3COM CORP
Form 10-Q
January 07, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended November 29, 2002

or

o **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 (State or other jurisdiction of incorporation or organization)	**94-2605794** (I.R.S. Employer Identification No.)
5400 Bayfront Plaza **Santa Clara, California** (Address of principal executive offices)	**95052** (Zip Code)

Registrant's telephone number, including area code: **(408) 326-5000**

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 ý No o

Indicate by check mark whether the Registrant is an accelerated filer (as defined by Rule 12b-2 of the Exchange Act).

Yes ý No o

As of December 27, 2002, 361,204,619 shares of the Registrant's Common Stock were outstanding.

3Com Corporation

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3Com, CommWorks, and Megahertz are registered trademarks and XRN is a trademark of 3Com Corporation or its subsidiaries. Palm is a trademark of Palm, Inc.

PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

3Com Corporation
Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	November 29, 2002	**November 30, 2001**	**November 29, 2002**	**November 30, 2001**
Sales	$ 303,194	$ 393,854	$ 607,916	$ 783,443
Cost of sales	147,316	260,857	306,573	587,678
Gross margin	155,878	132,997	301,343	195,765
Operating expenses:				
Sales and marketing	67,661	85,027	134,642	191,251
Research and development	44,597	73,220	95,526	159,101
General and administrative	25,633	28,786	52,539	69,785
Amortization and write down of intangibles	10,048	12,884	12,500	29,368
Restructuring charges	69,539	31,536	92,696	89,051
(Gain) loss on land and facilities, net	(265)		887	
Total operating expenses	217,213	231,453	388,790	538,556
Operating loss	(61,335)	(98,456)	(87,447)	(342,791)
Loss on investments, net	(7,087)	(4,620)	(18,552)	(7,270)
Interest and other income, net	3,909	26,640	13,506	45,798
Loss before income taxes and cumulative effect of change in accounting principle	(64,513)	(76,436)	(92,493)	(304,263)
Income tax provision	4,000	27,238	8,000	31,795
Loss before cumulative effect of change in accounting principle	(68,513)	(103,674)	(100,493)	(336,058)
Cumulative effect of change in accounting principle			(65,601)	
Net loss	$ (68,513)	$ (103,674)	$ (166,094)	$ (336,058)
Basic and diluted loss per share:				
Loss before cumulative effect of change in accounting principle	$ (0.19)	$ (0.30)	$ (0.28)	$ (0.97)
Cumulative effect of change in accounting principle			(0.18)	
Net loss	$ (0.19)	$ (0.30)	$ (0.46)	$ (0.97)
Shares used in computing per share amounts:				

	Three Months Ended		Six Months Ended	
Basic and diluted	359,340	346,703	358,389	345,508

See notes to condensed consolidated financial statements.

3Com Corporation
Condensed Consolidated Balance Sheets
(In thousands, except par value)

	November 29, 2002	May 31, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and equivalents	$ 467,692	$ 679,055
Short-term investments	965,910	702,993
Accounts receivable, net	137,848	147,113
Inventories	44,010	61,777
Investments and other	58,349	72,106
Total current assets	1,673,809	1,663,044
Property and equipment, net	487,152	676,154
Deposits and other assets	59,999	87,213
Deferred income taxes	6,055	6,192
Intangible assets, net	15,222	27,689
Goodwill	899	66,500
Total assets	$ 2,243,136	$ 2,526,792
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 109,050	$ 125,903
Accrued liabilities and other	249,130	275,965
Current portion of debt	31,952	101,354
Total current liabilities	390,132	503,222
Long-term debt	45,139	68,404
Other long-term obligations	4,638	4,961
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000 shares authorized; none outstanding		
Common stock, $.01 par value, 990,000 shares authorized; shares issued: 366,153 and 365,449, respectively	2,131,410	2,126,583
Treasury stock, at cost, 5,057 and 7,743 shares, respectively	(113,463)	(182,341)

	November 29, 2002	May 31, 2002
Note receivable from sale of warrants	(16,841)	(21,052)
Unamortized stock-based compensation	(3,019)	(5,030)
Retained earnings (deficit)	(192,057)	35,814
Accumulated other comprehensive loss	(2,803)	(3,769)
Total stockholders' equity	1,803,227	1,950,205
Total liabilities and stockholders' equity	$ 2,243,136	$ 2,526,792

See notes to condensed consolidated financial statements.

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3Com Corporation
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended	
	November 29, 2002	November 30, 2001
Cash flows from operating activities:		
Net loss	$ (166,094)	$ (336,058)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	74,972	155,698
Loss on fixed assets	59,234	16,633
Write downs of goodwill and intangibles, including the cumulative effect of change in accounting principle	73,251	3,473
Loss on investments, net	18,552	7,270
Deferred income taxes	246	24,625
Stock-based expense	4,883	5,983
Changes in current assets and liabilities:		
Accounts receivable	9,266	102,089
Inventories	12,567	100,023
Other assets	15,863	41,121
Accounts payable	(16,853)	(82,470)
Accrued liabilities and other	(37,906)	(257,961)
Income taxes payable	10,763	82,934
Net cash provided by (used in) operating activities	58,744	(136,640)
Cash flows from investing activities:		
Purchase of investments	(714,302)	(183,653)
Proceeds from sales and maturities of investments	453,428	342,039

	Six Months Ended	
Purchase of property and equipment	(10,777)	(336,951)
Proceeds from sale of property and equipment	79,944	4,067
Net cash used in investing activities	(191,707)	(174,498)
Cash flows from financing activities:		
Issuance of common stock	10,604	13,353
Repurchase of common stock	(1,548)	(3,660)
Net proceeds (repayments) on revolving line of credit	(70,000)	102,200
Proceeds from term loan		105,000
Repayments of long-term borrowings	(22,581)	(129)
Collection on note receivable from sale of warrants	4,211	
Other, net	914	(5,266)
Net cash provided by (used in) financing activities	(78,400)	211,498
Decrease in cash and equivalents	(211,363)	(99,640)
Cash and equivalents, beginning of period	679,055	897,797
Cash and equivalents, end of period	$ 467,692	$ 798,157

See notes to condensed consolidated financial statements.

3Com Corporation

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1.

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by 3Com Corporation (3Com), 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 (consisting solely of normal recurring adjustments) necessary for a fair presentation of 3Com's financial position as of November 29, 2002, and results of operations and cash flows for the three and six months ended November 29, 2002 and November 30, 2001. Certain amounts from the prior period have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net loss as previously reported.

3Com uses a 52- or 53-week fiscal year ending on the Friday nearest to May 31. The results of operations for the three and six months ended November 29, 2002 may not be indicative of the results to be expected for the fiscal year ending May 30, 2003. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in 3Com's Annual Report on Form 10-K for the fiscal year ended May 31, 2002.

Revenue Recognition

3Com generally recognizes a sale when the product has been delivered and risk of loss has passed to the customer, collection of the resulting receivable is reasonably assured, persuasive evidence of an arrangement exists, and the fee is fixed or determinable. 3Com accrues related allowances for product returns, warranty, other post-contract support obligations, and royalty expenses in the period of sale. A limited warranty is provided on 3Com products for periods ranging from 90 days to the lifetime of the product, depending upon the product. Sales of service and maintenance are recognized upon delivery and completion of the service or, in the case of maintenance contracts, ratably over the contract term, provided that all other revenue recognition criteria have been met. 3Com provides limited product return and price protection rights to certain distributors and resellers. Product return rights are generally limited to a percentage of sales over a one to three month period.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 141, "Business Combinations," which addresses the financial accounting and reporting for business combinations and supersedes Accounting Principles Board (APB) Opinion 16, "Business Combinations," and SFAS 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." SFAS 141 requires that all business combinations be accounted for by the purchase method, modifies the criteria for recognizing intangible assets, and expands disclosure requirements. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001. 3Com adopted SFAS 141 on June 1, 2002. The adoption of SFAS 141 did not have a material impact on the Company's results of operations or statements of financial position.

In June 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets," which addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion 17, "Intangible Assets." SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives. In addition, SFAS 142 expands the disclosure requirements about goodwill and other

intangible assets in the years subsequent to their acquisition. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of SFAS 142 are to be reported as a change in accounting principle.

3Com adopted SFAS 142 on June 1, 2002 and ceased amortization of net goodwill totaling $66.5 million, which included $0.7 million of acquired workforce intangible assets previously classified as purchased intangible assets; amortization continues on net finite-lived intangible assets with remaining useful lives of generally two to three years and totaling $15.2 million as of November 29, 2002 as discussed in Note 7. In the first quarter of fiscal 2003, 3Com completed the first phase of the SFAS 142 analysis, which indicated that an impairment might have existed for goodwill associated with the Company's Enterprise Networking and CommWorks segments. In the second quarter of fiscal 2003, 3Com completed the transitional goodwill impairment evaluation and recorded a charge totaling $65.6 million as a change in accounting principle effective June 1, 2002 to write off goodwill of $45.4 million in the Enterprise Networking segment and $20.2 million in the CommWorks segment. The remaining recorded goodwill for 3Com after this impairment charge was $0.9 million as of November 29, 2002, and related solely to the Connectivity segment. A reconciliation of previously reported net loss and net loss per share to the amounts adjusted for the exclusion of goodwill and acquired workforce amortization follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	November 29, 2002	**November 30, 2001**	**November 29, 2002**	**November 30, 2001**
Reported net loss	$ (68,513)	$ (103,674)	$ (166,094)	$ (336,058)
Add back goodwill amortization		8,306		16,627
Add back acquired workforce amortization		669		1,335
Adjusted net loss	$ (68,513)	$ (94,699)	$ (166,094)	$ (318,096)
Reported net loss per share-Basic and Diluted:	$ (0.19)	$ (0.30)	$ (0.46)	$ (0.97)
Add back goodwill amortization		0.03		0.05
Add back acquired workforce amortization				
Adjusted net loss-Basic and Diluted	$ (0.19)	$ (0.27)	$ (0.46)	$ (0.92)

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Company adopted SFAS 144 on June 1, 2002. The adoption of

SFAS 144 did not have a material impact on the Company's results of operations or financial position.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost as defined in EITF 94-3 was recognized at the date of an entity's commitment to an exit plan. SFAS 146 also establishes that the liability initially should be measured and recorded at fair value. 3Com will adopt the provisions of SFAS 146 for exit or disposal activities that are initiated after December 31, 2002.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002.

The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. 3Com has not yet determined the impact of the adoption of FIN 45 on the Company's results of operations or financial position.

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. The EITF will be effective for fiscal years beginning after June 15, 2003. 3Com has not yet determined the impact of the adoption of EITF 00-21 on the Company's results of operations or financial position.

2.
Restructuring Charges

In fiscal 2001, 3Com began the restructuring of its business to enhance the focus and cost effectiveness of its business units in serving their respective markets. 3Com implemented a reduction in workforce and other actions aimed at reducing costs, expenses and assets; exited its consumer Internet appliance and cable and digital subscriber line (DSL) modem product lines; and outsourced the manufacturing of certain high volume server, desktop and mobile connectivity products in a contract manufacturing arrangement as part of this restructuring effort.

In the first quarter of fiscal 2003, 3Com announced it would merge its Business Connectivity Company (BCC) into its Business Networks Company (BNC) to leverage common infrastructure in order to drive additional cost out of the business, resulting in three ongoing operating segments as listed in Note 9 Enterprise Networking, Connectivity, and CommWorks. Additionally, the Company entered into an agreement to outsource certain information technology (IT) functions, and continued its efforts to consolidate its real estate portfolio. Components of accrued restructuring charges, which are included in accrued liabilities and other in the accompanying balance sheet, and changes in accrued amounts related to this restructuring program as of November 29, 2002 were as follows (in thousands):

	Employee Separation Expenses	Long-term Asset Write downs	Facilities-related Charges	Other Restructuring Costs	Total
Balance at May 31, 2002	$ 4,953	$	$ 5,354	$ 3,447	$ 13,754
Provision	14,427	1,894	6,196	640	23,157
Payments and asset write downs	(9,859)	(1,894)	(6,217)	(859)	(18,829)
Balance at August 30, 2002	9,521		5,333	3,228	18,082
Provision (benefit)	10,570	3,064	56,410	(505)	69,539
Payments and asset write downs	(13,091)	(3,064)	(57,240)	(330)	(73,725)
Balance at November 29, 2002	$ 7,000	$	$ 4,503	$ 2,393	$ 13,896
Estimated remaining cash payments	$ 7,000	$	$ 4,503	$ 2,393	$ 13,896

	Employee Separation Expenses	Long-term Asset Write downs	Facilities-related Charges	Other Restructuring Costs	Total

Employee separation expenses are comprised of severance pay, outplacement services, medical and other related benefits. Affected employee groups include corporate services, manufacturing and logistics, product organizations, research and development, sales, customer support and administrative positions. The total reduction in workforce since the inception of this restructuring program through November 29, 2002 includes approximately 6,100 employees who have been separated or were in the separation process. There were approximately 200 additional employees who have been notified but have not yet worked their last day. Included in the $10.6 million provision in the second quarter of fiscal 2003 were credits of approximately $0.5 million relating to revisions of previous estimates. Since the inception of this restructuring program, $157.4 million of separation payments have been made.

Long-term asset write downs include items identified as no longer needed to support ongoing operations for 3Com. During the second quarter of fiscal 2003, 3Com recorded a charge of

$3.1 million, primarily for excess manufacturing equipment being sold at a price below the Company's original estimate.

Facilities-related charges include write downs of land and buildings held for sale and lease terminations. In the second quarter of fiscal 2003, 3Com recorded $56.4 million in facilities-related charges, including a $31.2 million loss on the sale of its Marlborough, Massachusetts campus; $9.0 million of accelerated depreciation of facilities in Santa Clara, California; and $7.5 million and $6.6 million in write downs of facilities in Ireland and the U.K., respectively, both of which have been reclassified as held for sale in the second quarter of fiscal 2003.

Other restructuring costs include expenses associated with terminating other contractual arrangements. The net benefit in the second quarter of fiscal 2003 includes $0.5 million of revisions of previous estimates of restructuring costs.

3.

Comprehensive Loss

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

	Three Months Ended		Six Months Ended	
	November 29, 2002	November 30, 2001	November 29, 2002	November 30, 2001
Net loss	$ (68,513)	$ (103,674)	$ (166,094)	$ (336,058)
Other comprehensive income (loss):				
Change in net unrealized gain on investments	482	(181)	94	(2,397)
Change in accumulated translation adjustments	(502)	(380)	873	(236)
Total comprehensive loss	$ (68,533)	$ (104,235)	$ (165,127)	$ (338,691)

4.

Net Loss Per Share

The following table presents the calculation of basic and diluted loss per share (in thousands, except per share data):

	Three Months Ended	Six Months Ended

	Three Months Ended		Six Months Ended	
	November 29, 2002	November 30, 2001	November 29, 2002	November 30, 2001
Loss before cumulative effect of change in accounting principle	$ (68,513)	$ (103,674)	$ (100,493)	$ (336,058)
Cumulative effect of change in accounting principle			(65,601)	
Net loss	$ (68,513)	$ (103,674)	$ (166,094)	$ (336,058)
Weighted average shares-basic	359,340	346,703	358,389	345,508
Effect of dilutive securities:				
Employee stock options				
Restricted stock				
Weighted average shares-diluted	359,340	346,703	358,389	345,508
Net loss per share-basic and diluted:				
Loss before cumulative effect of change in accounting principle	$ (0.19)	$ (0.30)	$ (0.28)	$ (0.97)
Cumulative effect of change in accounting principle			(0.18)	
Net loss	$ (0.19)	$ (0.30)	$ (0.46)	$ (0.97)

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Employee stock options and restricted stock totaling 2.8 million shares, 3.0 million shares, 4.2 million shares, and 5.1 million shares for the three and six months ended November 29, 2002 and the three and six months ended November 30, 2001, respectively, were not included in the diluted weighted average shares calculation as the effects of these securities were antidilutive.

5. Inventories

Inventories consist of (in thousands):

	November 29, 2002	May 31, 2002
Finished goods	$ 18,285	$ 29,730
Work-in-process	10,258	15,458
Raw materials	15,467	16,589
Total inventory	$ 44,010	$ 61,777

6. Sale of Facilities

In July 2002, 3Com sold its 639,000 square foot manufacturing and office facility in Mount Prospect, Illinois that was classified as held for sale as of May 31, 2002. The estimated net realizable value of this property as of May 31, 2002 was $17.4 million. Net proceeds from the sale were $17.8 million, resulting in a $0.4 million credit that was recorded against restructuring charges in the first quarter of fiscal 2003. Additionally, as a portion of 3Com's term loan was collateralized by the Mount Prospect facility, 3Com repaid approximately $7.5 million of the term loan balance with the proceeds of this sale as was required under the terms of the financing agreement.

In October 2002, 3Com sold its 185,000 square foot office and research and development facility in Salt Lake City, Utah that was classified as held for sale prior to the inception of its restructuring programs. Net proceeds from the sale were $4.2 million, resulting in a gain of approximately $0.3 million that was recorded in (gain) loss on land and facilities, net, in the second quarter of fiscal 2003, resulting in a net loss of $0.9 million for the six months ended November 29, 2002 related to this property.

In November 2002, 3Com sold its 550,000 square foot Marlborough campus, and will lease back approximately 168,000 square feet of the campus at prevailing market rates. Net proceeds from the sale were $56.6 million, resulting in a loss of $31.2 million that was recorded in restructuring charges in the second quarter of fiscal 2003.

7. Intangible Assets, Net

Intangible assets, net, consist of (in thousands):

	As of November 29, 2002			
Segments:	**Enterprise Networking**	**Connectivity**	**CommWorks**	**Total**
Developed and core technology, gross	$ 21,582	$ 20,992	$	$ 42,574
Accumulated amortization	(13,231)	(14,279)		(27,510)
Developed and core technology, net	8,351	6,713		15,064
Customer relationships, gross	420	56		476
Accumulated amortization	(291)	(27)		(318)
Customer relationships, net	129	29		158
Total net intangible assets	$ 8,480	$ 6,742	$	$ 15,222

	As of May 31, 2002			
Segments:	**Enterprise Networking**	**Connectivity**	**CommWorks**	**Total**
Developed and core technology, gross	$ 24,780	$ 20,992	$ 14,041	$ 59,813
Accumulated amortization	(11,449)	(12,236)	(9,934)	(33,619)
Developed and core technology, net	13,331	8,756	4,107	26,194
Customer relationships, gross	420	56	4,864	5,340
Accumulated amortization	(221)	(20)	(3,604)	(3,845)
Customer relationships, net	199	36	1,260	1,495
Total net intangible assets	$ 13,530	$ 8,792	$ 5,367	$ 27,689

In the second quarter of fiscal 2003, 3Com recorded an impairment of intangible assets associated with its Enterprise Networking and CommWorks segments. For each segment, 3Com determined the amount of the impairments by comparing the carrying value against the fair value, which was estimated using discounted cash flows. As a result of this analysis, 3Com recorded a write down of $3.2 million for the Enterprise Networking segment relating to the NBX Corporation acquisition, and write offs of $4.4 million and $0.1 million for the

CommWorks segment relating to the Call Technologies, Inc. and LANSource Technologies, Inc. acquisitions, respectively. These impairments are recorded in amortization and write down of intangibles and are components of contribution margin in the three and six months ended November 29, 2002, as reported in Note 9.

8.

Stock Repurchase Program

In September 2002, 3Com's Board of Directors approved a stock repurchase program providing for expenditures of up to $40.0 million and authorized a twelve-month time limit on such repurchases. In the second quarter of fiscal 2003, 3Com repurchased 0.4 million shares of its own common stock for $1.5 million.

9.

Business Segment Information

The following tables display information on 3Com's reportable segments (in thousands):

	Three Months Ended		Six Months Ended	
	November 29, 2002	November 30, 2001	November 29, 2002	November 30, 2001
Sales:				
Enterprise Networking	$ 190,170	$ 198,282	$ 385,983	$ 394,481
Connectivity	81,291	132,882	149,221	257,352
CommWorks	31,008	64,106	66,553	123,461
Exited Product Lines	725	(1,416)	6,159	8,149
	$ 303,194	$ 393,854	$ 607,916	$ 783,443
Contribution Margin (Loss):				
Enterprise Networking	$ 14,319	$ (17,920)	$ 37,630	$ (57,328)
Connectivity	38,566	8,926	57,534	(19,585)
CommWorks	(11,549)	(10,419)	(22,861)	(42,718)
Exited Product Lines	1,573	350	960	(21,781)
	$ 42,909	$ (19,063)	$ 73,263	$ (141,412)

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A reconciliation of the totals reported for the operating segments to the applicable line items in the consolidated financial statements is set forth below (in thousands):

	Three Months Ended		Six Months Ended	
	November 29, 2002	November 30, 2001	November 29, 2002	November 30, 2001
Total contribution margin (loss) from operating segments	$ 42,909	$ (19,063)	$ 73,263	$ (141,412)
Indirect operating expenses (1)	34,970	47,857	67,127	112,328
Restructuring charges	69,539	31,536	92,696	89,051
(Gain) loss on land and facilities, net	(265)		887	

	Three Months Ended		Six Months Ended	
Total operating loss	(61,335)	(98,456)	(87,447)	(342,791)
Loss on investments, net	(7,087)	(4,620)	(18,552)	(7,270)
Interest and other income, net	3,909	26,640	13,506	45,798
Loss before income taxes and cumulative effect of change in accounting principle (2)	$ (64,513)	$ (76,436)	$ (92,493)	$ (304,263)

(1) Indirect operating expenses include expenses that are not directly attributable to a reporting segment, such as corporate marketing and general and administrative expenses.

(2) As discussed in Note 1, the cumulative effect of a change in accounting principle for the six months ended November 29, 2002 related to the transitional goodwill impairment analysis that resulted in a write off of $45.4 million and $20.2 million of goodwill in the Enterprise Networking and CommWorks segments, respectively. These impairment charges were not included as a component of contribution margin (loss) as presented above.

10. Litigation

3Com is a party to lawsuits in the normal course of its business. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. 3Com believes that it has defenses in each of the cases set forth below and is vigorously contesting each of these matters. An unfavorable resolution of one or more of the following lawsuits could adversely affect its business, results of operations, or financial condition.

Securities Litigation

In November 2000, a shareholder derivative and class action lawsuit, captioned *Shaev v. Claflin, et al.*, No. CV794039, was filed in California Superior Court. The complaint alleges that 3Com's directors and officers made misrepresentations and/or omissions and breached their fiduciary duties to the Company in connection with the adjustment of employee and director stock options in connection with the separation of 3Com and Palm Inc. (Palm). It is unclear whether the plaintiff is seeking recovery from 3Com or if 3Com was named solely as a nominal defendant, against whom the plaintiff seeks no recovery. On November 29, 2001, the Superior Court granted the defendants' demurrer with leave to amend. The plaintiff filed a First Amended Complaint to which defendants again demurred. On July 9, 2002, the Superior Court again granted the defendants' demurrer to the plaintiff's First Amended Complaint with leave to amend. On or about December 13, 2002, the plaintiff filed a Second Amended Complaint. 3Com's response to such Second Amended Complaint is currently due by January 13, 2003.

Intellectual Property

On May 26, 2000, 3Com filed suit against Xircom, Inc. (Xircom) in the United States District Court for the District of Utah, Civil Action No. 2:00-CV-0436C alleging infringement of U.S. Patents Nos. 6,012,953, 5,532,898, 5,696,660, and 5,777,836, accusing Xircom of infringement of one or more of the claims of the patents-in-suit by reason of the manufacture, sale, and use of the RealPort and RealPort2 families of PC Cards, as well as a number of Xircom's Type II PC Modem Cards. On November 14, 2000, 3Com amended its complaint to assert infringement of then-newly issued U.S. Patent No. 6,146,209, also asserted against Xircom's RealPort and RealPort2 families of products. Xircom counter-claimed for a declaratory judgment that the asserted claims of the patents-in-suit were invalid and/or not infringed. On July 19, 2002 the Honorable Tena Campbell granted 3Com's motion for a preliminary injunction on the 6,146,209 patent prohibiting Xircom from manufacturing, using, selling, offering to sell within the United States or importing into the United States 26 RealPort and RealPort2 products as identified in the Court's order pending the final outcome of the lawsuit. Xircom appealed this ruling to the Court of Appeals for the Federal Circuit. In the second quarter of fiscal 2003, 3Com and Xircom announced the settlement of all litigation between them. Under the terms of the settlement, 3Com received $15.0 million for a paid-up technology license, which was recorded as royalty revenue; a consent judgment acknowledging the validity of 3Com patents and infringement by Xircom products, including RealPort and RealPort2, has been entered; cross licensing of the patents in suit has been agreed upon and the Xircom lawsuit against 3Com has been dismissed with prejudice. 3Com, Xircom and Intel Corporation, Xircom's parent company, have also agreed upon a two-year limited covenant not to sue each other with respect to any patent infringement claims.

On September 21, 2000, Xircom filed an action against 3Com Corporation in the United States District Court for the Central District of California, Case No.: 00-10198 MRP, accusing 3Com of infringement of U.S. Patents Nos. 5,773,332, 5,940,275, 6,115,257, and 6,095,851, accusing 3Com of infringement by reason of the manufacture, sale, and use of the 3Com® 10/100 LAN+Modem CardBus Type III PC Card, the 3Com 10/100 LAN CardBus Type III PC Card, the 3Com Megahertz® 10/100 LAN CardBus PC Card, the 3Com Megahertz 10/100 LAN+56K Global Modem CardBus PC Card and the 3Com Megahertz 56K Global GSM and Cellular Modem PC Card. On July 6, 2001, Xircom filed a second action against 3Com, Case No. 01-05902 GAF JTLX, also filed in the United States District Court for the Central District of California, alleging infringement of U.S. Patent No. 6,241,550. The 6,241,550 patent was asserted against the 3Com 10/100 LAN+Modem CardBus Type III PC Card and the 3Com 10/100 LAN CardBus Type III PC Card products. This second action asserting the 6,241,550 patent was consolidated with the first action, with both cases being heard by the Honorable Mariana R. Pfaelzer. 3Com counter-claimed for declaratory judgment that the asserted claims of the patents-in-suit were not infringed and/or invalid and that the claims of the 5,940,275 and 6,241,550 patents were unenforceable. Xircom filed a motion for preliminary injunction seeking to enjoin 3Com from the continued manufacture and sale of its Type III PC card products. The motion was heard on March 26, 2001 and was denied by the Court. Xircom subsequently filed a motion for preliminary injunction on the 6,241,550 patent. Xircom's second motion was resolved by agreement between the parties. 3Com continues to sell its type III PC cards, without the light pipe, which does not adversely affect the functionality of the cards. As discussed above, 3Com and Xircom settled all outstanding patent-related litigation in the second quarter of fiscal 2003.

On April 28, 1997, Xerox Corporation (Xerox) filed suit against U.S. Robotics Corporation and U.S. Robotics Access Corporation in the United States District Court for the Western District of New York. The case is now captioned Xerox Corporation v. 3Com Corporation, U.S. Robotics Corporation, U.S. Robotics Access Corporation, Palm Computing, Inc., and Palm, Inc. (Civil Action Number 97-CV-6182T). Xerox alleged willful infringement of United States Patent Number 5,596,656, entitled "Unistrokes for Computerized Interpretation of Handwriting." Xerox sought to recover damages and to permanently enjoin the defendants from infringing the patent in the future. In 2000, the District Court

dismissed the case, ruling that there was no infringement. On appeal, the Court of Appeals for the Federal Circuit affirmed-in-part, reversed-in-part and remanded the case to the District Court. On December 20, 2001, the District Court granted Xerox's motion for summary judgment that the patent is valid, enforceable, and infringed. The defendants then filed a Notice of Appeal. On February 22, 2002, the District Court denied Xerox's motion for an injunction prohibiting further alleged infringement during the appeal and ordered the defendants to post a bond in the amount of $50 million. Xerox then appealed the denial of the injunction. The appeal has been fully briefed by both sides but oral argument on the appeal has not yet been scheduled. In connection with the separation of Palm from 3Com, pursuant to the terms of the Indemnification and Insurance Matters Agreement, dated February 26, 2000, between 3Com and Palm, Palm agreed to indemnify and hold 3Com harmless for any damages or losses that might arise out of the Xerox litigation.

On August 14, 2001, 3Com filed suit against Broadcom Corporation (Broadcom) in California Superior Court, captioned *3Com Corporation v. Broadcom Corporation*, CV800685, seeking to recover from Broadcom, pursuant to a promissory note, the principal amount of $21.1 million together with interest thereon and attorney fees. On January 8, 2002, Broadcom filed its answer denying that any sums are due and asserting numerous affirmative defenses. In the second quarter of fiscal 2003, 3Com and Broadcom settled this suit. Under the terms of the settlement agreement, Broadcom will pay 3Com $22.0 million dollars, representing principal and a portion of prior periods' accrued interest, plus additional interest as it accrues during the repayment period. Broadcom will make five quarterly installments, beginning in November 2002, of $4.4 million, plus additional accrued interest. Broadcom also agreed to entry of a stipulated judgment in 3Com's favor for $22.0 million, plus interest. 3Com agreed to extend the terms of the warrant held by Broadcom to purchase 7.1 million shares of 3Com common stock for an additional 12 months to December 4, 2003.

3Com Corporation

Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

This quarterly report on Form 10-Q contains forward-looking statements. These forward-looking statements include, without limitation, predictions regarding the following aspects of our future:

- Balance sheet, results of operations, and financial position;
- Cash position and cash requirements;
- Sales and margins;
- Sources, amounts and concentration of revenue;
- Costs and expenses;
- Accounting estimates, including treatment of goodwill and intangible assets, doubtful accounts, inventory, restructuring, and warranty, and product returns;
- Operations, including international operations, supply chain, quality control, manufacturing capacity and facilities, and direct ship program;
- Products, price of products, product lines, and product and sales channel mix;
- Relationship with customers, suppliers and strategic partners;
- Acquisition activity;
- Credit facility and ability to raise financial capital;
- Real estate arrangements;
- Activities of 3Com Ventures;
- Global economic conditions;
- Ability to identify and respond to trends;
- Tax position;
- Employees;
- Sources of competition;

Protection of intellectual property;

Outcome and effect of current and potential future litigation;

Adoption of accounting pronouncements; and

Trading price of our common stock.

You can identify these and other forward-looking statements by the use of words such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue," or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Business Environment and Industry Trends. All

forward-looking statements included in this document are based on our assessment of information available to us at this time. We undertake no obligation to update any forward-looking statements.

Critical Accounting Policies

Our significant accounting policies require us to make estimates and assumptions that affect the amounts reported by us. The following items require the most significant judgment and often involve complex estimation:

Revenue recognition: We generally recognize a sale when the product has been delivered and risk of loss has passed to the customer, collection of the resulting receivable is reasonably assured, persuasive evidence of an arrangement exists, and the fee is fixed or determinable. The assessment of whether the fee is fixed or determinable considers whether a significant portion of the fee is due after our normal payment terms. If we determine that the fee is not fixed or determinable, we recognize revenue at the time the fee becomes due, provided that all other revenue recognition criteria have been met. Also, sales arrangements, particularly with CommWorks customers, may contain product acceptance requirements that can impact the timing of the recognition of the related revenue.

We assess collectibility based on a number of factors, including general economic and market conditions, past transaction history with the customer, and the credit-worthiness of the customer. We do not typically request collateral from our customers. If we determine that collection of the fee is not probable, then we will defer the fee and recognize revenue upon receipt of payment.

A significant portion of our sales are to distributors and value-added resellers. Revenue is generally recognized when title and risk of loss pass to the customer, assuming all other revenue recognition criteria have been met. Sales to these customers are recorded net of appropriate allowances, including estimates for product returns, price protection, and potentially excess channel inventory levels.

Sales of service and maintenance revenue are recognized upon delivery and completion of the service or, in the case of maintenance contracts, ratably over the contract term, provided that all other revenue recognition criteria have been met. Royalty revenue from licensing is recognized as earned.

Allowance for doubtful accounts: We continuously monitor payments from our customers and maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. When we evaluate the adequacy of our allowances for doubtful accounts, we take into account various factors including our accounts receivable aging, customer credit-worthiness, historical bad debts, and geographic and political risk. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. As of November 29, 2002, our net accounts receivable balance was $137.8 million.

Inventory: Inventory is stated at the lower of standard cost, which approximates cost, or net realizable value. Cost is based on a first-in, first-out basis. We review the net realizable value of inventory, both on hand as well as for inventory that we are committed to purchase, in detail on an on-going basis, with consideration given to deterioration, obsolescence, and other factors. If actual market conditions differ from those projected by management, and our estimates prove to be inaccurate, benefits or additional write downs or adjustments to cost of sales may be required. As of November 29, 2002, our inventory balance was $44.0 million.

Goodwill and intangible assets: We review the value of our long-lived assets, including goodwill, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. During fiscal 2002, we recognized $70.1 million of write downs of goodwill and intangible assets, and in the first half of fiscal 2003 we recorded $7.7 million of additional intangible asset write downs, as well as a $65.6 million write off of goodwill in our Enterprise Networking and CommWorks segments resulting from the transitional goodwill impairment evaluation under Statement of Financial

Accounting Standards (SFAS) 142. As of November 29, 2002, we had $15.2 million of net intangible assets and $0.9 million of goodwill remaining on the balance sheet, which we believe to be realizable based on the estimated future cash flows of the associated products and technology. However, it is possible that the estimates and assumptions used, such as future sales and expense levels, in assessing the carrying value of these assets may need to be reevaluated in the case of continued market deterioration, which could result in further impairment of these assets.

Restructuring charges: Over the last several years we have undertaken significant restructuring initiatives, which have required us to develop formalized plans for exiting certain business activities. These plans have required us to utilize significant estimates related to held for sale properties, which resulted in both accelerated depreciation charges and write downs of those properties. In addition, we have had to record estimated expenses for severance and outplacement costs, lease cancellations, long-term asset write downs, and other restructuring costs. Given the significance of, and the timing of the execution of such activities, this process is complex and involves periodic reassessments of estimates made at the time the original decisions were made. The accounting for restructuring costs and asset impairments requires us to record provisions and charges when we have a formal and committed plan. Our policies require us to continually evaluate the adequacy of the remaining liabilities under our restructuring initiatives. As management continues to evaluate the business, there may be additional charges for new restructuring activities as well as changes in estimates to amounts previously recorded.

Warranty: A limited warranty is provided on our products for periods ranging from 90 days to the lifetime of the product, depending upon the product, and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to recognize additional cost of sales may be required.

Results of Operations

The following table sets forth, for the periods indicated, the percentage of total sales represented by the line items reflected in 3Com's condensed consolidated statements of operations:

	Three months ended		Six months ended	
	November 29, 2002	**November 30, 2001**	**November 29, 2002**	**November 29, 2001**
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	48.6	66.2	50.4	75.0
Gross margin	51.4	33.8	49.6	25.0
Operating expenses:				
Sales and marketing	22.3	21.6	22.2	24.5
Research and development	14.7	18.6	15.7	20.3
General and administrative	8.5	7.3	8.6	8.9
Amortization and write down of intangibles	3.3	3.3	2.1	3.7

	Three months ended		Six months ended	
Restructuring charges	23.0	8.0	15.3	11.4
(Gain) loss on land and facilities, net	(0.1)		0.1	
Total operating expenses	71.7	58.8	64.0	68.8
Operating loss	(20.3)	(25.0)	(14.4)	(43.8)
Loss on investments, net	(2.3)	(1.2)	(3.0)	(0.9)
Interest and other income, net	1.3	6.8	2.2	5.9
Loss before income taxes and cumulative effect of change in accounting principle	(21.3)	(19.4)	(15.2)	(38.8)
Income tax provision	1.3	6.9	1.3	4.1
Loss before cumulative effect of change in accounting principle	(22.6)	(26.3)	(16.5)	(42.9)
Cumulative effect of change in accounting principle			(10.8)	
Net loss	(22.6)%	(26.3)%	(27.3)%	(42.9)%

Sales

Sales in the second quarter of fiscal 2003 totaled $303.2 million, a decrease of $90.7 million, or 23 percent, compared to the same quarter one year ago. Sales in the first half of fiscal 2003 were $607.9 million, a decrease of $175.5 million, or 22 percent, compared to the same period one year ago.

Enterprise Networking. Sales of Enterprise Networking products (switches, hubs, networked telephony, wireless Local Area Networks (LANs) and wireless Network Interface Cards (NICs), and customer service and support) in the second quarter of fiscal 2003 were $190.2 million, a decrease of $8.1 million, or four percent, compared to the same quarter one year ago. Sales of Enterprise Networking products in the first half of fiscal 2003 were $386.0 million, a decrease of $8.5 million, or two percent, compared to the first half of fiscal 2002. The decline in sales from the same periods one year ago was due primarily to a decline in sales of DSL routers, a decrease in our shared hub product lines in line with a general technology shift towards switching, and lower service maintenance contract revenue due to fewer maintenance contract renewals. Partially offsetting the second quarter and first half declines were increases in the sales of Layer 3 fixed Gigabit switches and LAN Telephony products, both of which benefited from market growth, new product introductions, and increased investment in sales and marketing. Layer 2 fixed-configuration products also grew moderately during the first half of fiscal 2003 versus the same period last year. Sales of Enterprise Networking products in

both the second quarter and first half of fiscal 2003 represented 63 percent of total sales, compared to 50 percent in both the second quarter and first half of fiscal 2002.

Connectivity. Sales of Connectivity products (wired NICs, PC Cards, LAN On Motherboard (LOM) application-specific integrated circuits (ASICs), and Mini-PCI) in the second quarter of fiscal 2003 were $81.3 million, a decrease of $51.6 million, or 39 percent, compared to the same quarter one year ago. Sales of Connectivity products in the first half of fiscal 2003 were $149.2 million, a decrease of $108.1 million, or 42 percent, compared to the first half of fiscal 2002. The decline in sales from the same periods one year ago was due largely to lower volumes. This decline was partially offset by the recognition of $15.0 million in royalty revenue from a paid-up license resulting from the settlement of patent litigation with Xircom Inc. (Xircom) as discussed in Note 10 of the condensed consolidated financial statements.

Factors that reduced volumes were a shift in the market from NICs, PC Cards and Mini-PCI form factors to silicon-based alternatives where we have lower market share, and lower sales to our original equipment manufacturer (OEM) partners. While declining average selling prices (ASPs) resulting from competition placed further downward pressure on revenues, this was mitigated by a favorable product mix shift, including a decrease in sales to OEMs, which normally have lower ASPs, as well as increased sales of our Gigabit Ethernet products and security fiber cards, which have higher ASPs. Sales of Connectivity products in the second quarter and first half of fiscal 2003 represented 27 percent and

25 percent of total sales, respectively, compared to 34 and 33 percent in the second quarter and first half of fiscal 2002, respectively.

CommWorks. Sales of CommWorks® products (carrier-class Internet Protocol (IP)-based multi-service access and service creation hardware platforms for wired and wireless access, software and softswitch elements that enable telecommunications services to be delivered over these platforms, and professional services) in the second quarter of fiscal 2003 were $31.0 million, a decrease of $33.1 million, or 52 percent compared to the same quarter one year ago. For the first half of fiscal 2003, sales were $66.6 million, a decrease of $56.9 million, or 46 percent, compared to the first half of fiscal 2002. Sales declined across all product lines and markets, as carriers and service providers continue to curtail capital spending in response to the weakened telecommunications industry environment. Sales of CommWorks products in the second quarter and first half of fiscal 2003 represented 10 percent and 11 percent of total sales, respectively, compared to 16 percent in both the second quarter and first half of fiscal 2002.

Exited Product Lines. Sales of exited product lines (analog-only modems and high-end LAN and WAN chassis products, internet appliances, and consumer cable and DSL modem products) were negligible in the second quarter of both fiscal 2003 and 2002. Sales of exited products for the first half of fiscal 2003 were $6.2 million, compared to $8.1 million for the same period one year ago. Sales of exited product lines were substantially eliminated by the second quarter of fiscal 2002 resulting from our business restructuring and change in strategic focus, and the sales in the first half of fiscal 2003 resulted mainly from the first quarter recognition of revenue that was deferred as of May 31, 2002. Sales of exited products as a percentage of total sales in the second quarter of both fiscal 2003 and 2002 were nil. Sales of exited products in the first half of both fiscal 2003 and 2002 were one percent of total sales.

Geographic

In the second quarter and first half of fiscal 2003, U.S. sales decreased 16 percent and 22 percent, respectively, as compared to the same periods one year ago. International sales for the second quarter and first half of fiscal 2003 decreased 27 percent and 23 percent, respectively. U.S. sales represented 39 percent of total sales in the second quarter of fiscal 2003, compared to 36 percent in the second quarter of fiscal 2002, and represented 41 percent of total sales in the first half of both fiscal 2003 and 2002. The decline in international sales spanned all major geographic regions.

Gross Margin

Gross margin as a percentage of sales was 51.4 percent in the second quarter of fiscal 2003, compared to 33.8 percent in the second quarter of fiscal 2002. Gross margin improved ten percentage points due largely to component cost improvements and a mix shift towards higher margin products primarily in our Enterprise Networking and Connectivity segments. Included in the mix shift of Connectivity products is a decline in sales to OEM customers, which generally have lower ASPs. Also impacting Connectivity margins was the recognition of the $15.0 million in royalty revenue associated with the Xircom settlement discussed above that had no associated cost of goods sold, and resulted in an additional improvement in gross margin of approximately three percentage points. Gross margin improved two percentage points due to a reduction of underutilized capacity in our manufacturing plants. Gross margin improved a combined three percentage points from a one-time duty refund of $4.4 million, lower provision for excess and obsolete inventory, and lower post-sales support expenses. The sale or disposition of inventory that had previously been written off totaling $1.5 million did not materially improve gross margin in the second quarter of fiscal 2003.

Gross margin as a percentage of sales was 49.6 percent and 25.0 percent for the first six months of fiscal 2003 and fiscal 2002, respectively. As compared to the same period one year ago, gross margin increased 12 percentage points due largely to component cost improvements and mix shift towards higher margin products primarily in our Enterprise Networking and Connectivity segments as described above. Gross margin benefited approximately one percentage point in the first half of fiscal 2003 due to the second quarter's $15.0 million of royalty revenue in the Connectivity segment. Gross margin increased five percentage points due mainly to the prior period's excess and obsolete inventory provisions. These prior period provisions were largely the result of reduced demand and product transition of certain Connectivity products. Gross margin increased four percentage points for the reduction of underutilized capacity in our manufacturing plants. Gross margin improved a combined three percentage points from one-time duty refunds totaling approximately $8.1 million, the sale or disposition of inventory that had previously been written off totaling $4.6 million, and lower post-sales support expenses.

Operating Expenses

Operating expenses in the second quarter of fiscal 2003 were $217.2 million, or 71.7 percent of sales, compared to $231.5 million, or 58.8 percent of sales, in the second quarter of fiscal 2002. Operating expenses in the second quarter of fiscal 2003 included amortization and write down of intangibles of $10.0 million, restructuring charges of $69.5 million, and net gains on land and facilities of $0.3 million. Operating expenses in the second quarter of fiscal 2002 included amortization and write down of intangibles of $12.9 million and restructuring charges of

$31.5 million. Excluding these items, operating expenses for the second quarter of fiscal 2003 were $137.9 million, or 45.5 percent of sales, compared to $187.0 million, or 47.5 percent of sales, in the second quarter of fiscal 2002.

Operating expenses in the first six months of fiscal 2003 were $388.8 million, or 64.0 percent of sales, compared to $538.6 million, or 68.8 percent of sales, in the first six months of fiscal 2002. Operating expenses in the first six months of fiscal 2003 included amortization and write down of intangibles of $12.5 million, restructuring charges of $92.7 million, and net losses on land and facilities of $0.9 million. Operating expenses in the first six months of fiscal 2002 included amortization and write down of intangibles of $29.4 million and restructuring charges of $89.1 million. Excluding these items, operating expenses for the first half of fiscal 2003 were $282.7 million, or 46.5 percent of sales, compared to $420.1 million, or 53.6 percent of sales, in the first half of fiscal 2002.

Sales and Marketing. Sales and marketing expenses in the second quarter of fiscal 2003 decreased $17.4 million, or 20.4 percent, compared to the second quarter of fiscal 2002, and increased to 22.3 percent of total sales for the second quarter of fiscal 2003, compared to 21.6 percent of total sales

for the second quarter of fiscal 2002. Sales and marketing expenses in the first half of fiscal 2003 decreased $56.6 million, or 29.6 percent, compared to the first half of fiscal 2002. The decreases as compared to the same periods in the prior year were primarily due to significantly lower sales force expenses in the first two quarters of fiscal 2003 resulting from headcount reductions, and decreased spending on marketing and advertising. Additionally, our IT outsourcing and facilities consolidation efforts have produced further savings, a portion of which benefited sales and marketing functions.

Research and Development. Research and development expenses in the second quarter of fiscal 2003 decreased $28.6 million, or 39.1 percent, compared to the second quarter of fiscal 2002, and decreased to 14.7 percent of total sales in the second quarter of fiscal 2003 compared to 18.6 percent of total sales in the second quarter of fiscal 2002. Research and development expenses in the first half of fiscal 2003 decreased $63.6 million, or 40.0 percent, compared to the first half of fiscal 2002. The decrease in research and development costs compared to the same periods one year ago was primarily due to headcount reductions as we focus on a smaller number of projects. Expense reductions also resulted from decreased depreciation expense associated with engineering assets that were disposed of as part of our restructuring efforts, as well as a decrease in project materials used in research and development efforts. In addition, research and development functions also benefited from the company-wide savings in IT and facilities spending.

General and Administrative. General and administrative expenses in the second quarter of fiscal 2003 decreased $3.2 million, or 11.0 percent, compared to the second quarter of fiscal 2002, and increased to 8.5 percent of total sales as compared to 7.3 percent of total sales in the second quarter of fiscal 2002. General and administrative expenses in the first six months of fiscal 2003 decreased $17.2 million, or 24.7 percent, compared to the first six months of fiscal 2002. The decrease in general and administrative expenses compared to the same periods one year ago was due primarily to headcount reductions. In addition, general and administrative functions also benefited from the company-wide savings in IT and facilities spending. These expense reductions were partially offset by credits for bad debt in the second quarter and first half of fiscal 2002 and increased legal expenses in the second quarter of fiscal 2003.

Amortization and Write Down of Intangibles. Amortization and write down of intangibles in the second quarter of fiscal 2003 decreased $2.8 million, or 22.0 percent, compared to the second quarter of fiscal 2002. Amortization and write down of intangibles in the first half of fiscal 2003 decreased $16.9 million, or 57.4 percent, compared to the first half of fiscal 2002. Due to the adoption of SFAS 142 on June 1, 2002, we stopped amortizing goodwill, resulting in reductions in amortization of $9.0 million and $18.0 million for the second quarter and first half of fiscal 2003, respectively. Additionally, the first half of fiscal 2002 included a $3.5 million write down of intangible assets and associated goodwill related to the LANSource Technologies, Inc. (LANSource) acquisition. These declines were partially offset in the second quarter and first half of fiscal 2003 by write downs of $3.2 million of intangible assets in our Enterprise Networking segment relating to the NBX Corporation acquisition, and $4.4 million and $0.1 million of intangible assets in our CommWorks segment relating to the Call Technologies, Inc. and LANSource acquisitions, respectively.

Restructuring Charges. Restructuring charges in the second quarter and first half of fiscal 2003 were $69.5 million and $92.7 million, respectively. Expenses for the second quarter of fiscal 2003 were composed primarily of charges for write downs of facilities, severance and outplacement costs, and long-term asset write downs. The facilities charges in the second quarter and first half of fiscal 2003 included a $31.2 million loss on the sale of our Marlborough, Massachusetts campus, $9.0 million of accelerated depreciation of buildings in Santa Clara, California, and write downs of properties in Ireland and the U.K. of $7.5 million and $6.6 million, respectively. None of these properties were classified as held for sale as of May 31, 2002 or August 30, 2002. In addition to these items, restructuring charges for the first half of fiscal 2003 also included a credit of $0.4 million related to the sale of our Mount Prospect, Illinois facility. Restructuring charges for the first half of fiscal 2003 were

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the result of the consolidation of our real estate portfolio, the integration of our Business Connectivity Company and Business Networks Company, IT outsourcing efforts, and continued cost reduction actions. Restructuring charges in the second quarter and first half of fiscal 2002 were $31.5 million and $89.1 million, respectively. Expenses for both periods were composed primarily of charges for accelerated depreciation of facilities, severance and outplacement costs, and long-term asset write downs. These charges were the result of both cost reduction actions we took to restructure our operations that were announced on December 21, 2000, as well as consolidation of our manufacturing facilities and the discontinuation of our consumer cable and DSL modem product lines as announced during June 2001. As the consolidation of our operations continues, we expect to incur additional expenses related to the consolidation of facilities in fiscal 2003.

(Gain) Loss on Land and Facilities, Net. The net gain on land and facilities in the second quarter of fiscal 2003 was $0.3 million and related to the sale of our Salt Lake City, Utah facility. The net loss on land and facilities was $0.9 million for the first six months of fiscal 2003, and included a $1.2 million write down of our Salt Lake City facility that was recorded in the first quarter of fiscal 2003. This facility was classified as held for sale prior to the inception of our restructuring programs.

Loss on Investments, Net

Net loss on investments in the second quarter of fiscal 2003 was $7.1 million, due primarily to market value adjustments of limited partner venture funds and write downs of long term equity investments. Net loss on investments in the second quarter of fiscal 2002 was $4.6 million, due primarily to sales of marketable equity securities and declines in the value of publicly-traded equity securities determined to be other-than-temporary. Net loss on investments in the first half of fiscal 2003 was $18.6 million, due primarily to market value adjustments and sale of investments in limited partner venture funds. Net loss on investments in the first half of fiscal 2002 was $7.3 million, due primarily to losses on the sales of marketable equity securities and declines in the value of publicly-traded equity securities determined to be other-than-temporary and in limited partnership venture capital funds.

Interest and Other Income, Net

Interest and other income, net, in the second quarter of fiscal 2003 was $3.9 million, a decrease of $22.7 million compared to the second quarter of fiscal 2002. In the first six months of fiscal 2003, interest and other income, net, was $13.5 million, a decrease of $32.3 million compared to the first six months of fiscal 2002. The decrease in interest and other income, net, compared to the same quarter one year ago was due primarily to the receipt of $12 million of interest income on a tax refund received in the second quarter of fiscal 2002, as well as lower interest income as a result of lower interest rates and increased borrowing costs associated with our term loan and revolving line of credit. These same factors contributed to the decrease in interest and other income, net, in the first half of fiscal 2003 as compared to the first half of 2002, partially offset by the collection in the first quarter of fiscal 2003 of approximately $5.1 million of interest income that primarily related to a tax refund received in fiscal 2002.

Income Tax Provision

Our income tax provision was $4.0 million for the second quarter of fiscal 2003 and $8.0 million for the first half of fiscal 2003, compared to a $27.2 million provision for the second quarter of fiscal 2002 and a $31.8 million provision for the first half of fiscal 2002. The tax provision in the first quarter and first half of fiscal 2003 was the result of providing for taxes in foreign and state jurisdictions. The tax provision in the second quarter and first half of fiscal 2002 was the result of a write down of a deferred tax asset that previously had been supported by the appreciation in our real estate portfolio and providing for taxes in foreign and state jurisdictions.

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Cumulative Effect of Change in Accounting Principle

We adopted SFAS 142 effective June 1, 2002. In accordance with SFAS 142, we conducted a transitional goodwill impairment evaluation of the $66.5 million of goodwill recorded as of May 31, 2002. In the first quarter of fiscal 2003, we completed the first phase of the SFAS 142 analysis, which indicated that an impairment might have existed for the goodwill associated with our Enterprise Networking and CommWorks segments. In the second quarter of fiscal 2003, we completed the evaluation and recorded a charge totaling $65.6 million as a change in accounting principle effective June 1, 2002 to write off goodwill of $45.4 million in the Enterprise Networking segment and $20.2 million in the CommWorks segment.

Liquidity and Capital Resources

Cash and equivalents and short-term investments at November 29, 2002 were $1,433.6 million, an increase of approximately $51.6 million compared to the balance of $1,382.0 million at May 31, 2002.

For the six months ended November 29, 2002, net cash provided by operating activities was $58.7 million. Accounts receivable at November 29, 2002 decreased $9.3 million from May 31, 2002 to $137.8 million. Days sales outstanding in receivables increased to 41 days at November 29, 2002, compared to 39 days at May 31, 2002 primarily due to a deterioration in sales linearity throughout the second quarter of fiscal 2003 as compared to the fourth quarter of fiscal 2002. Inventory at November 29, 2002 decreased $12.6 million from May 31, 2002 to $44.0 million. Annualized inventory turnover was 12.8 turns for the quarter ended November 29, 2002, compared to 11.3 turns for the quarter ended May 31, 2002. Other assets at November 29, 2002 decreased $15.9 million from May 31, 2002, primarily due to collections of non-trade receivables. Accounts payable and accrued liabilities and other at November 29, 2002 decreased $54.8 million from May 31, 2002, and includes the final payment related to excess manufacturing capacity. Income taxes payable, net, increased $10.8 million due mainly to our $8.0 million tax provision for the first half of fiscal 2003 and the receipt of a $5.0 million income tax refund.

3Com Ventures selectively makes strategic investments in privately-held companies and in limited partnership venture capital funds, which in turn invest in privately-held companies. This may include a strategic commercial or technology relationship, such as a component supply agreement or technology license arrangement, with these privately-held companies. We believe these investments complement our business strategies and research and development efforts. In the first half of fiscal 2003 we sold our interest in several limited partnership venture capital funds. We collected proceeds of $4.4 million associated with the sale of these funds and, as part of this transaction, transferred the obligations of future capital calls associated with such funds. 3Com Ventures has made strategic investments of $2.2 million over the last six months and has committed to make additional capital contributions to certain venture capital funds totaling $22.9 million. We estimate that we will pay approximately $7.0 million over the next twelve months as capital calls are made.

During the six months ended November 29, 2002, we made $10.8 million in capital expenditures, primarily for projects relating to facilities consolidations projects and information systems and new product introductions. Additionally, we collected $79.9 million from sales of property and equipment, including facilities in Marlborough, Mount Prospect, and Salt Lake City for net proceeds of $56.6 million, $17.8 million, and $4.2 million, respectively. As of November 29, 2002, capital expenditure commitments outstanding were approximately $4.7 million. Additionally, we have commitments relating to royalty and patent licenses whose technologies are incorporated into our products that extend through May 2005. As of November 29, 2002, these commitments were approximately $31.9 million, $9.3 million of which are expected to be paid over the next 12 months.

We have several agreements whereby we have sold product to resellers who have, in turn, sold the product to end users, and we have guaranteed the payments of the end users to our customers. If all

end users under these agreements were to default on their payments, as of November 29, 2002 we would be required to pay approximately $14.3 million. As deferred revenue associated with such sales approximates the guaranteed amounts, any payments resulting from end user defaults would not have a material impact on our results of operations.

As of November 29, 2002, we had $75.1 million outstanding on our term loan and no amounts outstanding on our revolving line of credit. During the first half of fiscal 2003 we repaid the entire $70.0 million line of credit balance and $22.5 million on our term loan. Included in the term loan repayments are two quarterly repayments of $7.5 million each, plus an additional $7.5 million due to the sale of our Mount Prospect facility as was required under the terms of the financing agreement.

During the six months ended November 29, 2002, we collected $4.2 million plus interest on the note receivable from the sale of warrants to Broadcom Corporation (Broadcom). This note was previously the subject of litigation between us and Broadcom, which was settled in the second quarter of fiscal 2003, as discussed in Note 10 of the condensed consolidated financial statements.

During the six months ended November 29, 2002, we repurchased 0.4 million shares of common stock for $1.5 million, and received net cash of $10.6 million from the sale of approximately 3.5 million shares of common stock to employees through our employee stock purchase and option plans. Our stock option program is a broad-based, long-term retention program that is intended to attract and retain talented employees and align stockholder and employee interests. We consider our option program critical to our operation and productivity; essentially all of our employees participate. The program consists of three plans: one under which officers and key employees may be granted options to purchase shares of our stock, one under which non-employee directors are granted options, and a broad-based plan under which options may be granted to all employees other than officers and directors.

As of November 29, 2002, our outstanding stock options as a percentage of outstanding shares was 29 percent. This potential dilutive effect of stock options to existing stockholders is an area of attention of senior management, and is mainly the result of the effect of our distribution of Palm, Inc. common stock in the first quarter of fiscal 2001. As a result of the distribution, the number of shares subject to option grants was adjusted to preserve the intrinsic value of the stock options, resulting in an increase of 134 million options, and bringing the total option shares outstanding to 169 million at the time of the distribution. As a result of employee reductions and management of new grants, we have been able to reduce the number of outstanding options 37 percent since the Palm distribution.

Stock option activity during the first half of fiscal 2003 and stock option detail as of November 29, 2002, were as follows:

(Shares in thousands)	Number of shares	Weighted average exercise price
Outstanding, May 31, 2002	111,102	$ 7.25
Granted	12,237	4.48
Exercised	(1,247)	3.26
Canceled	(15,634)	7.71
Outstanding, November 29, 2002	106,458	$ 6.91

Range of exercise prices		Outstanding options as of November 29, 2002: Number of shares (in thousands)	Outstanding options as of November 29, 2002: Weighted average exercise price	Exercisable options as of November 29, 2002: Number of shares (in thousands)	Exercisable options as of November 29, 2002: Weighted average exercise price
$ 0.13	$ 4.80	29,977	$ 4.23	13,861	$ 3.96
4.81	5.54	20,721	5.38	14,445	5.40
5.55	6.68	22,043	5.96	19,756	5.98
6.71	11.73	20,241	8.80	13,296	8.68
11.76	21.57	13,476	13.94	7,623	13.91
Total		106,458	$ 6.91	68,981	$ 6.85

There are no assurances that we can reduce losses from operations and avoid future negative cash flow or raise capital as needed to fund the operations of 3Com. However, based on current plans and business conditions, but subject to the discussion in the Business Environment and Industry Trends, we believe that our existing cash and equivalents, short-term investments, revolving line of credit, and cash generated from operations will be sufficient to satisfy anticipated cash requirements for at least the next twelve months.

Effects of Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 141, "Business Combinations" which addresses the financial accounting and reporting for business combinations and supersedes Accounting Principles Board (APB) Opinion 16, "Business Combinations," and SFAS 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." SFAS 141 requires that all business combinations be accounted for by the purchase method, modifies the criteria for recognizing intangible assets, and expands disclosure requirements. The provisions of SFAS 141 apply to all business combinations initiated after June 30, 2001. We adopted SFAS 141 on June 1, 2002. The adoption of SFAS 141 did not have a material impact on our results of operations or statements of financial position.

In June 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets," which addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion 17, "Intangible Assets." SFAS 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives. In addition, SFAS 142 expands the disclosure requirements about goodwill and other intangible assets in the years subsequent to their acquisition. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of SFAS 142 are to be reported as a change in accounting principle.

We adopted SFAS 142 on June 1, 2002 and ceased amortization of net goodwill totaling $66.5 million, which included $0.7 million of acquired workforce intangible assets previously classified as purchased intangible assets; amortization continues on net finite-lived intangible assets, with remaining useful lives of generally two to three years and totaling $15.2 million as of November 29, 2002 as discussed in Note 7 of the condensed consolidated financial statements. In the first quarter of fiscal 2003, we completed the first phase of the SFAS 142 analysis, which indicated that an impairment might have existed for the goodwill associated with our Enterprise Networking and CommWorks segments. In the second quarter of fiscal 2003, we completed the transitional goodwill impairment evaluation and recorded a charge totaling $65.6 million as a change in accounting principle effective June 1, 2002 to write off goodwill of $45.4 million in the Enterprise Networking segment and $20.2 million in the

CommWorks segment. The remaining recorded goodwill for the Connectivity segment after this impairment charge was $0.9 million as of November 29, 2002. A reconciliation of previously reported net loss and net loss per share to the amounts adjusted for the exclusion of goodwill and acquired workforce amortization follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	November 29, 2002	**November 30, 2001**	**November 29, 2002**	**November 30, 2001**
Reported net loss	$ (68,513)	$ (103,674)	$ (166,094)	$ (336,058)
Add back goodwill amortization		8,306		16,627
Add back acquired workforce amortization		669		1,335
Adjusted net loss	$ (68,513)	$ (94,699)	$ (166,094)	$ (318,096)
Reported net loss per share-Basic and Diluted:	$ (0.19)	$ (0.30)	$ (0.46)	$ (0.97)
Add back goodwill amortization		0.03		0.05
Add back acquired workforce amortization		0.00		0.00
Adjusted net loss-Basic and Diluted	$ (0.19)	$ (0.27)	$ (0.46)	$ (0.92)

In August 2001, the FASB issued SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. We adopted SFAS 144 on June 1, 2002. The adoption of SFAS 144 did not have a material impact on our results of operations or financial position.

In June 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost as defined in EITF 94-3 was recognized at the date of an entity's commitment to an exit plan. SFAS 146 also establishes that the liability should initially be measured and recorded at fair value. We will adopt the provisions of SFAS 146 for exit or disposal activities that are initiated after December 31, 2002.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. We have not yet determined the impact of the adoption of FIN 45 on our results of operations or financial position.

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. The EITF will be effective for fiscal years beginning after June 15, 2003. We have not yet determined the impact of the adoption of EITF 00-21 on our results of operations or financial position.

Business Environment and Industry Trends

Industry trends and specific risks may affect our future business and results in our business. Some of the factors that could cause future results to materially differ from past results or those described in forward-looking statements include the matters discussed below.

Our business and our ability to grow revenues has been adversely impacted by the economic slowdown and related uncertainties affecting markets in which we operate

Adverse economic conditions worldwide have contributed to a technology industry slowdown and impacted our business resulting in:

- reduced demand for most of our products;
- increased price competition for our products;
- increased risk of excess and obsolete inventories;
- excess facilities and manufacturing capacity; and
- higher overhead costs, as a percentage of revenues.

Recent political and social turmoil in many parts of the world, including actual incidents and potential future acts of terrorism and war, may continue to put pressure on global economic conditions. These political, social and economic conditions and uncertainties make it extremely difficult for 3Com, our customers and our vendors to accurately forecast and plan future business activities. This reduced predictability challenges our ability to operate profitably or to increase revenues. In particular, it is difficult to develop and implement strategies, sustainable business models and efficient operations, and effectively manage outsourced relationships for certain contract manufacturing and information technology services. If the current economic or market conditions continue or further deteriorate, there could be additional material adverse impact on our financial position, revenues, results of operations and cash flow.

We face operational risks in implementing our strategy to evaluate and implement the outsourcing of certain functions that do not differentiate our ability to compete successfully and achieve profitable growth

We are continuing to evaluate the potential for outsourcing certain functions or operations that do not differentiate 3Com or create a competitive advantage for our company supporting profitable growth. This outsourcing strategy has included certain software development for IT applications and outsourcing a substantial portion of 3Com's IT infrastructure. Implementation of such outsourcing may not result in reduction of actual costs associated with such services or function and may increase risk of disruption of operations upon which we rely on third parties to meet our needs. Moreover, future events are unpredictable and there may be substantial penalties for terminating agreements early or failing to maintain minimum service levels.

We face operational risks in consolidating our research and development design centers

As part of our ongoing cost reduction efforts in our CommWorks business, we are consolidating our research and development activities into fewer design centers. These consolidation activities involve significant transfers of product development efforts among design centers and reductions in employment. Failure to properly manage the consolidation activities could result in disruptions to our product development programs which, in turn, could adversely impact the cost or timing of introducing new or enhanced products, revenues or overall financial performance.

Cost containment and expense reductions are critical to achieving positive cash flow from operations and profitability

We are continuing efforts to reduce our expense structure. We believe strict cost containment and expense reductions are essential to achieving positive cash flow from operations in future quarters and returning to profitability, especially since the outlook for future quarters is subject to numerous challenges. Further costs and expense reductions may be sought if revenues and market conditions do not improve. A number of factors could preclude us from successfully bringing costs and expenses in line with our revenues, such as our inability to accurately forecast business activities, further deterioration of our revenues, and our inability to reduce our General and Administrative expenses commensurate with, and at the same pace as, any further deterioration in our revenues. If we are not able to effectively reduce our costs and achieve an expense structure commensurate with our business activities and revenues, we may have inadequate levels of cash for operations or for capital requirements, which could significantly harm our ability to operate the business.

We face increased competition and our financial performance and future growth depend upon sustaining or growing market positions in our existing markets and successfully targeting new markets

We face competitive challenges that are likely to arise from a number of factors, including:

- industry volatility resulting from rapid development and maturation of technologies;
- industry consolidation resulting in competitors with greater financial, marketing and technical resources;
- greater competition for fewer customers as a result of consolidation in the reseller and distribution channels; potential consolidation among networking equipment providers; as well as consolidation in the telecommunications service provider market due to excess capacity and the financial difficulties being experienced by some service providers; and the potential emergence of new competitors with lower cost structures and more competitive offerings;
- increasing price competition in the face of weakening economic conditions, excess inventories and excess capacity in the telecommunications service provider market; and
- continuing silicon integration of networking products.

We compete in three specific markets that serve enterprise and telecommunications service provider customers. Our competitors range from large, diversified telecommunications equipment and networking companies to smaller companies with a more specialized focus. Our principal competitors in the Enterprise Networking segment include: Avaya, Inc., Cisco Systems, Inc. (Cisco), Dell Computer Corporation (Dell), D-Link Systems Inc. (D-Link), Enterasys Networks, Inc., Extreme Networks, Inc, Hewlett-Packard Company (HP), Linksys, Lucent Technologies Inc. (Lucent), and Nortel Networks Corporation (Nortel). In the Connectivity segment, our principal competitor is Intel Corporation; other competitors include Accton Technology Corporation, Broadcom Corporation, D-Link, Linksys and NetGear, Inc. Principal competitors in the telecommunications service provider market on a worldwide basis include: Cisco, Comverse Technology, Inc., Lucent, Nortel, and Sonus Networks, Inc.; other key competitors in selected regional markets include Huawei Technologies Co., Ltd., ZTE Corporation, NEC Corporation, and Oki Electric Industry Co., Ltd. As siliconization continues and networking functions become more embedded on the motherboard, we are increasingly facing competition from parties who are also our current suppliers of products. Our failure to compete successfully against current or future competitors could harm our business, operating results or financial condition. Likewise, integration of networking, communications, and computer processing functionality on a reduced number of semiconductor components may adversely affect our future sales growth and operating results.

We are making significant investments in various technologies for emerging product lines. These investments include XRN technology, Gigabit Ethernet technology, IP telephony, CDMA wireless networking products and services, softswitch technologies, wireless LANs, Layer 3+ switching, network security technology (such as our embedded firewall products) and Network Jack switches. We expect these product lines to account for a higher percentage of our future sales over time, although the markets for these products and solutions are still emerging and may not develop to our expectations. Industry standards for some of these technologies are yet to be widely adopted and the market potential remains unproven. If the markets for these new technologies or products do not develop or grow as we expect, or if we have not adopted optimal sales and go-to-market strategies for these new technologies and products, our financial results could be adversely affected and we might need to change our business strategy.

Also, in the markets in which we compete, products have short life cycles and rapid technology transitions. Therefore, our success depends on our ability to identify new market and product opportunities, to develop and introduce new products in a timely manner, to gain market acceptance of new products, particularly in our targeted emerging markets, and to rapidly and efficiently transition our customers from older to newer connectivity technologies. Additionally, as we increase our reliance on relationships with strategic partners, such as original design manufacturer's (ODMs), we may encounter greater difficulties in quickly and effectively introducing new products with the quality, functionality, costs and features that are optimal for the market. This increased reliance may also limit our ability to independently identify current product and technology trends and respond to such trends. Any delay in new product introductions, lower than anticipated demand for our new products, failure to meet market needs for features or functionality or higher manufacturing costs could have an adverse affect on our operating results or financial condition, particularly in those product markets we have identified as emerging high-growth opportunities.

Future cash requirements or restrictions on cash could adversely impact our financial position; and an event of default under the Credit Facility may impair our ability to conduct business operations

We incurred net losses in fiscal 2002 and in the first half of fiscal 2003. Our overall cash balance declined in fiscal 2002 and, although we generated cash in the first half of fiscal 2003 we could incur negative overall cash flow in future quarters. If cash flow significantly deteriorates in the future, our liquidity and ability to operate our business could be adversely impacted. Additionally, our ability to raise financial capital may be hindered due to our net losses and the possibility of future negative cash flow, thus reducing our operating flexibility.

The following items could require unexpected future cash payments, limit our ability to generate cash or restrict our use of cash:

- triggering of certain payment obligations, breach of covenants or acceleration of payment obligations under our revolving and term loan facilities;
- inability to dispose of real estate holdings;
- taxes due upon the transfer of cash held in foreign locations; and
- taxes assessed by local authorities where we conduct business.

During fiscal 2002, we entered into a $210,000,000 revolving and term loan facility with a syndication of financial institutions led by Bank of America (the "Credit Facility") and, contemporaneously, we retired the operating lease arrangements we had with respect to certain of our real properties. The Credit Facility has a term of three years and is secured by priority liens over certain assets (including inventory, accounts receivable, plant and equipment and certain real properties), but specifically excludes our cash, cash equivalents, short-term investments, equity investments and intellectual property. The primary financial covenant under the Credit Facility obligates us to maintain a minimum

of $400 million of available cash, cash equivalents and short-term investments. Falling below $400 million would be an event of default and, among other things, (i) Bank of America may accelerate the payment of the complete facility, (ii) use of cash in certain bank accounts will be severely restricted, and (iii) significant operational constraints such as limitations on selling assets and funding certain operations, will automatically take effect. We also have the ability to prepay and terminate the Credit Facility at any time.

While we plan to adhere to the financial covenants of the Credit Facility and avoid an event of default, in the event that it appears we are unable to avoid an event of default, it may be necessary or advisable to retire and terminate the Credit Facility and pay all remaining balances borrowed. Such payment of the Credit Facility would further limit our available cash and cash equivalents. Furthermore, we may not be able to retire the Credit Facility if we do not have adequate resources available when necessary to avoid an event of default or if, because of a rapid decline in revenues and cash and cash equivalents, we do not have adequate time to retire the Credit Facility. The consequences of an event of default under the Credit Facility may prevent us from conducting normal business operations.

As we continue our efforts to consolidate our real estate portfolio and liquidate certain real estate holdings that we occupy or lease to third parties, we may enter into other financial arrangements, such as sale-leaseback or mortgage arrangements that may subject us to additional financial covenants and restrictions, thereby further reducing our operating flexibility. Notwithstanding the foregoing, because of the economic conditions in the U.S. and the fact that much of our real estate holdings are in Silicon Valley, which has been particularly hard hit by the technology industry slowdown, our ability to consolidate and liquidate our holdings or to use our real estate to support other financial arrangements to gain additional liquidity may be impaired. Additionally, to the extent that we continue to own excess facilities and are not able to lease the facilities, we will be adversely affected through continuing to bear the operating costs associated with these properties and the inability to generate rental income.

We maintain substantial cash deposits in foreign locations, portions of which may be subject to significant tax or tax withholding upon transfer or withdrawal. This risk is mitigated, but not completely eliminated, by the existence of our net operating losses and tax credit carryforwards. Furthermore, we regularly engage in discussions with tax authorities in various jurisdictions where we operate about our tax positions. While we believe our tax positions in these various jurisdictions are proper and fully defensible, these tax authorities may nevertheless assess taxes and render judgments against us if we are unable to convince them of our position. In such an event, we could be required to make unexpected cash payments in satisfaction of such assessments or judgments or incur additional expenses to defend our position.

The above cash requirements or restrictions could lead to an inadequate level of cash for operations or for capital requirements, which could have a material negative impact on our financial position and significantly harm our ability to operate the business.

Retaining key employees and management are critical to our success

Our success depends upon retaining and recruiting highly qualified employees and management personnel. This is especially important in our current operating structure involving three operating segments, since each management team must possess the skills, experience and talent to run its business on an independent basis. However, like many companies in the industries in which we operate, we face challenges in attracting and retaining highly qualified employees and management personnel. In addition, the significant downturn in our business environment has had a negative impact on our operations, and as a result, we have restructured our operations to reduce our workforce and implement other cost reduction activities. Although we believe these various changes and actions will improve our organizational effectiveness and competitiveness, they could lead, in the short term, to disruptions in our business, reduced employee morale and productivity, increased attrition and

problems with retaining existing employees and recruiting future employees and increased financial costs.

Recruiting and retaining skilled personnel, including engineers, sales representatives and product marketing managers, continues to be difficult. At certain locations where we operate the cost of living is extremely high and it may be difficult to attract and retain key employees and management personnel at a reasonable cost. If we cannot successfully recruit and retain such persons, our product introduction schedules, customer relationships, operating results and financial condition may become impaired and our overall ability to compete may be adversely affected.

A significant portion of our revenues is derived from sales to a small number of customers who may decide not to purchase our products in the future

We distribute many of our enterprise networking and connectivity products through two-tier distribution channels that include distributors, systems integrators and value-added resellers. We also sell to PC OEMs and telecommunications service providers. For enterprise networking and connectivity products, a significant portion of our sales is concentrated among a few distributors and OEM customers. There has been a recent trend of decreased demand for connectivity products from OEM customers such as Dell and HP, due to increased siliconization of networking connections and also to factors specific to our OEM customers. Additionally, consolidation in our distribution channels and among PC OEMs is reducing the number of customers in the domestic and international markets. In an effort to streamline our operations, we may increase the focus of our distribution sales resources on selected distribution channel customers.

For CommWorks products, a significant portion of our sales is concentrated with the major telecommunications service providers. We cannot be certain that these customers will continue to purchase our products at current levels, particularly in light of the serious challenges confronting the worldwide telecommunications industry. Such challenges are causing telecommunications service providers to experience serious credit problems and other financial difficulties and may result in far fewer companies surviving, thereby reducing competition and negatively impacting the amount and timing of purchases of telecommunications infrastructure equipment from us or other suppliers.

Our results of operations, financial condition, or market share could be adversely affected if our customers:

- stop purchasing our products or focus more on buying or reselling our competitors' products;
- reduce, delay, or cancel their orders or defer implementation of new emerging technologies and products; or
- experience competitive, operational, or financial difficulties, impairing our ability to collect payments from them.

We depend on distributors who could negatively affect our operations by reducing the level of our products in their inventory

Our distributors maintain inventories of our products. 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. Notwithstanding such efforts, if our channel partners reduce their levels of inventory of our products or if they do not maintain sufficient levels of inventory of our products to meet customer demand, our sales could be negatively impacted.

Changes in sales channel mix to PC OEMs and product mix to lower margin connectivity products may negatively impact our revenues and margins

We sell our connectivity products to PC OEMs, PC ODMs who sell to PC OEMs, and to distributors who, in turn, sell to commercial enterprises. Sales to distributors typically generate higher ASPs and gross margins than sales to PC OEMs. The trend in sales for our enterprise connectivity products over the past several years has been a shift from two-tier distribution to PC OEMs and ODMs, with the result that our revenue from distribution sales has decreased as a percentage of our total revenues. This mix shift towards PC OEMs and ODMs has lowered the ASPs for our products. If this trend continues and we cannot lower our costs of the products or transition customers to products with higher ASPs, then our margins will be reduced and our financial results will be adversely impacted.

We derive a significant portion of our sales of connectivity products from PC OEMs such as Dell, Gateway, Inc., HP and International Business Machines Corporation, all of which are manufacturers that incorporate our NICs, PC cards, Mini-PCI, and ASIC products into their products. These companies also have begun utilizing chip sets that contain integrated Ethernet LAN connectivity solutions into their products. As Ethernet connectivity technology continues to mature, we have seen the incorporation of NIC, PC Card, and Mini-PCI product features into lower-priced form factors such as LOM and integrated into the chip sets on the motherboard. Certain competitors that have a significant share of the PC chip set market may be bundling such PC chip sets with integrated LAN connectivity at little or no price premium to PC chip sets without LAN connectivity. This bundling of PC chip sets and LAN connectivity will have an adverse impact on competition in the LAN connectivity market, including a significant negative impact on our ability to sell LAN connectivity solutions to our existing PC OEM or ODM customers. We expect that PC OEMs and ODMs increasingly will purchase the lower-priced form factors of connectivity products. If we cannot lower our costs of the products or transition customers to products with higher ASPs, then our margins will be reduced and our financial results will be adversely impacted.

Continued slowdown of capital expenditures in the telecommunications industry may negatively impact CommWorks revenues

CommWorks' customers in the telecommunications service provider market include incumbent local exchange carriers (ILECs), interexchange carriers (IXCs), post, telephone, and telegraph administrators (PTTs), competitive local exchange carriers (CLECs), wireless service operators, Internet service providers (ISPs) and other alternative service providers. The deteriorating economic conditions prevailing in the telecommunications industry over the past several quarters have combined to exert downward pressure on service provider revenues, margins, and profitability and have resulted in longer sales cycles and decreased levels of capital expenditures for new equipment and services. Moreover, the challenges presented by the current industry environment are causing many telecommunications service providers and equipment vendors to experience serious credit problems and other financial difficulties and could result in additional bankruptcies and consolidations. A continuation or worsening of the current depressed economic conditions in the telecommunications industry could have a material adverse effect on our revenues and overall financial performance.

Revenues from sales of our CommWorks products are subject to substantial fluctuations from period to period and are difficult to predict. Such fluctuations and difficult predictability are the result of several factors characteristic of the CommWorks business, including the relatively small number of key customers, the uncertainty related to the rate of deployment of new equipment and services by customers, uncertainty related to lengthening sales cycles and the timing of individual sales transactions, and product acceptance requirements that can impact the timing of the recognition of the sale. For these reasons, revenues in any particular quarter from sales of our CommWorks products may be more prone to and adversely affected by operational decisions of individual customers.

Our increased reliance on contract manufacturing and our excess manufacturing capacity may adversely impact our financial results and operations

We have changed our manufacturing strategy so that more of our products are being sourced from contract manufacturers. Also, during the second quarter of fiscal 2003, CommWorks completed the transition of its contract manufacturing requirements from Manufacturers' Serviced Limited, which previously announced its intentions to cease manufacturing operations at its Mount Prospect facility, to another of our existing suppliers.

We have sold manufacturing operations and facilities associated with those products now sourced from contract manufacturers. Therefore, our ability to resume internal manufacturing operations for those products is severely limited. The cost, quality, performance and availability of contract manufacturing operations are and will be essential to the successful production and sale of many of our products. The inability of any contract manufacturer to meet our cost, quality, performance and availability standards could adversely impact our financial condition or results of operations. We may not be able to provide contract manufacturers with product volumes that are high enough to achieve sufficient cost savings. If shipments fall below forecasted levels, we may incur increased costs or be required to take ownership of the inventory. Also, our ability to control the quality of products produced by contract manufacturers may be limited and quality issues may not be resolved in a timely manner, which could adversely impact our financial condition or results of operations.

We are implementing a direct ship program in a phased manner with our manufacturing partners. Through this program, we will be relying on such partners for fulfillment of customer demand. This program may not yield the efficiencies that we expect, which would negatively impact our financial performance. Any disruptions to on-time delivery to customers would adversely impact our business and revenues.

Furthermore, because we have outsourced significant manufacturing operations to contract manufacturers and have exited a number of businesses, we now have excess manufacturing capacity in existing facilities. We are currently restructuring our operations and implementing cost reduction activities to eliminate this excess capacity, including the consolidation of our real estate portfolio and facilities associated with our former manufacturing and other business operations in Santa Clara, Ireland, and the U.K. In fiscal 2002 we sold our Singapore manufacturing facility and have leased back space for our Asia Pacific region distribution center and office location for sales management, information technology, training and customer service and support operations. In fiscal 2003 we sold our manufacturing facility in Mount Prospect, our office and research and development facility in Salt Lake City, and our manufacturing, research and development, and office facility in Marlborough, a portion of which we are leasing back. Our ability to reduce our excess manufacturing capacity and to consolidate facilities may be made more difficult by further weakening of the networking industry and worsening of general economic conditions in the United States and globally. If we are unable to reduce our excess manufacturing capacity and facilities, this may negatively impact our operations, cost structure and financial performance.

Demand forecasting, increased contract manufacturing, delivery and logistics disruptions and historical component shortages continue to pose major supply chain risks

Current business conditions and operational challenges in managing our supply chain affect our business in a number of ways:

- certain key components, in the recent past, have had limited availability;

- there are a smaller number of suppliers and we have narrowed our supplier base, including in some cases the sole sourcing of certain components from a single supplier;

as siliconization of networking features continues, we are increasingly facing competition from parties who have traditionally been and are currently our suppliers;

our ability to accurately forecast demand is diminished, especially in light of general economic weakness and uncertainty following the terrorist events in the last year and continually deteriorating conditions in the telecommunications industry;

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

our present manufacturing capacities exceed our current needs; and

we may experience disruptions to our logistics, such as the recent lock-outs that have occurred in west coast ports.

Some of our suppliers are also our competitors. We cannot be certain that in the future our suppliers, particularly those who are also in active competition with us, will be able or willing to meet our demand for components in a timely and cost-effective manner.

Increasingly, we have been sourcing a greater number of components from a smaller number of vendors. Also, there has recently been a trend toward consolidation of vendors of electronic components. This greater reliance on a smaller number of suppliers and the inability to quickly switch vendors increase the risk of logistics disruptions, unfavorable price fluctuations or disruptions in supply, particularly in a supply-constrained environment.

Operation of the supply chain requires accurate forecasting of demand, which has become more challenging. If overall demand for our products, product mix and growth of these markets is significantly different from our expectations, we may face inadequate, or excess, component supply. 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 revenues, financial results or market share. If our demand forecasts are too high or our forecasts of product mix are inaccurate, we may experience excess and obsolete inventories and excess manufacturing capacity, which could adversely affect our financial results.

Our current and future decisions to exit certain product lines may have unforeseen negative impacts to our business

In fiscal 2001 and early fiscal 2002, we exited certain business and product lines, including the cable modem business. In certain cases, we continue to be responsible pursuant to the original warranty obligations for these products. Our exiting of these business and product lines may have adversely impacted our relationships with channel partners and end customers since many of these channel partners and customers perceived our remaining products as not being part of a larger integrated or complementary solution or questioned our commitment to their markets and therefore shifted to products from alternative vendors. We may consider exiting other businesses that do not meet our goal of delivering appropriate financial returns in a reasonable amount of time. Future decisions to exit businesses could result in deterioration of our channel partner and customer relationships, increased employee costs (such as severance, outplacement and other benefits), contract termination costs and asset impairments. We may also experience delays in the execution of our plan to exit a business that may create disruptions in our transactions with suppliers and customers.

The reduced role of acquisitions in our current business strategy may negatively impact our growth and increase our reliance on strategic relationships

Historically, acquisitions, some of them substantive, had been a major part of 3Com's strategy. However, commensurate with the downturn in the IT industry, we have not made any acquisitions since the third quarter of fiscal 2001. We expect that the number of acquisitions of businesses or product lines could remain at this level. The networking business is highly competitive, and while we continue to evaluate possible acquisitions, our decision not to complete any such transactions in the recent past could hamper our ability to enhance existing products and introduce new products on a timely basis. Future consolidations in the networking industry may result in new companies with greater resources and stronger competitive positions and products than us. Furthermore, companies may be created that are able to respond more rapidly to market opportunities. Continued consolidation in our industry may adversely affect our operating results or financial condition.

If industry and company performance stabilizes and we continue to have a strong balance sheet, we may begin to pursue acquisitions, investments, or other strategic relationships to complement internal development of new technologies and enhancement of existing products and to exploit market potentials. These strategic relationships can present additional problems since, in most cases, we must compete in some business areas with companies with which we have strategic alliances and, at the same time, cooperate with the same companies in other business areas. If these companies fail to perform, or if these relationships fail to materialize as expected, we could suffer delays in product or market development or other operational difficulties. Furthermore, our results of operations or financial condition could be adversely impacted if we experience difficulties managing relationships with our partners or if projects with partners are unsuccessful. In addition, if our strategic partners are acquired by third parties or if our competitors enter into successful strategic relationships, we may face increased competition.

Certain of our international markets are risky and may negatively impact our operating results

We operate internationally and expect that international markets will continue to account for a significant percentage of our sales. The recent global economic slowdown has already had and is likely to continue to have a negative effect on various international markets in which we operate. This may cause us to simplify our international legal entity structure and reduce our presence in certain countries, which may negatively affect the overall level of business in such countries. Continuing political and social turmoil may likely further exacerbate existing economic and political instability and currency fluctuations in certain international markets in which we participate, and such conditions can adversely affect our operating results or financial condition. Unforeseen conditions and events will positively or negatively impact the level of international sales or our international operations in different regions. For example, a strengthening of the U.S. dollar relative to other countries' currencies could make our products more expensive than locally manufactured products, thereby negatively impacting demand for our products. Also, our contract manufacturers manufacture many of our products overseas, sometimes in politically or economically unstable countries. Should international regions experience economic or political instability, our results of operations may be adversely affected, our ability to forecast demand for our products may also be impacted and our supply of products may be interrupted.

Our reliance on industry standards, a favorable regulatory environment, technological change in the marketplace and new product initiatives may cause our revenues to fluctuate or decline

The networking industry in which we compete is characterized by rapid changes in technology and customer requirements, evolving industry standards and complex government regulation. As a result, our success depends on:

- the emergence of new technology or the convergence of technologies such as voice and data networking or IP telephony;
- our ability to develop new products to address changes in technologies and related customer requirements on a timely basis;
- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards;
- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards; and
- a favorable regulatory environment.

Slow market acceptance of new technologies, products or industry standards could adversely affect our revenues or overall financial performance. 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 revenues from sales of such products or our overall financial performance could be adversely affected.

The telecommunications industry, in particular, is subject to complex government regulation, including regulations defined by the U.S. federal government, its agencies such as the Federal Communications Commission, state public service commissions and various governmental authorities in foreign countries. Failure to obtain all necessary regulatory approvals for our products or to comply with all applicable government regulations could adversely impact our revenues or overall financial performance or expose us to fines or other penalties. In addition, new or revised government regulations could adversely affect the basic business economics for new technologies or their rates of acceptance or adoption by potential customers; in turn, this could adversely impact our revenues or overall financial performance.

Our customer order fulfillment capabilities fluctuate and may negatively impact our operating results

The timing and amount of our sales depend on a number of factors that make estimating operating results uncertain. Throughout our business, we do not typically maintain a significant backlog, and sales are partially dependent on our ability to appropriately forecast product demand. In addition, our customers historically request fulfillment of orders in a short period, resulting in limited visibility to sales trends and potential pricing pressures. Consequently, our operating results depend on the volume and timing of orders and our ability to fulfill orders in a timely manner. Historically, sales in the third month of the quarter have been higher than sales in each of the first two months of the quarter. Non-linear sales patterns make business planning difficult, and increase the risk that our quarterly results will fluctuate due to disruptions in functions such as manufacturing, order management, information systems, and shipping.

We may not always be able to adequately protect or maintain our intellectual property rights

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, and individual inventors have obtained or applied for patents in areas of technology that may relate to our business.

The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights.

In the course of our business, we frequently 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 we must negotiate licenses or cross-licenses to incorporate or use the proprietary technologies, protocols, or specifications in our products. 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 results of operations or financial condition could be adversely impacted.

In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our intellectual property rights. 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 by diverting 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 or uncertain. Thus, the existence of or any adverse determinations in this litigation could subject us to significant liabilities and costs. In addition, if we are the alleged infringer, 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. If we are asserting our intellectual property rights, we could be prevented from stopping others from manufacturing or selling competitive products. Any one of these factors could adversely affect our product margins, results of operations, financial condition, or cash flows.

Our future quarterly operating results are subject to factors that can cause fluctuations in our stock price

Historically, our stock price has experienced substantial price volatility. We expect that our stock price may continue to experience volatility in the future, due to a variety of potential factors such as fluctuations in our quarterly operating results, changes in our cash balances, variations between our actual financial results and the published analysts' expectations and announcements by our competitors. In addition, over the past several quarters, the stock market has experienced extreme 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.

Some of our facilities in California are located near an earthquake fault, and an earthquake or other types of natural disasters could disrupt our operations and adversely effect results

Significant portions of our operations are concentrated at a single location in the Silicon Valley area of California, and we also have various functions and related infrastructure to support our international operations in the U.K. In the event of a natural disaster, such as an earthquake or flood, or localized extended outages of critical utilities or transportation systems, we do not have a formal business continuity or disaster recovery plan, and could therefore experience a significant business interruption.

Legacy computer systems may be vulnerable to breaches of security

We use computer systems, including our enterprise-wide financial system, that may not include the most advanced security features available. There is a risk of unauthorized access to computer systems, including our financial systems. While management makes concerted efforts to assess risks and prevent and detect such security breaches, including our current project to upgrade our existing enterprise-wide

financial system to a new SAP release, our financial results could be impacted if such an unauthorized access were to occur and not be detected within our normal internal control procedures.

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

3Com holds a portfolio of marketable equity securities that have a short trading history and are highly subject to market price volatility. Equity security price fluctuations of plus or minus 50 percent would not have a material impact on the value of these securities as of the end of the second quarter of fiscal 2003.

For interest rate sensitivity and foreign currency exchange risk, reference is made to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended May 31, 2002.

Item 4. **Controls and Procedures**

a.

Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer along with our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, our President and Chief Executive Officer along with our Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to 3Com (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

Our review of our internal controls was made within the context of the relevant professional auditing standards defining "internal controls," "reportable conditions," and "material weaknesses." "Internal controls" are processes designed to provide reasonable assurance that our transactions are properly authorized, our assets are safeguarded against unauthorized or improper use, and our transactions are properly recorded and reported, all to permit the preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States. "Significant deficiencies" are referred to as "reportable conditions," or control issues that could have a significant adverse effect on our ability to properly authorize transactions, safeguard our assets, or record, process, summarize or report financial data in the condensed consolidated financial statements. A "material weakness" is a particularly serious reportable condition where the internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the condensed consolidated financial statements and not be detected within a timely period by employees in the normal course of performing their assigned functions. As part of our internal controls procedures, we also address other, less significant control matters that we or our auditors identify, and we determine what revision or improvement to make, if any, in accordance with our on-going procedures. However, the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and there is no certainty that any design will succeed in achieving its stated goal under all potential future considerations, regardless of how remote.

b.

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation, nor were there any significant deficiencies or material weaknesses in our internal controls. As a result, no corrective actions were required or undertaken.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The material set forth in Note 10 of Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

(a) The Annual Meeting of Shareholders was held on September 24, 2002.

(b) Each of the persons named in the Proxy Statement as a nominee for director was elected and the proposals listed below were approved. The following are the voting results of the proposals:

Proposal I	**For**	**Withheld**	**Broker Non-Votes**
Election of Directors:			
Eric A. Benhamou	314,981,778	12,060,323	0
Gary T. DiCamillo	308,129,126	18,912,975	0
James R. Long	315,026,534	12,015,567	0
Raj Reddy	319,403,337	7,638,764	0

Other Directors whose term of office as a director continued after the meeting were Fred D. Anderson, Bruce L. Claflin, and Paul G. Yovovich.

Proposal II	**For**	**Against**	**Abstain**	**Broker Non-Votes**
To ratify the appointment of Deloitte & Touche LLP as the Company's independent public accountants for the fiscal year ending May 30, 2003:	313,342,225	13,323,490	376,385	0

Item 5. Other Information

None.

Item 6. **Exhibits and Reports on Form 8-K**

(a)

Exhibits

Exhibit Number	Description
2.1	Master Separation and Distribution Agreement between the Registrant and Palm, Inc. effective as of December 13, 1999, as amended (8)
2.2	General Assignment and Assumption Agreement between the Registrant and Palm, Inc., as amended (8)
2.3	Master Technology Ownership and License Agreement between the Registrant and Palm, Inc. (8)
2.4	Master Patent Ownership and License Agreement between the Registrant and Palm, Inc. (8)
2.5	Master Trademark Ownership and License Agreement between the Registrant and Palm, Inc. (8)
2.6	Employee Matters Agreement between the Registrant and Palm, Inc. (8)
2.7	Tax Sharing Agreement between the Registrant and Palm, Inc. (8)
2.8	Master Transitional Services Agreement between the Registrant and Palm, Inc. (8)
2.9	Real Estate Matters Agreement between the Registrant and Palm, Inc. (8)
2.10	Master Confidential Disclosure Agreement between the Registrant and Palm, Inc. (8)
2.11	Indemnification and Insurance Matters Agreement between the Registrant and Palm, Inc. (8)
3.1	Certificate of Incorporation (5)
3.2	Certificate of Correction filed to Correct a Certain Error in the Certificate of Incorporation (5)
3.3	Certificate of Merger (5)
3.4	Corrected Certificate of Merger filed to correct an error in the Certificate of Merger (7)
3.5	Registrant's Bylaws, as amended on August 7, 2001 (17)
3.6	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock (15)
4.1	Amended and Restated Rights Agreement dated December 31, 1994 (3)
4.2	Third Amended and Restated Preferred Shares Rights Agreement, dated as of November 4, 2002 (18)
10.1	3Com Corporation 1983 Stock Option Plan, as amended and restated effective September 30, 2001 (16)*
10.2	Amended and Restated Incentive Stock Option Plan (2)*
10.3	License Agreement dated March 19, 1981 (1)
10.4	3Com Corporation 1984 Employee Stock Purchase Plan, as amended and restated as of September 20, 2001 (17)*
10.5	3Com Corporation Director Stock Option Plan, as amended (16)*
10.6	3Com Corporation Restricted Stock Plan, as amended July 1, 2001 (17) *
10.7	3Com Corporation 1994 Stock Option Plan, as amended and restated effective April 30, 2002 (17)*
10.8	Amended and Restated Agreement and Plan of Merger by and among the Registrant, TR Acquisitions Corporation, 3Com (Delaware) Corporation, and U.S. Robotics Corporation, dated as of February 26, 1997 and amended as of March 14, 1997 (4)
10.9	Form of Management Retention Agreement, effective as of June 2, 1999, for E. Benhamou and B. Claflin (9)*
10.10	Form of Management Retention Agreement, effective as of June 2, 1999, for I. Ali, J. Graham, J. Hart, R. Heffner, E. Masri, J. McClelland, M. Michael, and E. Nelson (9)*
10.11	Employment Agreement with Bruce Claflin, effective as of January 1, 2001 (10)*

10.12	Summary of Severance Plan for Section 16b Officers (14)*
10.14	Credit Agreement dated as of November 28, 2001 between the Registrant, Bank of America, N.A., as Administrative Agent, Bank of America Securities, LLC, as Lead Arranger and Sole Book Manager, Foothill Capital Corporation, as Syndication Agent, and the Financial Institutions Named Herein, as Lenders (16)
10.15	Credit Agreement dated as of November 28, 2001 between 3Com Technologies and 3Com Europe Limited, Bank of America, N.A., as Administrative Agent, Bank of America Securities, LLC, as Lead Arranger and Sole Book Manager, Foothill Capital Corporation, as Syndication Agent, and the Financial Institutions Named Herein, as Lenders (16)
10.16	Security Agreement dated as of November 28, 2001, between the Registrant and Bank of America, N.A., in its capacity as Agent for Lenders (16)
10.17	Continuing Guaranty dated as of November 28, 2001, made by the Registrant in favor of the Lenders and Bank of America, N.A., as Agent for the Lenders (16)
10.18	Intercompany Subordination Agreement dated as of November 28, 2001, made among the Registrant and Bank of America, N.A., as Agent for itself and the Lenders (16)

10.19	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Financing dated November 28, 2001, between the Registrant, as Trustor, and First American Title Guaranty Company, as Trustee, and Bank of America, N.A., as Agent, for the Santa Clara, CA, Betsy Ross site (16)
10.20	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Financing dated November 28, 2001, between the Registrant, as Trustor, and First American Title Guaranty Company, as Trustee, and Bank of America, N.A., as Agent, for the Santa Clara, CA, West Campus (16)
10.21	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Financing dated November 28, 2001, between the Registrant, as Trustor, and First American Title Guaranty Company, as Trustee, and Bank of America, N.A., as Agent, for the Santa Clara, CA, East Campus (16)
10.22	Mortgage, Assignment of Rents, Security Agreement and Fixture Financing Statement dated November 28, 2001, between the Registrant, as Mortgagor, and Bank of America, N.A., as Agent, as Mortgagee, for the Rolling Meadows, IL site (16)
10.23	Amendment Number One to Security Agreement dated July 25, 2002, between the Registrant and Bank of America, N.A., as Administrative Agent, filed herewith
10.24	Warrant to Purchase Common Stock, dated December 4, 2000, between the Registrant and Broadcom Corporation, filed herewith
10.25	Amendment Number One to Warrant, dated November 1, 2002, between the Registrant and Broadcom Corporation, filed herewith

*
Indicates a management contract or compensatory plan.

(1)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Registration Statement on Form S-1 filed on January 25, 1984 (File No. 2-89045)

(2)
Incorporated by reference to the corresponding exhibit to Registrant's Registration Statement on Form S-4 filed on August 31, 1987 (File No. 33-16850)

(3)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on January 17, 1995 (File No. 000-12867)

(4)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Registration Statement on Form S-4 filed on March 17, 1997 (File No. 333-23465)

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(5)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on October 14, 1997 (File No. 000-12867)

(6)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on January 11, 1999 (File No. 000-12867)

(7)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on October 8, 1999 (File No. 002-92053)

(8)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on April 4, 2000 (File No. 333-34726)

(9)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-K filed on August 17, 2000 (File No. 000-12867)

(10)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on January 16, 2001 (File No. 000-12867)

(11)
Incorporated by reference to the corresponding exhibit to Registrant's Registration Statement on Form S-8 filed on April 25, 2001 (File No. 333-59504)

(12)
Incorporated by reference to Registrant's Registration Statement on Form 8-A 12G/A filed on June 15, 2001 (File No. 333-34726)

(13)
Incorporated by reference to the corresponding exhibit to Registrant's Registration Statement on Form S-8 filed on July 12, 2001 (File No. 333-64988)

(14)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-K filed on August 8, 2001 (File No. 000-12867)

(15)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on October 11, 2001 (File No. 000-12867)

(16)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-Q filed on January 11, 2002 (File No. 000-12867)

(17)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 10-K filed on August 2, 2002 (File No. 000-12867)

(18)
Incorporated by reference to the corresponding exhibit previously filed as an exhibit to Registrant's Form 8-A/A filed on November 27, 2002 (File No. 000-12867)

(b)
Reports on Form 8-K

A report on Form 8-K filed November 14, 2002, reporting under Item 5 the announcement that on November 12, 2002, 3Com Corporation issued a press release regarding the resolution of certain patent infringement lawsuits between 3Com and Xircom.

A report on Form 8-K filed December 2, 2002, reporting under Item 5 that during the second quarter of fiscal 2003, 3Com recorded a $65.6 million charge related to its adoption of Statement of Financial Accounting Standards 142.

A report on Form 8-K filed December 2, 2002, reporting under Item 5 that on November 26, 2002, 3Com Corporation completed the sale of its property located in Marlborough, Massachusetts.

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:	January 7, 2003	By:	/s/ MARK SLAVEN
			Mark Slaven Senior Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)

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Certification of Principal Executive Officer

I, Bruce L. Claflin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 3Com Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b)

any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date:	January 7, 2003	/s/ BRUCE L. CLAFLIN
		Bruce L. Claflin President and Chief Executive Officer

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Certification of Principal Financial Officer

I, Mark Slaven, certify that:

1. I have reviewed this quarterly report on Form 10-Q of 3Com Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5.

The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date:	January 7, 2003	/s/ MARK SLAVEN
		Mark Slaven Senior Vice President, Finance and Planning, and Chief Financial Officer

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

I, Bruce L. Claflin, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of 3Com Corporation on Form 10-Q for the fiscal quarter ended November 29, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of 3Com Corporation.

By:	/s/ BRUCE L. CLAFLIN
Name:	Bruce L. Claflin
Title:	President and Chief Executive Officer

I, Mark Slaven, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of 3Com Corporation on Form 10-Q for the fiscal quarter ended November 29, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of 3Com Corporation.

By:	/s/ MARK SLAVEN
Name:	Mark Slaven
Title:	Senior Vice President, Finance and Planning, and Chief Financial Officer

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