, \$0.8 million of TippingPoint stand alone audit fees and \$0.8 million of TippingPoint retention bonuses. Additionally, in the current period we recognized \$4.0 million of non-recurring gains more specifically, a \$2.3 million gain related to a class action lawsuit, a \$1.1 million sale of a state tax receivable, a \$0.4 million legal settlement and a \$0.2 million VAT recovery, partially offset by \$7.4 million of HP acquisition-related expenses.

*Amortization*

Amortization decreased \$6.6 million and \$23.1 million in the three and nine months ended February 28, 2010, respectively, when compared to the previous fiscal year due primarily to our Huawei non-compete agreement and certain intangible assets from our Roving Planet acquisition becoming fully amortized during fiscal 2009.

*Patent dispute resolution*

The Company and Realtek Group reached an agreement with respect to certain networking technologies of the Company

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that resolved a long-standing patent dispute between the companies. Under the terms of the agreement, Realtek paid the Company \$70.0 million, all of which was received in the three months ended August 31, 2008.

The Company recognized the full \$70.0 million as operating income in the first quarter of fiscal 2009.

### *Restructuring Charges*

Net restructuring charges in the three months ended February 28, 2010 consisted of \$0.1 million for severance and outplacement costs and relate primarily to continuation of programs initiated in prior periods. Net restructuring charges in the nine months ended February 28, 2010 consisted of \$2.6 million for severance and outplacement costs and \$0.1 million for facilities-related charges primarily related to severance for certain of our sales and marketing employees as the Company continues to shift our focus increasingly on the larger enterprise market.

Net restructuring charges in the three months ended February 28, 2009 consisted of \$2.9 million for severance and outplacement costs and relate primarily to our TippingPoint integration. Net restructuring charges in the nine months ended February 28, 2009 consisted of \$6.0 million for severance and outplacement costs and \$1.4 million for facilities-related charges.

See Note 5 to Condensed Consolidated Financial Statements for a more detailed discussion of restructuring charges.

### *Interest Expense, Net*

In the three months ended February 28, 2010 the Company earned \$0.7 million of net interest income, versus net interest expense of \$3.3 million in same period of the prior fiscal year. In the nine months ended February 28, 2010, the Company incurred \$2.3 million in net interest expense, versus net interest expense of \$5.1 million in same period of the prior fiscal year. The increase in net interest income reflects decreased interest expense due to the decreased principal balance of our long term debt from \$213 million in our fiscal 2009 third quarter to \$112 million in the current fiscal quarter as well as the decreased interest expense due to a lower LIBOR rate on the loan.

### *Other Income, Net*

Other income, net was \$19.7 million in the three months ended February 28, 2010, an increase of \$3.2 million compared to the three months ended February 28, 2009. Other income, net was \$37.1 million in the nine months ended February 28, 2010, a decrease of \$8.2 million compared to the nine months ended February 28, 2009. The increase in the three months ended February 28, 2010 was primarily due to an increase in amounts received under an operating subsidy program by the Chinese VAT authorities in the form of a partial refund of VAT taxes collected by our China-based sales region from purchasers of software products. In the three months ended February 28, 2010 we collected four months of refunds in the quarter compared to 3 months in the prior fiscal year. We collected September 2009's refund in October 2009 which falls in our fiscal third quarter. The subsidy payments are taken into income on a cash basis. The decrease in the nine months ended February 28, 2010 was primarily due to foreign exchanges losses in fiscal 2010 of \$0.2 million compared to foreign currency gains in fiscal 2009 of \$6.6 million as well as a decrease in amounts received under the operating subsidy program by the Chinese VAT authorities. The timing of the receipt of payments, the manner in which they are calculated, and the continuation of the program, are subject to the discretion of the Chinese VAT authorities. This program is scheduled to terminate on December 31, 2010.

**Table of Contents***Income Tax Provision*

The income tax provision in all periods was the result of providing for taxes in certain foreign jurisdictions at the prevailing statutory tax rates. We recorded an income tax expense of \$1.3 million for the three months ended February 28, 2010, compared to an income tax expense of \$12.8 million in the corresponding period of the previous fiscal year. The three months ended February 28, 2010 included a benefit of approximately \$9.9 million as a result of a decision by the Chinese tax authorities to grant the Company Key Software development Enterprise status which entitles the Company to a 10 percent tax rate in China for the calendar year ended December 31, 2009. Prior to this ruling, the Company had recorded taxes at a rate of 15 percent in China. By comparison, the three months ended February 28, 2009 included a \$12.1 million tax provision related to a change in the applicable tax rate in China from 10 percent to 15 percent.

For the nine months ended February 28, 2010, we recorded income tax expense of \$6.0 million compared to income tax expense of \$24.9 million in the corresponding period of the previous fiscal year. In addition to the tax benefits recorded in the third quarter of fiscal 2010, the Company recorded a tax benefit in the second quarter of fiscal 2010 related to the favorable resolution of our 2008 tax rate in China resulting in a \$10.8 million benefit. During the three and nine months ended February 28, 2010, taxes on our China based subsidiary were recorded at 10 percent compared to 15 percent for the three and nine months ended February 28, 2009.

Deferred tax assets and liabilities are recorded at the expected future tax rate in China of 15 percent.

**Segment Analysis (tables in thousands)**

The results of our regional Networking segments, Central Functions, and our TippingPoint Security business as our CODM reviews their profitability are presented below.

*China-based sales region:*

|                                     | Three months ended<br>February 28, |            | Nine months ended<br>February 28, |            |
|-------------------------------------|------------------------------------|------------|-----------------------------------|------------|
|                                     | 2010                               | 2009       | 2010                              | 2009       |
| Sales                               | \$ 187,963                         | \$ 190,385 | \$ 509,273                        | \$ 565,597 |
| Standard margin                     | 133,300                            | 128,160    | 353,397                           | 375,588    |
| Direct sales and marketing expenses | 43,109                             | 36,581     | 117,520                           | 106,194    |
| Segment contribution profit         | \$ 90,191                          | \$ 91,579  | \$ 235,877                        | \$ 269,394 |

Segment contribution profit in the three months ended February 28, 2010 decreased \$1.4 million to \$90.2 million when compared to the same period of the prior fiscal year. Segment contribution profit in the nine months ended February 28, 2010 decreased \$33.5 million to \$235.9 million when compared to the same period of the prior fiscal year. Segment contribution profit is standard margin less segment direct sales and marketing expenses. The decrease in the three and nine months ended February 28, 2010 was primarily driven by decreased sales to Huawei and increased agent commissions on higher China direct-touch sales. These decreases to segment contribution profit were partially offset by increased China direct-touch sales which carried higher margins and increased sales to Japan and Hong Kong.

*Rest of World sales region:*

|                                     | Three months ended<br>February 28, |            | Nine months ended<br>February 28, |            |
|-------------------------------------|------------------------------------|------------|-----------------------------------|------------|
|                                     | 2010                               | 2009       | 2010                              | 2009       |
| Sales                               | \$ 123,401                         | \$ 102,836 | \$ 349,862                        | \$ 368,838 |
| Standard margin                     | 79,033                             | 61,365     | 215,553                           | 215,479    |
| Direct sales and marketing expenses | 26,354                             | 23,360     | 75,663                            | 77,254     |
| Segment contribution profit         | \$ 52,679                          | \$ 38,005  | \$ 139,890                        | \$ 138,225 |





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Segment contribution profit in the three months ended February 28, 2010 increased \$14.7 million to \$52.7 million when compared to the same period of the prior fiscal year. Segment contribution profit in the nine months ended February 28, 2010 increased \$1.7 million to \$139.9 million when compared to the same periods of the prior fiscal year. Segment contribution profit is standard margin less segment direct sales and marketing expenses. The increase in the three months ended February 28, 2010 primarily relates to higher standard margins due primarily to increases in average selling prices and increased sales volume of our H3C enterprise solutions which carry higher margins. The increase in the nine months ended February 28, 2010 primarily relates to higher standard margins due primarily to increases in average selling prices and increased sales volume of our H3C enterprise solutions, partially offset by decreased sales in all regions due primarily to decreased volume as we experienced longer sales cycles, delayed or cancelled purchases and reduced incoming orders in the first half of fiscal 2010 as compared to the first half of 2009 because of the global economic downturn.

*Central Functions:*

|                                   | Three months ended<br>February 28, |           | Nine months ended<br>February 28, |            |
|-----------------------------------|------------------------------------|-----------|-----------------------------------|------------|
|                                   | 2010                               | 2009      | 2010                              | 2009       |
| Research and development expenses | \$ 40,409                          | \$ 37,574 | \$ 107,429                        | \$ 118,603 |
| Other operating expenses          | 61,567                             | 56,146    | 170,062                           | 177,697    |
| Total cost and expenses           | \$ 101,976                         | \$ 93,720 | \$ 277,491                        | \$ 296,300 |

Total costs and expenses in the three months ended February 28, 2010 increased \$8.3 million to \$102.0 million when compared to the same period of the prior fiscal year. Total costs and expenses in the nine months ended February 28, 2010 decreased \$18.8 million to \$277.5 million when compared to the same period of the prior fiscal year. Other operating expenses include supply chain costs, general and administrative costs and central marketing costs excluding those included in Eliminations and Other. The increase in the three months ended February 28, 2010 was primarily related to increased supply chain costs well as increased research and development costs due to increased incentive based compensation in China. The decrease in the nine months ended February 28, 2010 was primarily related to continued savings from integration of research and development, lower compensation charges due to headcount reductions and lower discretionary spending, specifically in travel and entertainment.

*TippingPoint Security business:*

|                                     | Three months ended<br>February 28, |           | Nine months ended<br>February 28, |           |
|-------------------------------------|------------------------------------|-----------|-----------------------------------|-----------|
|                                     | 2010                               | 2009      | 2010                              | 2009      |
| Sales                               | \$ 37,898                          | \$ 33,284 | \$ 106,334                        | \$ 92,499 |
| Standard margin                     | 32,076                             | 28,288    | 89,960                            | 76,962    |
| Direct sales and marketing expenses | 13,543                             | 10,882    | 37,325                            | 32,873    |
| Segment contribution profit         | 18,533                             | 17,406    | 52,635                            | 44,089    |
| Research and development expenses   | 7,050                              | 7,103     | 19,499                            | 20,698    |
| Segment income                      | \$ 11,483                          | \$ 10,303 | \$ 33,136                         | \$ 23,391 |

TippingPoint segment income in the three months ended February 28, 2010 was \$11.5 million compared to segment income of \$10.3 million in the same period of the prior fiscal year. TippingPoint segment income in the nine months ended February 28, 2010 was \$33.1 million compared to segment income of \$23.4 million in the same periods of the prior fiscal year. Segment income is standard margin less direct sales and marketing and research and development

expenses, excluding those included in Eliminations and Other. The increase in the three and nine months ended February 28, 2010 was due primarily to higher sales of both maintenance contracts and new products partially offset by increased sales and marketing expenses primarily due to increased headcount and increased commissions on higher bookings.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

Cash and equivalents and short-term investments as of February 28, 2010 were \$795.0 million, an increase of \$150.8 million compared to the balance of \$644.2 million as of May 31, 2009. These balances were comprised of the following (in millions):

|   | February<br>28,<br>2010 | May 31,<br>2009 |
|---|-------------------------|-----------------|
| Cash and equivalents                            | \$ 795.0                | \$ 545.8        |
| Short-term investments                          |                         | 98.4            |
| Cash and equivalents and short-term investments | \$ 795.0                | \$ 644.2        |

The following table shows the major components of our condensed consolidated statements of cash flows for the nine months ended February 28, 2010 and 2009 (in millions):

|   | Nine Months Ended February<br>28, |          |
|---|-----------------------------------|----------|
|   | 2010                              | 2009     |
| Cash and equivalents, beginning of period               | \$ 545.8                          | \$ 503.6 |
| Net cash provided by operating activities               | 224.8                             | 196.3    |
| Net cash provided by (used in) investing activities     | 87.5                              | (12.5)   |
| Net cash used in financing activities                   | (63.7)                            | (136.3)  |
| Effect of exchange rate changes on cash and equivalents | 0.6                               | 8.9      |
| Cash and equivalents, end of period                     | \$ 795.0                          | \$ 560.0 |

Net cash provided by operating activities was \$224.8 million for the nine months ended February 28, 2010 compared to \$196.3 million in the nine months ended February 28, 2009. The increase was primarily due to improvements in working capital, specifically accounts and notes receivable and an increase in accounts payables and deferred revenue as compared to the same period last year, partially offset by a decrease in net income of \$25.7 million due to the patent dispute resolution of \$70 million that was recorded in the prior year.

In the nine months ended February 28, 2010, inventory increased as we positioned the company to meet the demands of the economic recovery. In the nine months ended February 28, 2009, accounts and notes receivable increased as a result of significant sales increases during those periods, accounts payable decreased significantly as a result of the timing of payments.

Net cash provided by investing activities was \$87.5 million for the nine months ended February 28, 2010, resulting primarily from \$98.7 million of proceeds for the maturity of short-term investments, partially offset by \$11.2 million of outflows related to purchases of property and equipment.

Net cash used in financing activities was \$63.7 million in the nine months ended February 28, 2010. During the nine months ended February 28, 2010, we made a principal payment of \$88.0 million related to our long term debt, \$40 million of which was a voluntary prepayment. We had proceeds of \$28.5 million from issuances of our common stock upon exercise of stock options, partially offset by \$4.2 million of repurchases of shares of restricted stock awards and units upon vesting from employees, including those shares to satisfy the tax withholding obligations that arise in connection with such vesting.

On September 28, 2009 we made a \$48 million scheduled debt payment on the Company's credit facility and a \$40 million voluntary prepayment which the Company did not incur a penalty for, all of which was applied to reduce our fiscal year 2013 Tranche B principal balance.

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Remaining payments on the \$112 million principal balance outstanding on the Company's credit facility after our September 28, 2009 payment are due on September 28, of each year as follows, (in thousands):

| <b>Calendar Year</b> | <b>3Com Fiscal<br/>Year</b> | <b>Tranche A</b> | <b>Tranche B</b> |
|----------------------|-----------------------------|------------------|------------------|
| 2010                 | 2011                        | 46,000           | 2,000            |
| 2011                 | 2012                        |                  | 20,000           |
| 2012                 | 2013                        |                  | 44,000           |

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On September 28, 2009 our applicable LIBOR rates reset to 0.64 percent and the effective interest rate for the six months from that date will be 2.14 percent for the Tranche A Term Facility and 3.64 percent for the Tranche B Term Facility. On March 29, 2010 the LIBOR rates reset to 0.44 percent and the effective interest rate will be 1.94 percent for the Tranche A Term Facility and 3.44 percent for the Tranche B Term Facility and will remain the rates until September 29, 2010.

As of February 28, 2010, bank-issued standby letters of credit and guarantees totaled \$7.0 million, including \$6.0 million relating to potential foreign tax, custom, and duty assessments. We provide the bank with cash collateral for 100 percent of these amounts.

On June 8, 2009, we renewed a lease on our Marlborough, MA facility. The lease is for a ten year and two month term from June 1, 2009 through and including July 31, 2019. Under the terms of the lease agreement with landlord Bel Marlborough I LLC we will pay an average annual rent of \$3.0 million per year. These lease payments were included in the contractual obligations table in our Form 10-K for the period ended May 31, 2009.

We currently have no material capital expenditure purchase commitments other than ordinary course purchases of computer hardware, software and leasehold improvements.

In recent years, we have generated most of our positive cash flow from our China operations. Our capital requirements in Rest of World have been met from cash flow from operations as well as from existing cash balances and permitted dividends from China. Dividends from our China operations to our Rest of World operations are generally subject to the following restrictions: (1) a 10 percent reserve requirement imposed by PRC law (capped at 50 percent of registered capital), which was \$43.9 million at February 28, 2010), (2) a 5 percent withholding tax imposed by the PRC on profits earned on or after January 1, 2008 and (3) a credit agreement restriction limiting our ability to dividend cash outside of the H3C Group and requiring that a specified percentage of excess cash flow from China be annually used to prepay debt. There are also administrative requirements for making dividends out of China that involve filings with government agencies seeking approval to pay a dividend. Government officials can dictate when we can pay a dividend and can specify specific terms or conditions for making the payment. As of February 28, 2010 the H3C Group's net assets were \$877.3 million and are subject to these dividend restrictions.

An important exception to the credit agreement restriction permits us to annually dividend from China to Rest of World the percentage of H3C's excess cash flow that is not required to be prepaid to the banks under the terms of the agreement, provided that certain conditions are met. In the nine months ended February 28, 2010 we used this exception and made dividend payments of \$155.0 million. No dividends were made to our parent company. We have no prepayment penalty on our loan and at this time our cash and equivalents balances significantly exceed our outstanding principal loan balance.

In Rest of World we currently do not generate positive cash flow. As a result of these factors, we intend to continue to manage cash and monitor discretionary cash spending, especially in periods prior to receipt of any available and permitted annual dividend payments from China.

On May 25, 2007, our subsidiary H3C Holdings Limited ( "Borrower" ) entered into an amended and restated credit agreement with various lenders, including Goldman Sachs Credit Partners L.P., as Mandated Lead Arranger, Bookrunner, Administrative Agent and Syndication Agent, and Industrial and Commercial Bank of China (Asia) Limited, as Collateral Agent (the "Credit Agreement" ). Under the original credit agreement, the Borrower borrowed \$430 million in the form of a senior secured term loan with two tranches (Tranche A and Tranche B) to finance a portion of the purchase price for 3Com's acquisition of 49 percent of H3C Technologies Co., Limited, or H3C. Remaining principal is \$112 million as of February 28, 2010 and the final loan maturity date is on September 28, 2012.

Interest on borrowings is payable semi-annually on March 28 and September 28. All amounts outstanding under the Tranche A Term Facility will bear interest, at the Borrower's option, at the (i) LIBOR, or (ii) Base Rate (i.e., prime rate), in each case plus the applicable margin percentage set forth in the table below, which is based on a leverage ratio of consolidated indebtedness of the Borrower and its subsidiaries to EBITDA (as defined in the Credit Agreement) for the relevant twelve-month period:

|                       |                |                    |
|-----------------------|----------------|--------------------|
| <b>Leverage Ratio</b> | <b>LIBOR +</b> | <b>Base Rate +</b> |
|-----------------------|----------------|--------------------|

|                        |       |       |
|------------------------|-------|-------|
| >3.0:1.0               | 2.25% | 1.25% |
| ≤3.0:1.0 but > 2.0:1.0 | 2.00% | 1.00% |
| ≤2.0:1.0 but > 1.0:1.0 | 1.75% | 0.75% |
| ≤1.0:1.0               | 1.50% | 0.50% |

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All amounts outstanding under the Tranche B Term Facility will bear interest, at the Borrower's option, at the (i) LIBOR plus 3 percent or (ii) Base Rate (i.e., prime rate) plus 2 percent. We have elected to use LIBOR as the reference rate for borrowings to date, and expect to do so for the foreseeable future. Applicable LIBOR rates at February 28, 2010 were 0.64 percent and the effective interest rate is currently 2.14 percent for the Tranche A Term Facility and 3.64 percent for the Tranche B Term Facility.

Covenants and other restrictions under the Credit Agreement apply to the Borrower and its subsidiaries, which we refer to as the H3C Group, but not to 3Com's Rest of World reporting units or TippingPoint. The loans are secured by assets at the H3C level. H3C also guarantees the loans.

The loans may be prepaid in whole or in part without premium or penalty if paid at the time of making a semi-annual interest payment. The Borrower will be required to make mandatory prepayments using net proceeds from H3C Group (i) asset sales, (ii) insurance proceeds and (iii) equity offerings or debt incurrence. In addition, the Borrower will be required to make annual prepayments in an amount equal to 75 percent of excess cash flow of the H3C Group. This percentage will decrease to the extent that the Borrower's leverage ratio is lower than specified amounts. Any excess cash flow amounts not required to prepay the loan may be distributed to and used by the Company's other segments, provided certain conditions are met.

The Borrower must maintain a minimum debt service coverage, minimum interest coverage, maximum capital expenditures and a maximum total leverage ratio. Negative covenants restrict, among other things, (i) the incurrence of indebtedness by the Borrower and its subsidiaries, (ii) the making of dividends and distributions to 3Com's other segments, (iii) the ability to make investments including in new subsidiaries, (iv) the ability to undertake mergers and acquisitions and (v) sales of assets. Also, cash dividends from the PRC subsidiaries to H3C, and H3C to the Borrower, will be subject to restricted use pending payment of principal, interest and excess cash flow prepayments. Standard events of default and defaulted interest rates apply.

Our Merger Agreement with HP generally prohibits us from raising equity or debt capital, or paying dividends to 3Com stockholders, without first obtaining HP's prior written consent, which consent may not be unreasonably withheld, delayed or conditioned.

The final cash payment requirement under the H3C EARP (Equity Appreciation Rights Plan) is expected to occur in the spring of calendar 2010 in the amount of approximately \$14 million.

We believe that our future cash requirements will likely include an aggregate of \$2 million to \$5 million for professional and other fees related to our proposed acquisition by HP that are not contingent on the closing of the deal. We currently believe that our existing cash and equivalents and cash generated from future operations will be sufficient to satisfy our anticipated cash requirements and required loan payments for at least the next 12 months.

### **EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

*Accounting Pronouncements* The Financial Accounting Standards Board ( FASB ) is the authoritative body for financial accounting and reporting in the United States. On July 31, 2009, the FASB Accounting Standards Codification ( the Codification ) became the authoritative source of accounting principles to be applied to the financial statements of nongovernmental entities prepared in accordance with GAAP. The following is a list of recent pronouncements issued by the FASB:



**Table of Contents****Recently Issued and Adopted Accounting Pronouncements**

*Business Combinations:* Effective in the first quarter of fiscal 2010, the Company adopted the revised accounting guidance for business combinations. The more significant changes include an expanded definition of a business and a business combination; recognition of assets acquired, liabilities assumed and noncontrolling interests (including goodwill) measured at fair value at the acquisition date; recognition of acquisition-related expenses and restructuring costs separately from the business combination; recognition of assets acquired and liabilities assumed at their acquisition-date fair values with subsequent changes recognized in earnings; and capitalization of in-process research and development at fair value as an indefinite-lived intangible asset. The guidance also amends and clarifies the application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The impact of this accounting guidance and its relevant updates on the Company's results of operations or financial position will vary depending on each specific business combination or asset purchase. The Company has not had any business combinations or asset purchases since the adoption of this pronouncement.

*Noncontrolling Interests in Consolidated Financial Statements:* The pronouncement requires the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment and presentation of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary, and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. The Company adopted the pronouncement in the first quarter of fiscal 2010. The adoption did not have any impact on the Company's Condensed Consolidated Financial Statements.

*Fair Value Measurements and Disclosures:* The pronouncements define fair value, establish guidelines for measuring fair value, and expand disclosures regarding fair value measurements. In the first quarter of fiscal 2010, the Company adopted the fair value measurements guidance for all nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The adoption did not have a material impact on the Company's Condensed Consolidated Financial Statements. See Note 3 of Notes to Condensed Consolidated Financial Statements for additional information. The Company did not choose the fair value option which allows entities to choose to measure many financial instruments and certain other items at fair value that previously were not required to be measured at fair value.

In the second quarter of fiscal 2010, the Company adopted the fair value disclosure provision that requires the reporting of interim disclosures about the fair value of financial instruments previously only disclosed on an annual basis. The adoption did not have any impact on the Company's Condensed Consolidated Financial Statements as it relates only to disclosures. The required disclosures are included in Note 3 of Notes to Condensed Consolidated Financial Statements.

*Impairments of Debt Securities:* The pronouncement changed the impairment recognition and presentation model for debt securities. An other-than-temporary impairment is now triggered when there is intent to sell the security, it is more likely than not that the security will be required to be sold before recovery in value, or the security is not expected to recover its entire amortized cost basis (credit related loss). Credit related losses on debt securities will be considered an other-than-temporary impairment recognized in earnings, and any other losses due to a decline in fair value relative to the amortized cost deemed not to be other-than-temporary will be recorded in other comprehensive income. The Company adopted the pronouncement in the second quarter of fiscal 2010. The adoption did not have a material impact on the Company's Condensed Consolidated Financial Statements.

*Earnings Per Share:* The pronouncement provided guidance on determining whether instruments granted in share-based payment transactions are participating securities. Non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The company adopted this pronouncement in the first quarter of fiscal 2010. The adoption had no material effect on basic or diluted EPS for any of the periods presented in these Condensed Consolidated Financial Statements.

**Recently Issued but Not Yet Adopted Accounting Pronouncements**

*Revenue Arrangements with Multiple Deliverables:* The guidance amends the current revenue recognition guidance for multiple deliverable arrangements. It allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence, vendor objective evidence, or third-party evidence is unavailable.

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Additionally, it eliminates the residual method of revenue recognition in accounting for multiple deliverable arrangements. The guidance is effective for fiscal years beginning on or after June 15, 2010 (the Company's fiscal 2012), but early adoption is permitted. The Company is currently evaluating the impact that adoption of this pronouncement will have on the Company's Financial Statements.

*Revenue Arrangements with Software Elements:* The pronouncement modifies the scope of the software revenue recognition guidance to exclude tangible products that contain both software and non-software components that function together to deliver the product's essential functionality. The pronouncement is effective for fiscal years beginning on or after June 15, 2010 (the Company's fiscal 2012), but early adoption is permitted. This guidance must be adopted in the same period an entity adopts the amended revenue arrangements with multiple deliverables guidance described above. The Company is currently evaluating the impact that adoption of this pronouncement will have on the Company's Financial Statements.

*Variable Interest Entities and Transfers of Financial Assets and Extinguishments of Liabilities:* The pronouncement on transfers of financial assets and extinguishments of liabilities removes the concept of a qualifying special-purpose entity and removes the exception from applying variable interest entity accounting to qualifying special-purpose entities. The new guidance on variable interest entities requires an entity to perform an ongoing analysis to determine whether the entity's variable interest or interests give it a controlling financial interest in a variable interest entity. The pronouncements are effective for fiscal years beginning after November 15, 2009. The Company will adopt the pronouncements for interim and annual reporting periods beginning in the first quarter of fiscal 2011. The Company expects that adoption of this pronouncement will not have an impact on the Company's financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Interest Rate Sensitivity.* Interest to be paid by us on our senior secured loan is at an interest rate based, at our option, on either the LIBOR or the prime rate, plus an applicable margin. We expect the base interest rate generally to be based on the published LIBOR rate, which is subject to change on a periodic basis. Recently, interest rates have trended downwards in major global financial markets, stabilizing at relatively low levels over the past few months. If these interest rate trends were to reverse, this will result in increased interest expense as a result of higher LIBOR rates. In addition, interest income received by us fluctuates based on prevailing market interest rates.

*Foreign Currency Exchange Risk.* A significant portion of our sales and a portion of our costs are denominated in Renminbi, the Chinese currency. At the same time, our senior secured bank loan which we intend to service and repay primarily through cash flow from H3C's PRC operations is denominated in US dollars. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The Renminbi could appreciate or depreciate relative to the U.S. dollar. Any movement of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position, and may make it more difficult for us to service our U.S. dollar-denominated senior secured bank loan. More specifically, if the Renminbi appreciates in value as compared with the U.S. dollar, our reported revenues will derive a beneficial increase due to currency translation; and if the Renminbi depreciates, our revenues will suffer due to such depreciation. This currency translation impacts our expenses as well, but to a lesser degree. We believe a ten percent increase in exchange rates would not have a material effect on our financial position or results of operations. Outside of China, most of our sales are invoiced and collected in US dollars, while selling and administrative expenses are incurred in local currency. A depreciation of the US dollar will result in higher selling and administrative expenses outside of the United States, while an appreciation of the US dollar will reduce the reported selling and administrative expenses. With the exception of China, changes in currency valuations should not have a significant impact on our revenue or margin. We believe that a sudden or significant change in foreign exchange rates would not have a material impact on future net income or cash flows other than with respect to the Chinese Renminbi.

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**ITEM 4. CONTROLS AND PROCEDURES**

Our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-Q pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of February 26, 2010, our disclosure controls and procedures were effective.

The term "disclosure controls and procedures," as defined under the Exchange Act, means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting that occurred during the three months ended February 26, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 15 to the Notes to the Condensed Consolidated Financial Statements is incorporated by reference herein.

**ITEM 1A. RISK FACTORS**

Risk factors may affect our future business and results. The matters discussed below could cause our future business or results to differ materially from past business or results or those described in forward-looking statements and could have a material adverse effect on our business, financial condition, results of operations, prospects and/or stock price.

**Risk Related to Proposed Acquisition by Hewlett-Packard Company**

*Our proposed acquisition by Hewlett-Packard Company creates unique risks in the time leading up to closing, and there are also risks relating to completing the conditions to closing; if the transaction is delayed or does not close, it could result in adverse effects on our business and stock price.*

On November 11, 2009, we announced an agreement to be acquired by Hewlett-Packard Company pursuant to a merger agreement executed by the parties. We cannot assure you that the proposed acquisition will be consummated. In addition, the announcement and pendency of the merger could adversely affect and cause disruptions in our business, including, without limitation, affecting our relationships with our customers, partners, vendors and employees.

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The closing of the Merger is subject to the satisfaction or waiver of specified closing conditions, including, without limitation, (i) the adoption of the Merger Agreement by 3Com's stockholders and (ii) the expiration or termination of waiting periods, and obtaining of requisite approvals or clearances, under specified antitrust and competition laws (including, without limitation, in China, the European Union and the United States, among others). On December 22, 2009, the relevant U.S. antitrust authorities granted early termination of the waiting period under the U.S.

Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended. On February 12, 2010, the European Commission cleared the Merger under the EU Merger Regulation. In addition, on January 26, 2010, 3Com's stockholders adopted the Merger Agreement at a special meeting of stockholders. The closing is also subject to the other closing conditions described in the merger agreement. We can neither guarantee that these closing conditions will be satisfied nor assure you that we will receive the required approvals. Accordingly, we cannot assure you that the proposed acquisition will be completed. In the event that the proposed acquisition is not completed or is delayed:

management's and our employees' attention may be diverted from our day-to-day business because matters related to the proposed acquisition may require substantial commitments of their time and resources;

we may lose key employees;

our relationships with customers, partners and vendors may be substantially disrupted as a result of uncertainties with regard to our business and prospects;

certain costs related to the proposed acquisition, such as legal and accounting fees and reimbursement of certain expenses, are payable by us whether or not the proposed acquisition is completed;

under certain circumstances, if the proposed acquisition is not completed we may be required to pay a termination (break-up) fee of up to \$99 million; and

the market price of shares of our common stock may decline to the extent that the current market price of those shares reflects a market assumption that the proposed acquisition will be completed.

The merger agreement generally requires us to operate our business in the ordinary course pending consummation of the proposed acquisition, and it restricts us, without Hewlett-Packard Company's prior written consent, from taking certain specified actions until the acquisition is complete or the agreement is terminated, including, without limitation, not exceeding a certain amount in capital expenditures, not making dividends or acquisitions, not entering into certain types of contracts and other matters. These restrictions may prevent us from pursuing attractive business opportunities that may arise prior to the completion of the merger with Hewlett-Packard Company that could be favorable to us and our stockholders. Further, we risk losing key employees due to the uncertainty posed by the pending transaction. Efforts are needed by our employees to ensure that during the pendency of the proposed transaction we continue to execute on our business plan and strategy, including research and development work on new products; sales and marketing efforts relating to current marketed products, as well as the launch of new products; and management of relationships with important stakeholders to avoid disruption with those companies and persons, including our customers, partners and vendors.

Since the announcement of the proposed acquisition, a number of putative class action lawsuits have been filed in relation to the acquisition. See "Legal Proceedings" in Part II, Item 1 in this Form 10-Q for a description of pending litigation regarding the acquisition. We also could be subject to additional litigation related to the proposed acquisition whether or not it is consummated. While we currently believe all such litigation is without merit and will not succeed, these matters create additional uncertainty relating to the proposed transaction and defending the matters is costly and distracting to management.

Any of these events could have a material negative impact on our results of operations and financial condition and could adversely affect the price of our common stock.

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**Risk Related to Global Economic Conditions**

***If the global economic recovery continues to be slow, or if some or all of the regions in which we operate experience a return to recessionary economic conditions, our results may suffer.***

The business conditions in which we operate are subject to rapid and unpredictable change due to the recent global economic slowdown and the current nascent and slow economic recovery. Many of the world's economies are just emerging from a severe recession experienced over the last several years. Persistently tight credit conditions have made it harder for businesses to access needed capital. These factors have contributed to significant slowdowns in the technology industry in general over the last several years, and in many of the specific markets and geographies in which we operate, resulting in:

- reduced demand for our products in many regions as a result of constraints on information technology-related capital spending by our customers;

- risk of excess and obsolete inventories;

- longer sales cycles;

- delayed and/or cancelled purchases due to factors such as tight credit conditions and unfavorable local currency translation (noting that we denominate sales in USD in most locations outside of China); and

- risk of longer cash cycles as customers take longer to pay us for products and services and some customers deal with insolvency issues.

Our business is heavily dependent on China, a country whose historic strong growth rates slowed significantly over the last several years. While China's growth rates have recently stabilized, it is unclear whether this stabilization will result in increased growth rates in the future. Outside of China, economies generally appear to be experiencing a slow recovery from the global recession, although the increase in economic activity remains modest and it is not clear whether economic conditions in any particular jurisdiction will continue to improve or will experience a return to recessionary conditions. The slow recovery is evidenced by customers exercising restraint when considering IT-related capital spending.

The above factors make it more challenging to predict our future performance. If global economic and credit conditions in the major regions in which we operate, particularly in China, persist, spread, or deteriorate further, if the recovery continues to be slow, or if we experience a return to recessionary economic conditions, we may continue to experience a negative impact on our business, operating results and financial condition.

**Risks Related to Ability to Sustain and Increase Profitability and the Impact of our Secured Indebtedness**

***We may not be able to sustain or increase our profitability in the future.***

While we returned to profitability in our 2009 fiscal year (after numerous years of significant net losses) and continue to be profitable, we cannot assure you we will be able to sustain this profitability or, if sustained, increase our profitability. We face a number of challenges that have affected our operating results during the current and past several fiscal years. Specifically, we have experienced, and may continue to experience, the following:

- declining sales in certain regions;

- operating expenses that, as a percentage of sales, have exceeded our desired financial model;

- significant senior leadership and other management changes;

- significant non-cash accounting charges;

- increased sales and marketing expense as part of a strategy to help grow our market share; and

- disruptions and expenses resulting from our workforce reductions and employee attrition.



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To sustain and increase our profitability, we must maintain or increase our sales, and if we cannot do that, we may need to further reduce costs. As we have implemented significant cost reduction programs over the last several years, it may be difficult to make significant further cost reductions without in turn impacting our sales. In addition, we may choose to reinvest some or all of any realized cost savings in future growth opportunities. Any of these events or occurrences will likely cause our expense levels to continue to be at levels above our desired model.

If we cannot overcome these challenges, reduce our expenses and/or increase our revenue, we may not be able to sustain and increase our profitability.

### ***Our indebtedness could adversely affect our financial condition and ability to grow our business.***

We now have, and for the foreseeable future will continue to have, a significant amount of indebtedness. As of February 26, 2010, our total debt balance was \$112 million, of which \$48 million is classified as a current liability.

While we currently have cash and cash equivalents in excess of our total borrowings, our indebtedness could have significant negative consequences to us. For example, it could:

increase our vulnerability to general adverse economic and industry conditions;

limit our ability to obtain additional financing;

require the dedication of a substantial portion of our cash flow from operations to satisfy debt obligations, reducing the availability of capital to finance operations and growth;

limit our flexibility in planning for, or reacting to, changes in our business and our industry; and

place us at a competitive disadvantage relative to our competitors with less debt.

Covenants in the agreements governing our senior secured loan materially restrict our H3C subsidiary's operations based in China, including H3C's ability to incur debt, pay dividends, make certain investments and payments, make acquisitions of other businesses and encumber or dispose of assets. In addition, in the event H3C's financial results do not meet our plans, the failure to comply with the financial covenants contained in the loan agreements could lead to a default. An event of default, if not cured or waived, could have a material adverse effect on us because the lenders will be able to accelerate all outstanding amounts under the loan or foreclose on the collateral (which consists primarily of our H3C business). In addition, if the LIBOR rate increases, our interest obligations, which are based on LIBOR, will increase. Our interest obligations are also dependent on our H3C group leverage ratio, as defined under the credit agreement; if the ratio increases above specified levels (i.e., because H3C financial results decrease), our interest obligations will increase. Any of these actions could result in a material adverse effect on our business and financial condition.

In recent years, we have generated most of our positive cash flow from operations from our China business, and our operations outside of China have been mostly cash flow negative. The credit agreement limits our ability to dividend cash outside of China (i.e., outside of the H3C group) and requires that a substantial portion of H3C's cash flow be used to pay down debt obligations. Accordingly, we cannot use cash generated in China to fund our operations outside of China (except under certain conditions we are permitted to dividend outside of China a portion of H3C's annual excess cash flow (as defined by the credit agreement)). Because available and permitted dividends under the credit agreement are determined by H3C's consolidated excess cash flow and leverage ratio (as defined under the Credit Agreement), if H3C's results decrease, the permitted dividends, if any, we can make to our operations outside of China will likely decrease. If we do not generate or maintain appropriate cash on hand on a worldwide basis to finance operations and make investments where needed or desired, our business results and growth objectives may suffer; in particular, our cash balances outside of China could fall below our desired levels, particularly if we do not meet the conditions necessary to dividend cash up from China.



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**Risks Related to China-based Sales region and Dependence Thereon**

***We are significantly dependent on our China-based segment; if it is not successful we will likely experience a material adverse impact to our business, business prospects and operating results.***

For the fiscal quarter ended February 26, 2010, our China-based sales region was profitable, accounted for approximately 54 percent of our consolidated revenue and generated the majority of our positive cash flow from operations. Our China-based sales region is subject to specific risks relating to its ability to:

maintain a leading position in the networking equipment market in China;

build profitable operations in other emerging markets throughout the world, but particularly in the Asia Pacific region;

offer new and innovative products and services to attract and retain a larger customer base;

increase awareness of the H3C brand and continue to develop customer loyalty;

respond to rapidly changing competitive market conditions;

respond to changes in the regulatory environment;

manage risks associated with intellectual property rights;

maintain effective control of costs and expenses; and

attract, retain and motivate qualified personnel.

In China, we face competition from domestic Chinese industry participants, and as a foreign-owned business may not be as successful in selling to Chinese customers, particularly those in the public sector, to the extent that such customers favor Chinese-owned competitors.

We expect that a significant portion of our sales will continue to be derived from our China-based sales region for the foreseeable future. As a result, we are subject to economic, political, legal and social developments in China and surrounding areas; we discuss risks related to the PRC in further detail below. In addition, because we already have a significant percentage of the market share in China for enterprise networking products, our opportunities to grow market share in China are more limited than in the past. Our China-based sales region has experienced growth since its inception in part due to the growth in China's technology industry, which may not be representative of future growth or be sustainable. We cannot assure you that our China-based sales region's historical financial results are indicative of its future operating results or future financial performance, or that its profitability will be sustained or increased.

Given the significance of our China-based sales region to our financial results, if it is not successful our business will likely be materially adversely affected.

***If, as expected, Huawei Technologies, or Huawei, continues to significantly reduce its business with us, our business results will be materially adversely affected if we cannot increase other business to offset the decline.***

We historically have and currently derive a material portion of our sales from Huawei, which formerly held a significant investment in our H3C subsidiary. In the three months ended February 26, 2010, which includes results from our China-based sales region's December 31, 2009 quarter, Huawei accounted for approximately 7 percent of the revenue for our China-based sales region and approximately 4 percent of our consolidated revenue. Huawei's percentage of our China-based sales region's revenues has been trending downward from 46 percent during the 3 months ended November 30, 2006, to the current level. This decrease has been accelerating. We expect Huawei to continue to reduce its business with us and we believe that its purchases in absolute dollars will likely continue to decrease significantly. Huawei does not have any minimum purchase requirements under our existing OEM agreement, which expires in November 2010. We believe Huawei has begun to sell, and likely will continue to sell,

internally-developed networking equipment with respect to some of the products it formerly purchased from us. We further believe Huawei also has access to other networking equipment vendors that sell products comparable to our solutions. If and to the extent any of these events occur and/or continue, it will likely have an adverse impact on our sales and business performance. In order to minimize any adverse impact on our results from any decreased sales to Huawei, we need to successfully execute on our business strategies including, without limitation,

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increasing direct touch sales of networking products inside and outside of China. If we are not successful in these efforts, the risks described above, including adverse impacts to our financial results, may be heightened.

### **Risk Related to Core Business Strategy**

*If we cannot increase our enterprise account business, in particular outside of China, we likely will not reach our growth and profitability goals.*

We strive to be increasingly successful in direct-touch sales for larger enterprise and government accounts in all geographic regions. In China we are already an established provider of networking equipment to enterprise-class and government customers under the H3C brand. We must continue to execute in China. Our strategy also involves leveraging China as a principal market for enterprise-class solutions, developing and introducing new products in China and then marketing and selling them to other regions in the global marketplace.

To increase market share outside of China and develop our global enterprise brand we must be increasingly successful in capturing larger enterprise and government opportunities (in addition to our small-and-medium size business). Our ability to achieve such success is subject to numerous risks and challenges, including those described below.

Increasing our enterprise business will likely require a greater investment in sales and marketing, as well as the provision and maintenance of a global service organization that can respond to enterprise customers. The sales cycle is generally longer for enterprise accounts (possibly yielding uneven and unpredictable revenue from quarter to quarter) when compared to our small-and-medium-size business. We also expect intense competition from larger industry participants, many of whom possess a significantly larger market share and installed base than us. We will also need to be perceived by decision making officers of large enterprises as committed for the long-term to the enterprise networking business. We will also need to compete favorably on the offering of features and functionality that these enterprise customers demand; if our competitors are more effective at such efforts our ability to convert pipeline opportunities into sales will suffer. We seek to develop and expand the global channel for our H3C product portfolio, in particular outside of China. Our push to further expand sales to large enterprises may be disruptive in a variety of ways, including the risk our increased direct-touch sales efforts are perceived by existing channel partners as competitive or viewed by market participants as indicating a diminished focus on the small-and-medium business market. We will need to maintain an infrastructure that permits us to effectively document, process, manage, ship and account for these larger transactions. To gain market share, our global branding strategy (H3C for enterprise, 3Com for small-and-medium business and TippingPoint for security solutions) must be positively received by our customers, potential customers and channel partners. This strategy is relatively new.

If we fail to manage a transition outside of China to a business model focused more heavily on enterprise-class business, we will not achieve our business goals and our business results may suffer.

Our strategy also involves select integration activities between different parts of our business. Our H3C acquisition significantly increased the size, scope and complexity of 3Com, and we have since taken actions designed to maximize the potential of our integrated company. Overall, we seek to address the different cultures, languages and business processes of the two companies, and to leverage H3C and its brand on a global basis. Integration efforts may include streamlined research and development/engineering functions; coordinated product line management efforts; integrated sales and marketing, general and administrative, IT and supply chain functions; new branding strategies; and continued exploration of further initiatives to reduce expenses and unify the companies. We are also more fully integrating our TippingPoint business, including adding additional security features to our networking products. If we are not successful in executing the integration strategies we choose to implement, our business may be harmed.

### **Risk Related to Personnel**

*Our success is dependent on continuing to hire and retain qualified managers and other personnel and reducing senior management turnover; if we are not successful in attracting and retaining key personnel, our business will suffer.*

Competition for qualified employees is intense. If we fail to attract, hire, or retain qualified personnel, our business will be harmed. We have historically experienced significant turnover in our senior management team outside of China and we may continue to experience change at this level. If we cannot retain qualified senior managers, and provide stability in the senior management team to enable them to work together for an extended period of time, our business may not succeed.



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The senior management team at our China-based sales segment has been highly effective. We need to continue to incentivize and retain China-based management. We cannot be sure we will be successful in these efforts. If we are not successful, our China-based sales region may suffer, which, in turn, will have a material adverse impact on our consolidated business. Many of these senior managers, and other key China-based employees, originally worked for Huawei prior to the inception of our former joint venture with Huawei in China. Subject to non-competition agreements with us (if applicable), these employees could return to work for Huawei at any time. Huawei is not subject to any non-solicitation obligations with respect to us. Further, former Huawei employees employed by us may retain financial interests in Huawei.

**Risks Related to Competition*****Intense competition in the market for networking solutions and new or developing product markets could prevent us from increasing revenue and profitability.***

The market for networking solutions is intensely competitive. In particular, Cisco Systems, Inc., or Cisco, maintains a significant leadership position in this market and many of its products compete directly with our products and solutions. Cisco's substantial resources and market leadership have enabled it to compete aggressively. Purchasers of networking solutions may choose Cisco because of its broader product line, extensive set of features and functionality, larger installed base, extensive channel partner programs, substantial services organization, greater financial strength and strong reputation in the networking market. In addition, Cisco may have developed, or could in the future develop, new technologies that directly compete with our products or render our products obsolete. We cannot assure you we will be able to compete successfully against Cisco.

We also compete with several other significant companies in the networking industry. Some of our current and potential competitors have greater market leverage, longer operating histories, greater financial, technical, sales, marketing and other resources, stronger name recognition, broader partnerships with systems integrators and enterprise channel partners and larger installed customer bases. Additionally, we may face competition from new or previously unknown companies that may offer new competitive networking solutions and/or alternative technologies that displace the need for some of our products or services. We also face the possibility that consolidation in our industry could result in two or more of our competitors becoming a single competitor with greater resources, broader sales coverage and superior products.

As we focus on new market opportunities—for example, IP storage and IP video surveillance and other advanced technologies and emerging technologies—we will increasingly compete with large telecommunications equipment suppliers as well as startup companies. We cannot assure you we will compete favorably against these competitors for these market opportunities.

In order to remain competitive, we must, among other things, invest significant resources in developing new products with superior performance at lower prices than our competitors, enhance our current products and maintain customer satisfaction. If we fail to do these things, our products may not compete favorably with those of our competitors and our revenue and profitability could suffer.

***Our competition with Huawei could have a material adverse effect on our sales and our results of operations, particularly if Huawei increases its level of competition against us.***

As Huawei expands its operations, offerings and markets, there could be increasing instances where we compete directly with Huawei in the enterprise networking market. As a significant customer of our China-based segment, Huawei has had, and continues to have, access to H3C products for resale. This access enhances Huawei's current ability to compete directly with us both in China and in the rest of the world. We risk competition from enterprise products that Huawei internally develops and markets or sources from our equipment manufacturer competitors. Huawei has historically sold our networking products to carrier customers (who purchase for themselves and their own enterprise customers). We believe Huawei sells internally developed products to meet carrier demand for these products and it is possible Huawei may also use these products to market and sell more directly to enterprise customers in the future. Huawei is not bound by any contractual non-competition obligations with us. We also sell carrier class products in China through our direct-touch sales force in competition with Huawei and other carrier market equipment providers.

Huawei maintains a strong presence within China and the Asia Pacific region and possesses significant competitive resources, including vast engineering talent and ownership of the assets of Harbour Networks, a China-based competitor that possesses enterprise networking products and technology. We cannot predict the extent to which Huawei will compete with us. If Huawei increases its competition with us, or if we do not compete favorably with Huawei, it is likely that our business results, particularly in the Asia Pacific region and specifically in China, will be materially and negatively affected.

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### **Risks Related to Business and Technology Strategy**

***Our industry is characterized by a short product life cycle, and we may not be successful at identifying and responding to new and emerging market, technology and product opportunities, or at responding quickly enough to technologies or markets that are in decline.***

Our success depends on our ability to:

identify new market and product opportunities;

predict which technologies and markets will see declining demand;

develop and introduce new products and solutions (and new features and functionality for existing products and solutions) in a timely manner;

gain market acceptance of new products and solutions; and

rapidly and efficiently transition our customers from older to newer enterprise networking technologies.

Accordingly, our business will likely suffer if:

there is a delay in introducing new products, features or functionality;

we lose key channel partners;

our products do not satisfy customers in terms of features, functionality or quality; or

our products cost more to produce than we expect.

The enterprise networking industry in which we compete is characterized by rapid changes in technology and customer requirements and evolving industry standards. For example, our success depends on the convergence of technologies (such as voice, video and data) and the timely adoption and market acceptance of industry standards. Slow market acceptance of new technologies, products, or industry standards could adversely affect our sales or overall results of operations. In addition, if our technology is not included in an industry standard on a timely basis or if we fail to achieve timely certification of compliance to industry standards for our products, our sales of such products or our overall results of operations could be adversely affected.

We rely on our research and development base in Beijing, China to develop and design most of our new technologies, products and solutions. These engineers develop products for all of the global markets in which we participate and must design solutions for the developed world as well as for China and other emerging markets. Developed markets may have different products features and customer requirements than emerging markets, and we must timely develop product solutions that satisfy our customers on a worldwide basis. If we are not successful at these efforts, our business will suffer.

### **Risks Related to Operations and Distribution Channels**

***If we are not successful at partnering with system integrators and expanding our base of enterprise channel partners, reaching our growth and profitability goals will be more challenging and we will likely not reach our full potential.***

A significant portion of enterprise networking business is conducted through and with the assistance of system integrators, or SIs, and enterprise channel partners, including value-added resellers ( VARs ). The industry leaders with whom we compete as a general matter maintain significant relationships with at least one SI and in some cases have stronger enterprise channels. We seek to develop and expand our global channel for our H3C product portfolio, in particular outside of China. If we are not successful at increasing the number of partnerships we maintain with these types of organizations or if the strategic relationships we enter into are not effective or successful, it will be more difficult to reach our goals, and we likely will not reach our full potential to be a leading, truly global enterprise networking company.





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***A significant portion of our sales is derived from a small number of distributors. If any of these channel partners reduces its business with us, our business could be adversely affected.***

We distribute many of our products through two-tier distribution channels that include distributors and VARs. In some instances, we also use a system integrator. A significant portion of our sales is concentrated among a few distributors; our two largest distributors accounted for a combined 14 percent of our consolidated revenue for the three months ended February 26, 2010. If either of these distributors reduces its business with us, our sales and overall results of operations could be adversely affected.

We work closely with our distributors to monitor channel inventory levels and ensure that appropriate levels of products are available to resellers and end users. We maintain target ranges for channel inventory levels for supply on hand at our distributors. Partners with a below-average inventory level may incur stock outs that would adversely impact our sales. Our distribution agreements typically provide that our distributors may cancel their orders on short notice with little or no penalty. If our channel partners reduce their levels of inventory of our products, our sales would be negatively impacted during the period of change.

***We may be unable to manage our supply chain successfully, which would adversely impact our sales, gross margin and profitability.***

Our supply chain function involves the management of numerous external suppliers, vendors and contract manufacturers. We source component parts for our products from numerous vendors and outsource principally all of our manufacturing, a significant portion of our logistics and fulfillment functions and a portion of our service and repair functions. If we cannot adequately manage our supply chain, our business results and financial condition will likely suffer. Our ability to manage our supply chain successfully is subject to the following risks, among others:

- our ability to accurately forecast demand for our products and services;

- our reliance on, and long-term arrangements with, third-party manufacturers (which places much of the supply chain process out of our direct control, heightens the need for accurate forecasting and reduces our ability to transition quickly to alternative supply chain strategies); and

- our ability to minimize disruptions to our logistics and effectively manage disruptions that do occur.

We cannot be certain that in the future our suppliers will be able or willing to meet our demand for components in a timely and cost-effective manner. There has been a trend toward consolidation of vendors of electronic components. Our reliance on a smaller number of vendors and the inability to quickly switch vendors increases the risk of logistics disruptions, unfavorable price fluctuations or disruptions in supply. From time-to-time, supplies of certain key components have become tighter. We risk adverse impact to our gross margin to the extent there is a resulting increase in component costs and time necessary to obtain these components.

If overall demand for our products or the mix of demand for our products is significantly different from our expectations, we may face inadequate or excess component supply or inadequate (such as, if the current slow economic recovery accelerates faster than our ability to fill orders) or excess manufacturing capacity. This would result in orders for products that could not be manufactured in a timely manner, or a buildup of inventory that could not easily be sold. Either of these situations could adversely affect our market share, sales and results of operations or financial position.

***If we fail to adequately evolve our financial and managerial control and reporting systems and processes, our ability to manage and grow our business may be negatively affected.***

Our ability to successfully offer our products and services and implement our business plan in a rapidly evolving market depends in part upon effective planning and management processes and systems. Our company has undergone substantial change in the last several years, including strategic changes, operational changes, personnel changes and structural changes. We have historically had significant turnover in the executive management team and other parts of our employee population, acquired H3C (which has experienced considerable growth over a short period of time and now represents more than half of our sales) and implemented substantial downsizing in our businesses and infrastructure outside of China. These changes have increased our challenges and we will need to continue to improve, integrate and upgrade our financial and managerial control and our reporting systems and procedures in order to

manage our business effectively, analyze and make sound business decisions and improve efficiencies. If we fail to implement improved systems and processes, our ability to manage our business and results of operations could be adversely affected.

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### **Risks Related to our Operations in the People's Republic of China**

***China's legal and regulatory regime and changing political and economic environment may impact our business in China.***

As a result of the historic reforms of the past several decades, multiple government bodies are involved in regulating and administering affairs in the technology industry in China. These government agencies have broad discretion and authority over various aspects of the networking, telecommunications and information technology industry in China; accordingly their decisions may impact our ability to do business in China. Any of the following changes in China's political and economic conditions, laws, regulations and governmental policies could have a substantial impact on our business:

the promulgation of new laws and regulations and the interpretation of those laws and regulations;

enforcement and application of rules and regulations by the Chinese government authorities and or court system;

the introduction of measures to control growth or inflation or stimulate growth;

any actions that limit our ability to develop, manufacture, import or sell our products in China, or export our products outside of China, or to finance and operate our business in China; or

laws, rules or regulations that negatively impact our ability to pay dividends from China to outside of China, or impose restrictions (including conditions or timing restrictions) or additional taxes on such dividends.

Due to our dependence on China, if China were to experience a broad and prolonged economic slowdown or period of political or social unrest, our results of operations would likely suffer. The Chinese government has also from time-to-time implemented certain measures to control the pace of economic growth or to stimulate the economy. Measures to stimulate growth may not work and measures to control growth could cause a decrease in the level of economic activity in China, which in turn could adversely affect our results of operations and financial condition.

***Uncertainties with respect to the Chinese legal and regulatory system may adversely affect us.***

We conduct our business in China primarily through H3C Technologies Co., Limited, a Hong Kong entity which in turn owns several Chinese entities. These entities are generally subject to laws and regulations applicable to foreign investment in China. In addition, there are uncertainties regarding the interpretation and enforcement of laws, rules, regulations and policies in China. Because many laws and regulations are relatively new and the Chinese legal and regulatory system is still evolving, the interpretations of many laws, regulations and rules are not always uniform and local, provincial or central authorities may exercise significant discretion in applying them. Moreover, the interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. Finally, enforcement of existing laws or contracts based on existing law may be uncertain, and it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. Any litigation in China may be protracted and result in substantial costs and diversion of resources and management's attention. Administrative processes and operational decisions are subject to the risks and uncertainties described above, which could result in delays and changed positions.

***If PRC tax benefits available to us are reduced or repealed, our profitability or cash flow could suffer.***

New tax regulations came into effect on January 1, 2008 establishing the corporate income tax rate of 25 percent (phased in over time for certain companies) for companies subject to income tax in China. The new law also provided for a reduced tax rate of 15 percent for companies which qualify as new and high technology enterprises. Our main operating subsidiary in China, Hangzhou H3C Technologies Co., Ltd, has qualified for this reduced tax rate and accordingly, we expect that our long-term tax rate in China will be 15 percent.

If the tax benefits we currently enjoy in China are withdrawn or reduced, or if new taxes are introduced which have not applied to us previously, there would likely be a resulting increase to our statutory tax rate in the PRC. Increases to the tax rates in the PRC, where we are profitable, could adversely affect our results of operations and cash flow.



**Table of Contents*****If the Chinese VAT Authorities discontinue, reduce, or defer the VAT Software Subsidy Program, our results will likely be adversely affected.***

We benefit from a program run by the Chinese authorities which effectively provides us with nontaxable subsidy payments based on a percentage of the value-added tax, or VAT, collected by H3C on the sales of our software. We have recorded substantial income from this program since inception. The VAT subsidy payments are recorded in other income on a cash basis when actually received from the government. The timing of the receipt of payments is subject to the discretion of the Chinese tax authorities who must calculate and approve each application for these subsidies. The program ends on December 31, 2010, is subject to the complete discretion of the Chinese tax authorities and may be discontinued, reduced, or deferred at any time. If any of these events occur, our results of operations will likely be adversely affected.

***H3C is subject to restrictions on paying dividends and making other payments to us.***

Chinese regulations currently permit payment of dividends only out of accumulated profits, as determined in accordance with Chinese accounting standards and regulations. Our principal operating entity in China is required to set aside a portion of its after-tax profits currently 10 percent up to 50 percent of registered capital according to Chinese regulations, to fund certain reserves. The Chinese government also imposes controls on the conversion of Renminbi into foreign currencies and the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency. These restrictions may in the future limit our ability to receive dividends or repatriate funds from China or impact the timing of such payments. In addition, as discussed elsewhere in this Risk Factors section, the credit agreement governing our senior secured loan also imposes significant restrictions on our ability to pay dividends or make other payments from China to our other segments. Because available and permitted dividends under the credit agreement are determined by H3C's consolidated excess cash flow and leverage ratio (as defined under the credit agreement), if H3C's results decrease, the permitted dividends, if any, will likely decrease. While we are in default, or event of default, under the credit agreement we may not make permitted dividend payments. Finally, under a new PRC tax law all distributions of earnings realized from 2008 onwards from our PRC subsidiaries to our subsidiary in Hong Kong will be subject to a withholding tax at a rate of 5 percent. Our main PRC subsidiary generates the cash used to pay principal and interest on our H3C loan. Accordingly, we must earn proportionately higher profits in the PRC to service principal and interest on our loan, or be forced to fund any deficiencies from cash generated from other geographies. In sum, if we do not generate or maintain appropriate cash on hand on a worldwide basis to finance operations and make investments where needed or desired, our business results and growth objectives may suffer; in particular, our cash balances outside of China could fall below our desired levels.

***We are subject to risks relating to currency rate fluctuations and exchange controls and we do not hedge this risk in China.***

Approximately 49 percent of our sales and a portion of our costs are denominated in Renminbi, the Chinese currency. At the same time, our senior secured bank loan which we intend to service and repay primarily through cash flow from our China-based operations is denominated in U.S. dollars. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The Renminbi could appreciate or depreciate relative to the U.S. dollar. Any movement of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position, and may make it more difficult for us to service our U.S. dollar-denominated senior secured bank loan. More specifically, if the Renminbi appreciates in value as compared with the U.S. dollar, our reported revenues will derive a beneficial increase due to currency translation; and if the Renminbi depreciates, our revenues will suffer due to such depreciation. This currency translation impacts our expenses as well, but to a lesser degree. In some of our historical periods, we have benefited from the currency translation of Renminbi, but our results may in the future be harmed by it.

Our sales around the world are generally denominated in Renminbi (in China) and in US Dollars (in the rest of the world). We use those two currencies to price our products and generally do not accept local currencies as payment for product. When we sell our products in countries outside of China and the U.S. to customers in countries whose currencies have been devalued against the Renminbi or the U.S. Dollar, the currency fluctuation causes the cost of our products to these customers to be higher. We generally do not provide currency exchange risk protection to our

customers. For these reasons, when the Renminbi or U.S. Dollar is stronger against local currencies, we may experience delayed or cancelled purchases or general business softness in the relevant region.

We do not currently hedge the currency risk in China through foreign exchange forward contracts or otherwise and China employs currency controls restricting Renminbi conversion, limiting our ability to engage in currency hedging activities in China. Various foreign exchange controls are applicable to us in China, and such restrictions may in the future make it difficult for H3C or us to repatriate earnings, which could have an adverse effect on our cash flows and financial position.

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### **Risks Related to Intellectual Property**

***If our products contain undetected software or hardware errors, we could incur significant unexpected expenses and could lose sales.***

High technology products sometimes contain undetected software or hardware errors when new products or new versions or updates of existing products are released to the marketplace. We cannot assure you our testing programs will be adequate to detect all defects. Undetected errors could result in customer dissatisfaction, reduced sales opportunities, higher than expected warranty and service costs and expenses and the recording of an accrual for related anticipated expenses. From time to time, such errors or component failures could be found in new or existing products after the commencement of commercial shipments. These problems may have a material adverse effect on our business by causing us to incur significant warranty and repair costs, diverting the attention of our engineering personnel from new product development efforts, delaying the recognition of revenue and causing significant customer relations problems. Further, if products are not accepted by customers due to such defects, and such returns exceed the amount we accrued for defect returns based on our historical experience, our operating results would be adversely affected.

Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of hardware and software errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems would likely have a material adverse effect on our business, operating results and financial condition.

***We may need to engage in complex and costly litigation in order to protect, maintain or enforce our intellectual property rights; in some jurisdictions, such as China, our rights may not be as strong as the rights we enjoy in the U.S.***

Whether we are defending the assertion of intellectual property rights against us, or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations because it may divert the attention and energies of management and key technical personnel. Further, plaintiffs in intellectual property cases often seek injunctive relief and the measures of damages in intellectual property litigation are complex and often subjective and uncertain. In addition, such litigation may subject us to counterclaims or other retaliatory actions that could increase its costs, complexity, uncertainty and disruption to the business. Thus, the existence of this type of litigation, or any adverse determinations related to such litigation, could subject us to significant liabilities and costs. Any one of these factors could adversely affect our sales, gross margin, results of operations, cash flow or financial position.

In addition, the legal systems of many foreign countries do not protect or honor intellectual property rights to the same extent as the legal system of the United States. For example, in China, the legal system in general, and the intellectual property regime in particular, are still in the developmental stage. It may be very difficult, time-consuming and costly for us to attempt to enforce our intellectual property rights in these jurisdictions.

***We may not be able to defend ourselves successfully against claims that we are infringing the intellectual property rights of others.***

Many of our competitors, such as telecommunications, networking, and computer equipment manufacturers, have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, patent holding companies and individual inventors have obtained or applied for patents in areas of technology that may relate to our business. The industries in which we operate continue to be aggressive in assertion, licensing and litigation of patents and other intellectual property rights. It is very expensive to defend claims of patent infringement and we expect over time to incur significant time and expense to defend these claims and defend, protect, preserve and maintain our portfolio.

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In the course of our business, we receive claims of infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. We evaluate the validity and applicability of these intellectual property rights, and determine in each case whether to negotiate licenses or cross-licenses to incorporate or use the proprietary technologies, protocols, or specifications in our products, and whether we have rights of indemnification against our suppliers, strategic partners or licensors. If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those that must comply with industry standard protocols and specifications to be commercially viable, our financial position or results of operations could be adversely affected. In addition, if we are alleged to infringe the intellectual property rights of others, we could be required to seek licenses from others or be prevented from manufacturing or selling our products, which could cause disruptions to our operations or the markets in which we compete. Finally, even if we have indemnification rights in respect of such allegations of infringement from our suppliers, strategic partners or licensors, we may not be able to recover our losses under those indemnity rights. Many of our networking products use open source software, or OSS, licenses. Because OSS is often compiled from multiple components developed by numerous independent parties and usually comes as is and without indemnification, OSS is more vulnerable to third party intellectual property infringement claims. Some of the more prominent OSS licenses, such as the GNU General Public License, are the subject of litigation. It is possible that a court could hold such licenses to be unenforceable or someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable or that open source components of our product offerings may not be liberally copied, modified or distributed may have the effect of preventing us from selling or developing all or a portion of our products. If any of the foregoing occurred, it could cause a material adverse impact on our business.

### **Risks Related to the Trading Market**

***Fluctuations in our operating results and other factors may contribute to volatility in the market price of our stock.***

Historically, our stock price has experienced volatility. We expect that our stock price may continue to experience volatility in the future due to a variety of potential factors such as:

- announcements/expectations concerning the closing of our announced proposed acquisition by Hewlett-Packard Company;

- fluctuations in our quarterly results of operations and cash flow;

- changes in our cash and equivalents and short term investment balances;

- our ability to execute on our strategic plan, including our core business strategy to emphasize larger enterprise and government account business;

- general economic conditions on a global basis or in our key markets, such as China;

- variations between our actual financial results and published analysts' expectations; and

- announcements by our competitors, and announcements by, sales to or loss of significant customers.

Over the past several years, the stock market has experienced significant price and volume fluctuations that have affected the stock prices of many technology companies. These factors, as well as general economic and political conditions or investors' concerns regarding the credibility of corporate financial statements and the accounting profession, may have a material adverse affect on the market price of our stock in the future.



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***We may be required to record additional significant charges to earnings if our goodwill or intangible assets become impaired.***

Under accounting principles generally accepted in the United States, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill and other non-amortizing intangible assets are tested for impairment at least annually. The carrying value of our goodwill or amortizable assets may not be recoverable due to factors such as reduced estimates of future cash flows and slower growth rates in our industry or in any of our business units. Estimates of future cash flows are based on an updated long-term financial outlook of our operations. However, actual performance in the near-term or long-term could be materially different from these forecasts, which could impact future estimates. For example, if one of our business units does not meet its near-term and longer-term forecasts, the goodwill assigned to the business unit could be impaired. Similarly, a significant decline in our stock price and/or market capitalization may result in goodwill impairment for one or more business units. We may be required to record a charge to earnings in our financial statements during a period in which an impairment of our goodwill or amortizable intangible assets is determined to exist, which may negatively impact our results of operations. For example, in the three-month period ended May 30, 2008, we took a charge of \$158.0 million relating to impairment of the goodwill of our TippingPoint segment.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table summarizes repurchases of our stock, including shares surrendered to satisfy tax withholding obligations, in the quarter ended February 28, 2010:

| <b>Period</b>                               | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share</b> | <b>Total<br/>Number of<br/>Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans<br/>or Programs</b> | <b>Approximate<br/>Dollar<br/>Value of<br/>Shares<br/>that May Yet<br/>Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs</b> |
|---|---|---|---|---|
| November 28, 2009 through December 25, 2009 | 11,309(1)   | \$ 7.40   |   | \$  |
| December 26, 2009 through January 22, 2010  | 15,915(1)   | 7.59  |   |   |
| January 23, 2010 through February 26, 2010  | 229,610(1)  | 7.46  |   |   |
| <b>Total</b>                                | <b>256,834</b>                                      | <b>\$ 7.47</b>                                      |   | <b>\$</b>   |

(1) Includes shares surrendered to us to satisfy tax withholding obligations that arose upon the vesting of restricted stock awards and units of 11,309 in December 2009,

15,915 in  
January 2010  
and 229,610 in  
February 2010.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On January 26, 2010, 3Com, held a Special Meeting of Stockholders to vote on (1) a proposal ( Proposal I ) to adopt the Agreement and Plan of Merger (the Merger Agreement ), dated as of November 11, 2009, by and among 3Com, Hewlett-Packard Company ( HP ), and Colorado Acquisition Corporation, a wholly owned subsidiary of HP and (2) a proposal ( Proposal II ) to adjourn the special meeting, if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the special meeting to adopt the Merger Agreement. There were 396,006,355 shares eligible to vote as of the record date, December 9, 2009. A quorum was present at the special meeting. Proposal I was approved by the stockholders with 77.21% of the outstanding shares voting FOR adoption of the Merger Agreement. Proposal II was also approved, with 70.82% voting FOR adjournment, if necessary. The voting results of the two proposals are as follows:

| Proposal I                      | For         | Against    | Abstain |
|---------------------------------|-------------|------------|---------|
| A Adoption of Merger Agreement: | 305,769,093 | 5,361,511  | 243,226 |
| Proposal II                     | For         | Against    | Abstain |
| Adjournment, if necessary:      | 280,472,999 | 30,500,059 | 396,671 |

#### ITEM 5. OTHER INFORMATION

Not applicable.

**Table of Contents****ITEM 6. EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Exhibit Description</b>   | <b>Incorporated by Reference</b> |                 |                | <b>Filing<br/>Date</b> | <b>Filed<br/>Herewith</b> |
|---------------------------|--|----------------------------------|-----------------|----------------|------------------------|---------------------------|
|                           |  | <b>Form</b>                      | <b>File No.</b> | <b>Exhibit</b> |                        |                           |
| 2.1                       | Master Separation and Distribution Agreement between the Registrant and Palm, Inc. effective as of December 13, 1999   | 10-Q                             | 002-92053       | 2.1            | 4/4/00                 |                           |
| 2.2                       | Indemnification and Insurance Matters Agreement between the Registrant and Palm, Inc.  | 10-Q                             | 002-92053       | 2.11           | 4/4/00                 |                           |
| 2.3                       | Agreement and Plan of Merger, dated December 13, 2004, by and among the Registrant, Topaz Acquisition Corporation and TippingPoint Technologies, Inc.  | 8-K                              | 000-12867       | 2.1            | 12/16/04               |                           |
| 2.4                       | Securities Purchase Agreement by and among 3Com Corporation, 3Com Technologies, Huawei Technologies Co., Ltd. and Shenzhen Huawei Investment & Holding Co., Ltd., dated as of October 28, 2005 | 8-K/A                            | 000-12867       | 2.1            | 3/30/06                |                           |
| 2.5                       | Stock Purchase Agreement by and between Shenzhen Huawei Investment & Holding Co., Ltd. and 3Com Technologies, dated as of December 22, 2006  | 8-K                              | 000-12867       | 10.1           | 12/27/06               |                           |
| 2.6                       | Agreement and Plan of Merger by and among 3Com Corporation, Diamond II Holdings Inc. and Diamond II Acquisition Corp., dated September 28, 2007  | 8-K/A                            | 000-12867       | 2.1            | 9/28/07                |                           |
| 2.7                       | Agreement and Plan of Merger by and  | 8-K                              | 000-12867       | 2.1            | 11/12/09               |                           |

|      |   |       |           |     |          |
|------|---|-------|-----------|-----|----------|
|      | among 3Com Corporation,<br>Hewlett-Packard Company,<br>and Colorado Acquisition<br>Corporation, dated<br>November 11, 2009  |       |           |     |          |
| 3.1  | Amended and Restated<br>Certificate of<br>Incorporation filed with the<br>Secretary of State of the State<br>of Delaware on September<br>23, 2009   | 8-K   | 000-12867 | 3.1 | 9/24/09  |
| 3.2  | Registrant's Bylaws, as<br>amended on December 10,<br>2008  | 8-K   | 000-12867 | 3.1 | 12/16/08 |
| 4.1  | Third Amended and Restated<br>Preferred<br>Shares Rights Agreement,<br>dated as of November 4, 2002<br>( Rights Agreement )   | 8-A/A | 000-12867 | 4.1 | 11/27/02 |
| 4.2  | Amendment No. 1 to Rights<br>Agreement, dated as of<br>September 28, 2007   | 8-K/A | 000-12867 | 4.1 | 9/28/07  |
| 4.3  | Amendment No. 2 to Rights<br>Agreement, dated as of<br>November 11, 2009  | 8-K   | 000-12867 | 4.1 | 11/12/09 |
| 31.1 | Certification of Principal<br>Executive Officer   |       |           |     | X        |
| 31.2 | Certification of Principal<br>Financial Officer   |       |           |     | X        |
| 32.1 | Certification of Chief<br>Executive Officer<br>and Chief Financial Officer<br>pursuant to 18 U.S.C.<br>Section 1350, as adopted<br>pursuant to Section 906 of the<br>Sarbanes-Oxley Act of 2002 |       |           |     | X        |

\* Indicates a  
management  
contract or  
compensatory  
plan

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**SIGNATURES**

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.

3Com Corporation  
(Registrant)

Dated: April 6, 2010

By: /s/ Jay Zager  
Jay Zager  
Executive Vice President and Chief  
Financial Officer (Principal Financial  
and Accounting Officer and a duly  
authorized officer of the registrant)

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**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Exhibit Description</b>   | <b>Incorporated by Reference</b> |                 |                |                        | <b>Filed<br/>Herewith</b> |
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\* Indicates a  
management  
contract or  
compensatory  
plan