

3COM CORP  
Form 10-Q  
October 09, 2007

**Table of Contents**

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

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

**For the quarterly period ended August 31, 2007**

**OR**

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

**For the transition period from            to**

**Commission File No. 0-12867**

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

**Delaware**

**94-2605794**

(State or other jurisdiction of  
incorporation or organization)

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

**350 Campus Drive  
Marlborough, Massachusetts**

**01752**

(Address of principal executive offices)

(Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of September 29, 2006, 396,597,686 shares of the registrant's common stock were outstanding.

**3COM CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED AUGUST 31, 2007**  
**TABLE OF CONTENTS**

	<b>Page</b>
<u><b>PART I. FINANCIAL INFORMATION</b></u>	1
<u>Item 1. Financial Statements</u>	1
<u>Condensed Consolidated Statements of Operations</u> <u>Three Months Ended August 31, 2007 and 2006</u>	1
<u>Condensed Consolidated Balance Sheets</u> <u>August 31 and May 31, 2007</u>	2
<u>Condensed Consolidated Statements of Cash Flows</u> <u>Three Months Ended August 31, 2007 and 2006</u>	3
<u>Notes to Condensed Consolidated Financial Statements</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	23
<u>Item 4. Controls and Procedures</u>	24
<u><b>PART II. OTHER INFORMATION</b></u>	24
<u>Item 1. Legal Proceedings</u>	24
<u>Item 1A. Risk Factors</u>	24
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	37
<u>Item 6. Exhibits</u>	38
<u><b>SIGNATURES</b></u>	39
<u><b>EXHIBITS</b></u>	40
<u>EX-31.1 Section 302 Certification of CEO</u>	
<u>EX-31.2 Section 302 Certification of CFO</u>	
<u>EX-32.1 Section 906 Certification of CEO &amp; CFO</u>	

We use a 52 or 53 week fiscal year ending on the Friday nearest to May 31, with each fiscal quarter ending on the Friday generally nearest August 31, November 30 and February 28. For presentation purposes, the periods are shown as ending on August 31, November 30, February 28 and May 31, as applicable. H3C follows a calendar year basis of reporting and therefore results are consolidated on a two-month time lag.

3Com, the 3Com logo, Digital Vaccine, NBX, TippingPoint Technologies, and TippingPoint are registered trademarks and VCX is a trademark of 3Com Corporation or its subsidiaries. H3C is a trademark of H3C Technologies Co., Limited. Other product and brand names may be trademarks or registered trademarks of their respective owners.

This quarterly report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, predictions regarding the following aspects of our future: future growth; future growth of H3C, including strategy, growth, management of growth, dependence, expected benefits, method of consolidation, tax rate, sales from China, adjustments to preliminary purchase price allocation for 49 percent acquisition, and resources needed to comply with Sarbanes-Oxley and manage operations; impact of SFAS No. 123(R) and other accounting regulations; expected annual amortization expense; TippingPoint IPO; environment for enterprise networking equipment; challenges relating to sales growth; supply of components; trend towards Gigabit products; research and development focus; characteristics of IPS and certain H3C products; future sales of connectivity products; re-assessment, development and execution of our go-to-market strategy; strategic product and technology development plans; management of DVBU and Corporate segments to reach sustained profitability; goal of profitability; dependence on China; ability to satisfy cash requirements for at least the next twelve months; restructuring activities and expected charges to be incurred; potential additional restructuring and cost reduction activities; expected sale of land; expected cost savings from

restructuring activities and integration; potential acquisitions and strategic relationships including our announced proposed acquisition by an entity controlled by an affiliate of Bain Capital; future contractual obligations; recovery of deferred tax assets; reserves; market risk; outsourcing; competition and pricing pressures; and effect of litigation; and you can identify these and other forward-looking statements by the use of words such as may, can, should, expects, plans, anticipates, believes, estimates, predicts, intends, continue, or the negative of such terms, or other terminology. Forward-looking statements also include the assumptions underlying or relating to any forward-looking statements.

---

**Table of Contents**

Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Part II Item 1A Risk Factors. All forward-looking statements included in this document are based on our assessment of information available to us at the time this report is filed. We have no intent, and disclaim any obligation, to update any forward-looking statements.

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

---

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

(Unaudited)

(In thousands, except per share data)	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
Sales	\$ 319,434	\$ 300,144
Cost of sales	170,498	163,715
Gross profit	148,936	136,429
Operating expenses:		
Sales and marketing	74,404	77,122
Research and development	52,310	47,793
General and administrative	21,478	20,276
Amortization	26,006	12,181
Restructuring charges (benefit)	425	(75)
Total operating expenses	174,623	157,297
Operating loss	(25,687)	(20,868)
Gain on investments, net	327	2,292
Interest (expense) income, net	(3,567)	10,090
Other income, net	12,084	4,718
Loss before income taxes and minority interest	(16,843)	(3,768)
Income tax provision	(1,811)	(1,358)
Minority interest in income of consolidated joint venture		(8,942)
Net loss	\$ (18,654)	\$ (14,068)
Basic and diluted net loss per share	\$ (0.05)	\$ (0.04)
Shares used in computing per share amounts:		
Basic and diluted	397,041	391,885

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

**Table of Contents****3COM CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(In thousands, except per share data)	<b>August 31, 2007</b>	<b>May 31 , 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 501,046	\$ 559,217
Accounts receivable, less allowance for doubtful accounts of \$15,643 and \$15,292 respectively	132,589	102,952
Inventories	104,735	107,988
Notes receivable	64,883	77,368
Other current assets	48,271	50,157
Total current assets	851,524	897,682
Property and equipment, less accumulated depreciation and amortization of \$196,473 and \$234,554 respectively	69,250	76,460
Goodwill	767,274	766,444
Intangible assets, net	347,368	371,289
Deposits and other assets	29,809	39,217
Total assets	\$ 2,065,225	\$ 2,151,092
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 106,262	\$ 110,430
Current portion of long-term debt	94,000	94,000
Accrued liabilities and other	370,633	435,638
Total current liabilities	570,895	640,068
Deferred taxes and long-term obligations	14,542	23,725
Long-term debt	336,000	336,000
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized; none outstanding		
Common stock, \$0.01 par value, 990,000 shares authorized; shares issued: 399,557 and 399,064 respectively	2,327,872	2,323,356
Retained deficit	(1,195,060)	(1,176,406)
Accumulated other comprehensive income	10,976	4,349
Total stockholders' equity	1,143,788	1,151,299
Total liabilities and stockholders' equity	\$ 2,065,225	\$ 2,151,092

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

**Table of Contents**

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

(In thousands)	<b>Three Months Ended</b>	
	<b>August 31,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net loss	\$ (18,654)	\$ (14,068)
Adjustments to reconcile net loss to cash (used in) provided by operating activities:		
Depreciation and amortization	34,666	20,095
Stock-based compensation charges	3,863	3,287
Loss (gain) on property and equipment disposals	49	(7,605)
Gain on investments, net	(185)	(2,422)
Minority interest in income of consolidated joint venture		8,942
Deferred income taxes	(845)	(3,716)
Changes in assets and liabilities:		
Accounts receivable	(17,152)	(5,838)
Inventories	4,697	(21,662)
Other assets	2,945	14,314
Accounts payable	(4,001)	(6,623)
Other liabilities	(64,390)	18,582
Net cash (used in) provided by operating activities	(59,007)	3,286
Cash flows from investing activities:		
Purchases of investments		(190,310)
Proceeds from maturities and sales of investments	442	180,524
Purchases of property and equipment	(5,607)	(6,012)
Proceeds from sale of property and equipment	645	33,108
Net cash (used in) provided by investing activities	(4,520)	17,310
Cash flows from financing activities:		
Issuances of common stock	837	2,934
Repurchases of common stock	(183)	(187)
Net cash provided by financing activities	654	2,747
Effect of exchange rate changes on cash and equivalents	4,702	737
Net change in cash and equivalents during period	(58,171)	24,080
Cash and equivalents, beginning of period	559,217	501,097
Cash and equivalents, end of period	\$ 501,046	\$ 525,177



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

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

(Unaudited)

**NOTE 1. BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of our financial position as of August 31, 2007 and June 1, 2007, our results of operations for the three months ended August 31, 2007 and September 1, 2006 and our cash flows for the three months ended August 31, 2007 and September 1, 2006.

We use a 52 or 53 week fiscal year ending on the Friday nearest to May 31. For convenience, the condensed consolidated financial statements have been shown as ending on the last day of the calendar month. Accordingly, the three months ended August 31, 2007 ended on August 31, 2007, the three months ended August 31, 2006 ended on September 1, 2006, and the year ended May 31, 2006 ended on June 1, 2007. The results of operations for the three months ended August 31, 2007 may not be indicative of the results to be expected for the fiscal year ending May 30, 2008 or any future periods. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended June 1, 2007.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* ( FIN 48 ). The interpretation requires companies to recognize the tax benefits of uncertain tax positions only where the position is more likely than not to be sustained upon examination by tax authorities. The amount recognized would be the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability would be recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty on the excess. FIN 48 will require, among other items, a tabular reconciliation of the change during the reporting period, in the aggregate unrecognized tax benefits claimed or expected to be claimed in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Additional disclosure will also be required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next twelve months. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of June 2, 2007. See Note 5 - Income Taxes.

*Recently issued accounting pronouncements*

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by 3Com in the first quarter of fiscal 2009. We have not yet determined the impact, if any, that the implementation of SFAS No. 157 will have on our results of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are

reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by 3Com in the first quarter of fiscal 2009. 3Com currently is determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its consolidated results of operations and financial condition.

**Table of Contents**

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin 108

Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements , which expresses the staff's views regarding the process of quantifying financial statement misstatements. The Bulletin is effective at our fiscal year end 2008. The Company believes the implementation will have no impact on our results of operations, cash flow or financial position.

**NOTE 2. STOCK-BASED COMPENSATION**

In order to determine the fair value of stock options and employee stock purchase plan shares, we use the Black-Scholes option pricing model and apply the single-option valuation approach to the stock option valuation. In order to determine the fair value of restricted stock awards and restricted stock units we use the closing market price of 3Com common stock on the date of grant. We recognize stock-based compensation expense on a straight-line basis over the requisite service period of the awards for options granted following the adoption of SFAS No. 123(R) for time vested awards. We recognize compensation expense for performance based restricted stock in the fiscal quarter when an event makes it probable that performance will more than likely be achieved. For unvested stock options outstanding as of May 31, 2006, we will continue to recognize stock-based compensation expense using the accelerated amortization method prescribed in FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans .

As of August 31, 2007, total unrecognized stock-based compensation expense relating to unvested employee stock options, restricted stock and employee stock purchase plan, adjusted for estimated forfeitures, was \$29.7 million. This amount is expected to be recognized over a weighted-average period of 2.6 years. If actual forfeitures differ from current estimates, total unrecognized stock-based compensation expense will be adjusted for future changes in estimated forfeitures.

Stock-based compensation recognized in the three months ended August 31, 2007 as a result of the adoption of SFAS No. 123(R) as well as pro forma disclosures according to the original provisions of SFAS No. 123 for periods prior to the adoption of SFAS No. 123(R) use the Black-Scholes option pricing model for estimating the fair value of options granted under the company's equity incentive plans. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The underlying weighted-average assumptions used in the Black-Scholes model and the resulting estimates of fair value per share were as follows for options granted during the three months ended August 31, 2007 and August 31, 2006:

	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
<i><b>Employee stock options:</b></i>		
Volatility	40.2%	42.8%
Risk-free interest rate	4.8%	5.0%
Dividend yield	0.0%	0.0%
Expected life (years)	3.8	4.0
Fair value per share	\$1.50	\$1.84

The following table presents stock-based compensation expenses included in the accompanying consolidated statements of operations (in thousands):

	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
Cost of sales	\$ 384	\$ 319
Sales and marketing	975	1,237
Research and development	721	1,168

General and administrative	1,783	563
Stock-based compensation expense before tax	\$ 3,863	\$ 3,287

**Table of Contents**

As of August 31, 2007, our outstanding stock options as a percentage of outstanding shares were approximately 13 percent. Stock option detail as of August 31, 2007, was as follows (shares in thousands):

	<b>Number of shares</b>	<b>Weighted average exercise price</b>
Outstanding May 31, 2007	52,280	\$ 5.23
Granted	1,296	4.10
Exercised	(474)	1.77
Cancelled	(2,536)	6.37
Outstanding August 31, 2007	50,566	\$ 5.18
Exercisable	22,104	\$ 6.01
Weighted average grant-date fair value of options granted		\$ 1.50

During the quarter ended August 31, 2007 approximately 0.5 million options were exercised at an aggregate intrinsic value of \$1.2 million. The intrinsic value is calculated as the difference between the market value as of August 31, 2007 and the exercise price of the shares. The market value as of August 31, 2007 was \$3.75 as reported by the NASDAQ Global Select Market. The aggregate intrinsic value of in-the-money options outstanding and options exercisable as of August 31, 2006 was \$9.2 million and \$7.0 million, respectively.

Options outstanding that are vested and expected to vest as of August 31, 2007 are as follows:

	<b>Number of Shares (in thousands)</b>	<b>Weighted average Grant-Date Fair Value</b>	<b>Weighted Average Remaining Contractual Life (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Vested and expected to vest at August 31, 2007	36,031	\$ 5.41	4.4	\$ 8,638

Restricted stock award activity during the three months ended August 31, 2007 and restricted stock award detail as of August 31, 2007, were as follows (shares in thousands):

	<b>Number of Shares (unvested)</b>	<b>Weighted average Grant-Date Fair Value</b>
Outstanding May 31, 2007	2,403	\$ 4.33
Granted	300	4.28
Vested	(137)	4.26
Forfeited	(262)	4.14
Outstanding August 31, 2007	2,304	\$ 4.35

During the quarter ended August 31, 2007 approximately 0.1 million restricted shares with an aggregate fair value of \$0.6 million became vested.

On September 4, 2007 the Company granted to various employees 0.5 million restricted stock awards to having an aggregate fair value of \$1.8 million.

**Table of Contents**

Restricted stock unit activity during the quarter ended August 31, 2007 and restricted stock units outstanding as of August 31, 2007, were as follows (shares in thousands):

	<b>Number of Shares (unvested)</b>
Outstanding May 31, 2007	3,111
Granted	120
Vested	(27)
Forfeited	(127)
Outstanding August 31, 2007	3,077

Total aggregate intrinsic value of restricted stock units at August 31, 2007 was \$11.5 million with a weighted-average remaining contractual term of 1.0 years.

During the quarter ended August 31, 2007 approximately 0.1 million restricted share units with an aggregate fair value of \$0.1 million became vested.

On September 4, 2007 the Company granted to various employees 4.2 million restricted stock units having an aggregate fair value of \$15.3 million.

*Employee Stock Purchase Plan.* We have an employee stock purchase plan (ESPP) under which eligible employees may authorize payroll deductions of up to ten percent of their compensation, as defined, to purchase common stock at a price of 85 percent of the lower of the fair market value as of the beginning or the end of the six-month offering period. In September 2003, our stockholders approved an increase of five million shares available for issuance under the ESPP. We recognized \$0.4 million of stock-based compensation expense related to the ESPP in the quarter ended August 31, 2007.

**NOTE 3. ACQUISITIONS**

On November 17, 2003, we formed H3C, formerly known as the Huawei-3Com joint venture, with a subsidiary of Huawei Technologies, Ltd. (Huawei). H3C is domiciled in Hong Kong, and has its principal operating center in Hangzhou, China. Two years after formation of H3C, we had the one-time option to purchase an additional two percent ownership interest from Huawei. We exercised this right and entered into an agreement to purchase an additional 2 percent ownership interest in H3C from Huawei for an aggregate purchase price of \$28.0 million. The acquisition occurred on January 27, 2006 at which time we owned a majority interest in the joint venture and, therefore, consolidated H3C's financial statements (beginning February 1, 2006). Three years after formation of H3C, we and Huawei each had the right to initiate a bid process to purchase the equity interest in H3C held by the other. 3Com initiated the bidding process on November 15, 2006 to buy Huawei's 49 percent stake in H3C. Huawei accepted our bid and the transaction closed on March 29, 2007, at which time 3Com paid the \$882 million purchase price in full. As such, H3C is a wholly owned subsidiary in the three months ended August 31, 2007 as compared to the same period of the previous year, when we owned 51 percent and Huawei had a minority ownership. The transaction closed on March 29, 2007, at which time 3Com paid the \$882 million purchase price in full.

**NOTE 4. RESTRUCTURING CHARGES**

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

In fiscal 2001, we began a broad restructuring of our business to enhance the focus and cost effectiveness of our businesses in serving their respective markets. These restructuring efforts continued through fiscal 2008. As of August 31, 2007, accrued liabilities related to actions initiated in fiscal 2001, 2002, 2003, 2004, 2005, 2006, 2007, and 2008 (the Fiscal 2001 Actions, Fiscal 2002 Actions, Fiscal 2003 Actions, Fiscal 2004 Actions, Fiscal 2005 Actions, Fiscal 2006 Actions, Fiscal 2007 Actions, and Fiscal 2008 Actions) mainly consist of lease obligations associated with vacated facilities and employee separation costs.





**Table of Contents**

Restructuring charges related to these various initiatives resulted in a charge of \$0.4 million in the first quarter of fiscal 2008 and a net benefit of \$0.1 million in the first quarter of fiscal 2007. Net restructuring charges in the first quarter of fiscal 2008 included \$0.9 million for severance and outplacement costs and a \$0.5 million benefit for facilities-related charges. The net restructuring benefit in the first quarter of fiscal 2007 resulted from severance, outplacement and other costs of \$7.9 million, slightly more than offset by a gain on the sale of our Santa Clara facility of \$8.0 million.

Accrued liabilities associated with restructuring charges total \$1.8 million as of August 31, 2007 and are included in the caption *Accrued liabilities and other* in the accompanying consolidated balance sheets. These liabilities are classified as current because we expect to satisfy such liabilities in cash within the next 12 months.

**Fiscal 2008 Actions**

Activity and liability balances related to the fiscal 2008 restructuring actions are as follows (in thousands):

	<b>Employee Separation Expense</b>	<b>Total</b>
Balance as of May 31, 2007	\$	\$
Provisions	977	977
Payments and non-cash charges	(849)	(849)
Balance as of August 31, 2007	\$ 128	\$ 128

Employee separation expenses include severance pay, outplacement services, medical and other related benefits. Through August 31, 2007, the total reduction in workforce associated with actions initiated during fiscal 2008 included approximately 22 employees who had been separated or were currently in the separation process. We expect to complete any remaining activities related to actions initiated in fiscal 2008 during fiscal 2008.

**Fiscal 2007 Actions**

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

	<b>Employee Separation Expense</b>	<b>Facilities- related Charges</b>	<b>Other Restructuring Costs</b>	<b>Total</b>
Balance as of May 31, 2007	\$ 1,330	\$ 264	\$	\$ 1,594
Provisions (benefits)	(64)	(7)	39	(32)
Payments and non-cash charges	(623)	(103)	(39)	(765)
Balance as of August 31, 2007	\$ 643	\$ 154	\$	\$ 797

Employee separation expenses include severance pay, outplacement services, medical and other related benefits. The reduction in workforce affected employees involved in research and development, sales and marketing, customer support, and general and administrative functions. In the three months ended August 31, 2007, the total reduction in workforce associated with actions initiated during fiscal 2007 included approximately 3 employees who had been separated or were currently in the separation process and approximately 3 additional employees who had been notified but had not yet worked their last day.

We expect to complete any remaining activities related to actions initiated in fiscal 2007 during fiscal 2008.



**Table of Contents*****Fiscal 2001 through 2006 Actions***

Activity and liability balances related to the fiscal 2001 through 2006 restructuring actions are as follows (in thousands):

	<b>Employee Separation Expense</b>	<b>Facilities- related Charges</b>	<b>Other Restructuring Costs</b>	<b>Total</b>
Balance as of May 31, 2007	\$ 303	\$ 1,479	\$	\$ 1,782
Provisions (benefits)	(2)	(521)	3	(520)
Payments and non-cash charges		(416)	(3)	(419)
Balance as of August 31, 2007	\$ 301	\$ 542	\$	\$ 843

Facilities related benefits in the quarter were related to revised lease obligation terms.

We expect to complete any remaining activities related to these actions during fiscal 2008.

**NOTE 5. INCOME TAXES**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ), that clarifies the accounting and recognition for income tax positions taken or expected to be taken in our tax returns. FIN 48 provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 on June 2, 2007 which resulted in no adjustment to the beginning of the year retained earnings balance. As of the adoption date, the Company had unrecognized tax benefits of \$24.8 million and valuation allowances of \$937.1 million, for a total of \$961.9 million in unrecognized tax benefits. The valuation allowance of \$937.1 million includes \$143.5 million attributable to the tax benefit of stock option deductions, which, if recognized, will be allocated directly to paid-in-capital. In addition, the valuation allowance includes approximately \$59.3 million for acquired net operating loss carryforwards which, if realized, would result in a decrease in goodwill. The remaining tax benefits, if recognized would affect our effective tax rate. There was no significant change to the balance of unrecognized tax benefits during the first quarter of fiscal 2008.

The Company files a consolidated U.S. income tax return and tax returns in various state and local jurisdictions, and our subsidiaries file tax returns in various foreign jurisdictions. In the normal course of business, the company is subject to examination by taxing authorities throughout the world, including such major jurisdictions as China, the United Kingdom and Singapore, as well as the U.S. With some exceptions, the company is no longer subject to U.S. federal, state and local, or non-U.S., income tax examinations for years before 2004.

The significant exceptions are as follows. In Singapore we are subject to examination in relation to transfer pricing and other issues for fiscal years 1999 to 2004. In the Netherlands we are under examination for fiscal year 1997 in relation to the taxable status of income from an interest in a foreign partnership. In Hong Kong we are under examination for fiscal years 2000 to 2002 in relation to an offshore claim in respect of income from our Asia Pacific Region customer service business. It is possible that these examinations will be settled within the next twelve months and therefore it is reasonably possible that, as a result of settlement, there could be a material change in the balance of unrecognized tax benefits. However it is not possible to estimate the amount of the potential change.

We estimate that the balance of unrecognized tax benefits will decrease by approximately \$0.8million over the next twelve months as a result of the expiry of various statutes.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 2, 2007, the combined amount of accrued interest and penalties related to uncertain tax positions was \$2.1 million, which has been recorded within the balance of unrecognized tax benefits. There was no significant change to this amount

during the three months ended August 31, 2008.

**Table of Contents****NOTE 6. COMPREHENSIVE LOSS**

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

	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
Net loss	\$ (18,654)	\$ (14,068)
Other comprehensive income:		
Net unrealized (loss) gain on investments	(210)	1,039
Change in accumulated translation adjustments	6,838	682
<b>Total comprehensive loss</b>	<b>\$ (12,026)</b>	<b>\$ (12,347)</b>

**NOTE 7. NET LOSS PER SHARE**

Employee stock options of 50.6 million, restricted stock awards of 2.3 million and restricted stock units of 3.0 million shares for the three months ended August 31, 2007 and stock options of 45.4 million and restricted stock awards of 1.3 million shares for the three months ended August 31, 2006 were not included in the computation of diluted earnings per share as the net loss for these periods would have made their effect antidilutive.

**NOTE 8. INVENTORIES**

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

	<b>August 31, 2007</b>	<b>May 31, 2007</b>
Finished goods	\$ 69,526	\$ 61,857
Work-in-process	5,212	7,143
Raw materials	29,997	38,988
<b>Total</b>	<b>\$ 104,735</b>	<b>\$ 107,988</b>

**NOTE 9. INTANGIBLE ASSETS, NET**

The following table details our purchased intangible assets (in thousands):

	<b>August 31, 2007</b>			<b>May 31, 2007</b>		
	<b>Gross</b>	<b>Accumulated Amortization</b>	<b>Net</b>	<b>Gross</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Existing technology	\$ 373,258	\$ (149,484)	\$ 223,774	\$ 387,233	\$ (148,641)	\$ 238,592
Trademark	55,500		55,500	55,500		55,500
Huawei non-compete agreement	33,284	(5,564)	27,720	33,000	(61)	32,939
OEM agreement	24,025	(2,003)	22,022	23,800	(22)	23,778
Maintenance contracts	19,000	(8,181)	10,819	19,000	(7,389)	11,611
Other	21,970	(14,437)	7,533	21,924	(13,055)	8,869
<b>Total</b>	<b>\$ 527,037</b>	<b>\$ (179,669)</b>	<b>\$ 347,368</b>	<b>\$ 540,457</b>	<b>\$ (169,168)</b>	<b>\$ 371,289</b>

In the first quarter of fiscal 2008 we wrote off a \$15.6 million fully amortized existing technology intangible asset related to our connectivity business. We are exiting the connectivity business and feel the asset does not provide any future benefit. Additionally, in the first quarter our intangible assets increased by \$2.1 million for the appreciation on the Renminbi affecting the value of certain intangible assets tied to our Chinese business.



**Table of Contents****NOTE 10. ACCRUED WARRANTY**

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

The following table summarizes the activity in the allowance for estimated warranty costs for the three months ended August 31, 2007 and 2006 (in thousands):

	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
Accrued warranty, beginning of period	\$ 40,596	\$ 41,791
Cost of warranty claims processed during the period	(10,937)	(11,592)
Provision for warranties related to products sold during the period	10,244	11,589
Accrued warranty, end of period	\$ 39,903	\$ 41,788

**NOTE 11. LONG-TERM DEBT**

On March 22, 2007, H3C Holdings Limited (the Borrower), an indirect wholly-owned subsidiary of 3Com Corporation, entered into the Credit and Guaranty Agreement dated as of March 22, 2007 among H3C Holdings Limited, as Borrower, 3Com Corporation, 3Com Holdings Limited and 3Com Technologies, as Holdco Guarantors, various Lenders, Goldman Sachs Credit Partners L.P., as Mandated Lead Arranger, Bookrunner, Administrative Agent and Syndication Agent (GSCP), and Industrial and Commercial Bank of China (Asia) Limited, as Collateral Agent (the Credit Agreement). On March 28, 2007, the Borrower borrowed \$430 million under the Credit Agreement in the form of a senior secured term loan to finance a portion of the purchase price for 3Com's acquisition of 49 percent of H3C Technologies Co., Limited, or H3C.

On May 25, 2007, the parties amended and restated the Credit Agreement in order to, among other things, convert the facility into two tranches with different principal amortization schedules and different interest rates, as further described below (the A&R Loans). The parties closed the A&R Loans on May 31, 2007.

Interest on borrowings is payable semi-annually on March 28 and September 28, commencing on September 28, 2007. Payments of principal on the A&R Loans are due as follows on September 28, for fiscal years ending May 31 (in thousands):

	<b>Tranche A</b>	<b>Tranche B</b>
2008	\$92,000	\$ 2,000
2009	46,000	2,000
2010	46,000	2,000
2011	46,000	2,000
2012		20,000
2013		172,000

Accrued interest at August 31, 2007 related to the long-term debt is \$11.2 million.

As of August 31, 2007, we are in compliance with all of our debt covenants.



**Table of Contents****NOTE 12. SEGMENT INFORMATION**

Based on the information provided to our chief operating decision-maker (CODM) for purposes of making decisions about allocating resources and assessing performance, we review the operations of the business by looking at four reporting segments. In prior fiscal years we reported two segments, SCN and H3C. In fiscal 2008, we have realigned our internal reporting and, as a result, we have changed our segment reporting to be in line with the way we are now internally managing our business. This change breaks-out the SCN segment into the Data and Voice business unit ( DVBU ), TippingPoint and Corporate ( Corp ) expenses. We do not use any allocation methods to distribute these corporate expenses to our operating business units.

Management evaluates segment performance based on segment revenue, gross profit, direct operating expense and operating income (loss).

Summarized financial information of our continuing operations by segment for the three months ended August 31, 2007 and 2006 is as follows.

<b>Three Months Ended August 31, 2007</b>						
(in thousands)	<b>H3C</b>	<b>DVBU</b>	<b>Tipping Point</b>	<b>Corp</b>	<b>Eliminations/ Other</b>	<b>Total</b>
Revenue	\$ 186,928	\$ 139,576	\$ 25,468		\$ (32,538) <i>a</i>	\$ 319,434
Gross profit	94,790	43,542	16,626	(110) <i>b</i>	(5,912) <i>c</i>	148,936
Operating expense	67,811	48,202	17,179	11,521 <i>b</i>	29,910 <i>d</i>	174,623
Operating income (loss)	\$ 26,979	\$ (4,660)	\$ (553)	\$ (11,631)	\$ (35,822)	\$ (25,687)

<b>Three Months Ended August 31, 2006</b>						
(in thousands)	<b>H3C</b>	<b>DVBU</b>	<b>Tipping Point</b>	<b>Corp</b>	<b>Eliminations/ Other</b>	<b>Total</b>
Revenue	\$ 169,968	\$ 137,068	\$ 18,755		\$ (25,647) <i>a</i>	\$ 300,144
Gross profit	80,084	44,544	12,210	(90) <i>b</i>	(319) <i>c</i>	136,429
Operating expense	59,788	55,620	16,334	10,481 <i>b</i>	15,074 <i>d</i>	157,297
Operating income (loss)	\$ 20,296	\$ (11,076)	\$ (4,124)	\$ (10,571)	\$ (15,393)	\$ (20,868)

*a* Represents eliminations for inter-company revenue during the respective periods.

*b* Represents costs not directly attributable to any operating business segment.

*c* Includes stock based

compensation in  
all periods plus  
purchase  
accounting  
inventory  
related  
adjustments as  
applicable.  
d Includes  
stock-based  
compensation,  
amortization,  
and  
restructuring.

Certain product groups accounted for a significant portion of our sales. Sales from these product groups as a percentage of total sales for the respective periods are as follows (in thousands except percentages):

	<b>Three Months Ended August 31,</b>			
	<b>2007</b>		<b>2006</b>	
Networking	\$ 261,976	82.0%	\$ 244,033	81.3%
Security	31,483	9.9	25,462	8.5
Voice	16,321	5.1	15,949	5.3
Services	9,030	2.8	8,351	2.8
Connectivity Products	624	0.2	6,349	2.1
Total	\$ 319,434		\$ 300,144	

**Table of Contents****NOTE 13. GEOGRAPHIC INFORMATION**

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

	<b>Three Months Ended August</b>	
	<b>2007</b>	<b>2006</b>
		<b>31,</b>
China	\$ 146,754	\$ 134,117
Europe, Middle East and Africa	69,662	69,534
North America	60,018	58,423
Asia Pacific Rim (ex-China)	23,382	22,751
Latin and South America	19,618	15,319
 Total	 \$ 319,434	 \$ 300,144

Sales information by geography to the extent available is reported based on the customer's designated delivery point, except in the case of H3C's Original Equipment Manufacturer, or OEM, sales which are based on the hub locations of H3C's OEM partners.

**NOTE 14. LITIGATION**

We are a party to lawsuits in the normal course of our business. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. We believe that we have meritorious defenses in the matter set forth below in which we are named as a defendant. An unfavorable resolution of the lawsuit described below could adversely affect our business, financial position, or results of operations. We cannot estimate the loss or range of loss that may be reasonably possible as a result of this litigation and, accordingly, we have not recorded any associated liability in our consolidated balance sheets.

On December 5, 2001, TippingPoint and two of its current and former officers and directors, as well as the managing underwriters in TippingPoint's initial public offering, were named as defendants in a purported class action lawsuit filed in the United States District Court for the Southern District of New York. The lawsuit, which is part of a consolidated action that includes over 300 similar actions, is captioned *In re Initial Public Offering Securities Litigation, Brian Levey vs. TippingPoint Technologies, Inc., et al.* (Civil Action Number 01-CV-10976). The principal allegation in the lawsuit is that the defendants participated in a scheme to manipulate the initial public offering and subsequent market price of TippingPoint's stock (and the stock of other public companies) by knowingly assisting the underwriters' requirement that certain of their customers had to purchase stock in a specific initial public offering as a condition to being allocated shares in the initial public offerings of other companies. In relation to TippingPoint, the purported plaintiff class for the lawsuit is comprised of all persons who purchased TippingPoint stock from March 17, 2000 through December 6, 2000. The suit seeks rescission of the purchase prices paid by purchasers of shares of TippingPoint common stock. On September 10, 2002, TippingPoint's counsel and counsel for the plaintiffs entered into an agreement pursuant to which the plaintiffs dismissed, without prejudice, TippingPoint's former and current officers and directors from the lawsuit. In May 2003, a memorandum of understanding was executed by counsel for the plaintiffs, the issuer-defendants and their insurers setting forth the terms of a settlement that would result in the termination of all claims brought by the plaintiffs against the issuer-defendants and the individual defendants named in the lawsuit. In August 2003, TippingPoint's Board of Directors approved the settlement terms described in the memorandum of understanding. In May 2004, TippingPoint signed a settlement agreement on behalf of itself and its current and former directors and officers with the plaintiffs. This settlement agreement formalizes the previously approved terms of the memorandum of understanding and, subject to certain conditions, provides for the complete dismissal, with prejudice, of all claims against TippingPoint and its current and former directors and officers. Any direct financial impact of the settlement is expected to be borne by TippingPoint's insurers. On August 31, 2005, the District Court issued its preliminary approval of the settlement terms. The settlement remains subject to numerous conditions, including final approval by the District Court. There can be no assurance that such conditions will be met. If the District Court rejects the settlement agreement, in whole or in part, or the settlement does not occur for any

other reason and the litigation against TippingPoint continues, we intend to defend this action vigorously, and to the extent necessary, to seek indemnification and/or contribution from the underwriters in TippingPoint's initial public offering pursuant to its underwriting agreement with the underwriters. However, there can be no assurance that indemnification or contribution will be available to TippingPoint or enforceable against the underwriters. On December 22, 2006, Australia's Commonwealth Scientific and Research Organization (CSIRO) filed suit in the United

**Table of Contents**

States District Court for the Eastern District of Texas (Tyler Division) against several manufacturers and suppliers of wireless products, including 3Com, seeking money damages and injunctive relief. The complaint alleges that the manufacture, use, and sale of wireless products compliant with the IEEE 802.11(a) or 802.11(g) wireless standards infringes on CSIRO's patent, U.S. Patent No. 5,487,069. On March 9, 2007, 3Com filed its Answer, denying infringement and claiming invalidity and unenforceability of the CSIRO patent, among other defenses. The case is in the discovery phase of litigation. The majority of 3Com's wireless products are supplied to the Company under OEM Purchase and Development Agreements that impose substantial intellectual property indemnifications obligations upon 3Com's suppliers. We cannot make any predictions as to the outcome of this litigation and intend to vigorously defend the matter.

**NOTE 15. SUBSEQUENT EVENT**

On September 28, 2007 the Company entered into an Agreement and Plan of Merger to be acquired by an entity controlled by an affiliate of Bain Capital. The Board of Directors of the Company unanimously approved the Merger Agreement.

Pursuant to the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of common stock of the Company will be canceled and will be automatically converted into the right to receive \$5.30 in cash, without interest. Vesting of all outstanding 3Com equity based awards will continue until the closing of the merger, in accordance with their respective terms. At the closing of the merger, outstanding shares of restricted stock and restricted stock unit awards will be purchased for \$5.30 per share less applicable withholdings. Immediately prior to the closing of the merger, outstanding options will become fully vested and exercisable. To the extent unexercised as of the closing of the Merger, options with an exercise price below \$5.30 per share will be cashed out at the difference between \$5.30 and the exercise price of the option, less applicable withholdings. All other options will terminate as of the closing of the Merger.

The Merger Agreement contains a non-solicitation or no shop provision restricting the Company from soliciting alternative acquisition proposals from third parties and from providing information to and engaging in discussions with third parties regarding alternative acquisition proposals. The no-shop provision is subject to a customary fiduciary-out provision, which allows the Company under certain circumstances to participate in discussions with third parties with respect to bona fide written unsolicited alternative acquisition proposals and under certain circumstances, coupled with the payment of a termination fee of \$66.0 million to terminate the Merger Agreement. The Merger Agreement further provides that, upon its termination under specified circumstances, the buyers would be required to pay the Company a termination fee of either \$66.0 million or \$110.0 million as applicable.

The buyers have obtained equity and debt financing commitments for the transactions contemplated by the Merger Agreement. The aggregate proceeds of the commitments, together with the available cash of the Company, will be sufficient for the buyers to pay the aggregate merger consideration and all related fees and expenses. Consummation of the Merger is subject to customary conditions to closing, including the approval of the Company's stockholders and receipt of requisite antitrust and other regulatory approvals.

Several purported class action lawsuits have been filed since September 28, 2007 by 3Com shareholders against the Company, its current directors, a former director, Bain Capital Partners, and in some cases, Huawei Technologies. The plaintiffs seek class certification and injunctions against the proposed sale of the Company as announced on September 28, 2007, contending that the sale price agreed to by the directors is insufficient, that the directors breached their fiduciary duties, and that Bain Capital Partners, and in some cases, Huawei Technologies, aided and abetted the alleged breaches. The defendants intend to vigorously defend these suits.

**Table of Contents**

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

**INTRODUCTION**

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

**BUSINESS OVERVIEW**

We are incorporated in Delaware. A pioneer in the computer networking industry, we provide secure, converged networking solutions, as well as maintenance and support services, for enterprises and public sector organizations of all sizes. Headquartered in Marlborough, Massachusetts, we have worldwide operations, including sales, marketing, research and development, and customer service and support capabilities.

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

- § Networking;
- § Security;
- § Voice;
- § Services; and
- § Legacy Connectivity Products.

We have undergone significant changes in recent years, including:

- § The formation and subsequent 100% acquisition of our Chinese joint venture H3C;
- § financing a portion of the purchase price for our acquisition of H3C by entering into a \$430 million senior secured credit agreement;
- § restructuring activities which included outsourcing of information technology, all manufacturing activity in our DVBU segment, significant headcount reductions in other functions, and selling excess facilities;
- § significant changes to our executive leadership;
- § acquiring TippingPoint Technologies, Inc.; and
- § realigning our DVBU sales and marketing channels and expenditures.

We believe an overview of these significant recent events is helpful to gain a clearer understanding of our operating results.

*Significant Events*

**H3C**

On November 17, 2003, we formed H3C, formerly known as the Huawei-3Com joint venture, with a subsidiary of Huawei Technologies, Ltd. (Huawei). H3C is domiciled in Hong Kong, and has its principal operating center in Hangzhou, China. Two years after formation of H3C, we had the one-time option to purchase an additional two percent ownership interest from Huawei. We exercised this right and entered into an agreement to purchase an additional 2 percent ownership interest in H3C from Huawei for an aggregate purchase price of \$28.0 million. The acquisition occurred on January 27, 2006 at which time we owned a majority interest in the joint venture and, therefore, consolidated H3C's financial statements (beginning February 1, 2006). Three years after formation of H3C, we and Huawei each had the right to initiate a bid process to purchase the equity interest in H3C held by the other. 3Com initiated the bidding process on November 15, 2006 to buy Huawei's 49 percent stake in H3C. Huawei accepted our bid and the transaction closed on March 29, 2007, at which time 3Com paid the \$882 million purchase price in

full. As such, H3C is a wholly owned subsidiary for the three months ended August 31, 2007 as compared to the same period of the previous year, when we owned 51 percent and Huawei had a minority ownership. The transaction closed on March 29, 2007, at which time 3Com paid the \$882 million purchase price in full.

We financed a portion of the purchase price for the acquisition of Huawei's 49 percent ownership in H3C through a \$430 million senior secured credit agreement with several lenders.

**Table of Contents****New Products**

We have introduced multiple new products targeted at the small, medium and large enterprise markets, including modular switches and routers, as well as voice over IP, or VoIP, security, wireless, storage, surveillance and unified switching solutions. We also announced our Open Services Networking, or OSN, strategy.

***Business Environment and Future Trends***

Networking industry analysts and participants differ widely in their assessments concerning the prospects for near-term industry growth. Industry factors and trends also present significant challenges in the medium-term with respect to our goals for sales growth, gross margin improvement and profitability. Such factors and trends include:

- § Intense competition in the market for higher end, enterprise core routing and switching products;
- § Aggressive product pricing by competitors targeted at gaining share in market segments where we have had a strong position historically, such as the small to medium-sized enterprise market; and
- § The advanced nature and ready availability of merchant silicon, which allows low-end competitors to deliver competitive products and makes it increasingly difficult for us to differentiate our products.

We believe that long-term success in this environment requires us to be a global technology leader. With the closure of our H3C acquisition we have commenced our integration to leverage our global footprint to more effectively sell our products into expanding markets and to utilize cost-effective technology development strategies. We also believe that our long-term success is dependent on investing in the development of key technologies. Accordingly, our key focus for fiscal 2008 will continue to be to manage each of our operating segments toward sustainable growth, to make targeted investments in the integration of sales efforts and back office functions between H3C and both DVBU and Corporate, maintain investment in key technologies, and manage our TippingPoint and DVBU segments towards our goal of profitability. In fiscal 2008, we also intend to continue investing in the H3C segment, in which we expect continued growth, but at a slower rate than in the past. This is expected to involve continued investment in research and development, increased focus on growth both inside and outside of China, and growing the dedicated H3C infrastructure in concert with a global 3Com consolidated plan. In addition we may make certain targeted investments in the integration of the H3C with both the DVBU and Corporate operating segments designed to drive more profitable near and long-term growth of the business.

We continue to face significant challenges in the DVBU segment with respect to sales growth, gross margin and profitability. We believe future sales growth for the DVBU segment depends to a substantial degree on increased sales of our networking products, and we believe our best growth opportunity requires us to expand our product lines targeting small and medium businesses, or SMB, customers as well as selected medium-enterprise customers. These product enhancements are expected to be based in part upon leveraging open source and open architecture platforms to differentiate our networking offerings. These are also expected to be complemented by expanded security offerings such as the development of attack, access and application controls.

Finally, we intend to look to improve our channels to market on these products, especially through relationships with system integrators and service providers. In order to achieve our sales goals in the DVBU segment for fiscal 2008, it is important that we continue to enhance the features and capabilities of our products in a timely manner in order to expand our addressable market opportunities, distribution channels and market competitiveness. Also, we expect a very competitive pricing environment for the foreseeable future; this will likely continue to exert downward pressure on our DVBU sales, gross margin and profitability.

Other important factors in the continued success of our H3C business are expected to include: retaining key management and employees, continuing sales through Huawei as an OEM partner of H3C in the near to medium term, and continuing the year-over-year growth in H3C. We intend to retain employees through a long-term retention and incentive structure at H3C.



**Table of Contents**

Our future plans for fiscal 2008 include a potential initial public offering (IPO) of common stock of our wholly owned subsidiary TippingPoint, our business that develops, markets and sells security products and services, such as its intrusion prevention system appliances and its security protection updates through its Digital Vaccine service. Given our recent announcement regarding our proposed acquisition by an entity controlled by an affiliate of Bain Capital, these plans are subject to the discretion of these purchasers in the event our acquisition closes. Any sale of TippingPoint stock would be registered under the Securities Act of 1933, and such shares of common stock would only be offered and sold by means of a prospectus. This Form 10-Q does not constitute an offer to sell or the solicitation of any offer to buy any securities of TippingPoint, and there will not be any sale of any such securities in any state in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of such state.

*Summary of Three Months Ended August 31, 2006 Financial Performance*

- § Our sales in the three months ended August 31, 2007 were \$319.4 million, compared to sales of \$300.1 million in the three months ended August 31, 2006, an increase of \$19.3 million, or 6.4 percent.
- § Our gross margin improved to 46.6 percent in the three months ended August 31, 2007 from 45.5 percent in the three months ended August 31, 2006.
- § Our operating expenses in the three months ended August 31, 2007 were \$174.6 million, compared to \$157.3 million in the three months ended August 31, 2006, a net increase of \$17.3 million, or 11.0 percent.
- § Our net loss in the three months ended August 31, 2006 was \$18.7 million, compared to a net loss of \$14.1 million in the three months ended August 31, 2006.
- § Our balance sheet contains cash and equivalents of \$501.0 million as of August 31, 2007, compared to cash and equivalents of \$559.2 million at the end of fiscal 2007. The balance sheet also includes debt of \$430 million with \$94 million classified as a current liability as of both August 31, 2007 and the end of fiscal 2007.

**CRITICAL ACCOUNTING POLICIES**

Our critical accounting policies are described in Note 2 to our Consolidated Financial Statements contained in our Annual Report on Form 10-K for the fiscal year ended May 31, 2007. These policies continue to be those that we feel are most important to a reader's ability to understand our financial results.

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 ( FIN 48 ), that clarifies the accounting and recognition for income tax positions taken or expected to be taken in our tax returns. FIN 48 provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 on June 2, 2007 which resulted in no adjustment to the beginning of the year retained earnings balance. As of the adoption date, the Company has unrecognized tax benefits of \$24.8 million and valuation allowances of \$937.1 million, for a total of \$961.9 million in tax benefits. The valuation allowance of \$937.1 million includes \$143.5 million attributable to the tax benefit of stock option deductions, which, if recognized, will be allocated directly to paid-in-capital. In addition, the valuation allowance includes approximately \$59.3 million for acquired net operating loss carryforwards which, if realized, would result in a decrease in goodwill. The remaining tax benefits, if recognized would affect our effective tax rate. There was no significant change to the balance of unrecognized tax benefits during the first quarter of fiscal 2008. The Company files a consolidated U.S. income tax return and tax returns in various state and local jurisdictions, and our subsidiaries file tax returns in various foreign jurisdictions. In addition to the U.S., our major taxing jurisdictions include China, the United Kingdom and Singapore. For each of the major taxing jurisdictions, the tax years fiscal 1999 through fiscal 2007 remain open to examination by the respective taxing authorities.

We are currently subject to examination in certain foreign jurisdictions in relation to transfer pricing and other issues. It is possible that certain of these examinations will be settled within the next twelve months. As a result it is

reasonably possible that there could be a material change in the balance of unrecognized tax benefits, however it is not possible to estimate the amount of the potential change.

**Table of Contents**

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 2, 2007, the combined amount of accrued interest and penalties related to uncertain tax positions was \$2.1 million, which has been recorded within the balance of unrecognized tax benefits. There was no significant change to this amount during the three months ended August 31, 2008.

**RESULTS OF OPERATIONS****THREE MONTHS ENDED AUGUST 31, 2007 AND 2006**

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

	<b>Three Months Ended</b>	
	<b>August 31,</b>	
	<b>2007</b>	<b>2006</b>
Sales	100.0%	100.0%
Cost of sales	53.4	54.5
Gross profit margin	46.6	45.5
Operating expenses:		
Sales and marketing	23.3	25.7
Research and development	16.4	15.9
General and administrative	6.7	6.8
Amortization and write-down of intangible assets	8.1	4.1
Restructuring charges	0.1	0.0
Total operating expenses	54.6	52.4
Operating loss	(8.0)	(7.0)
Gain on investments, net	0.0	0.8
Interest expense income, net	(1.1)	3.3
Other income, net	3.8	1.6
Loss before income taxes and minority interest	(5.3)	(1.3)
Income tax provision	(0.5)	(0.4)
Minority interest in income of consolidated joint venture		(3.0)
Net loss	(5.8)%	(4.7)%

**Sales**

Consolidated sales for the three months ended August 31, 2007 and 2006 by segment were as follows (dollars in millions):

	<b>Three Months Ended</b>	
	<b>August 31,</b>	
	<b>2007</b>	<b>2006</b>
H3C	\$ 186.9	\$ 170.0
DVBU	139.6	137.1
TippingPoint	25.5	18.8
Intercompany eliminations	(32.6)	(25.8)
Consolidated sales	\$ 319.4	\$ 300.1

Sales in our H3C segment increased \$16.9 million, or 10.0%, in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. This growth is primarily attributable to increased sales to our DVBU segment and continued strong sales to our other original equipment manufacturers, primarily Huawei, as well as appreciation on the Renminbi related to our direct sales in China.

Sales in our DVBU segment increased \$2.5 million, or 1.8%, in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. This growth is primarily attributable to increased demand for DVBU's Gigabit products in both our EMEA region and our Latin America region partially offset by reductions in our North America and APR regions.

**Table of Contents**

Sales in our TippingPoint segment increased \$6.7 million, or 35.8%, in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. This increase is primarily attributable to increased global sales of TippingPoint products as we continue to increase TippingPoint's global footprint, as well as growth in the US market.

Eliminations and other increased by \$6.9 million or 26.9%, in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. This increase is primarily due to increased sales from our H3C segment to our DVBU segment.

Consolidated revenues increased by \$19.3 million or 6.4% in the three months ended August 31, 2007 compared to the same period in the previous fiscal year.

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

	<b>Three Months Ended August 31,</b>			
	<b>2007</b>		<b>2006</b>	
Networking	\$ 262.0	82%	\$ 244.0	81%
Security	31.5	10%	25.5	9%
Voice	16.3	5%	15.9	5%
Services	9.0	3%	8.4	3%
Connectivity Products	0.6	0%	6.3	2%
<b>Total</b>	<b>\$ 319.4</b>	<b>100%</b>	<b>\$ 300.1</b>	<b>100%</b>

Networking revenue includes sales of our Layer 2 and Layer 3 stackable 10/100/1000 managed switching lines, our modular switching lines, routers, wireless switching offerings and our small to medium-sized enterprise market products. Sales of our networking products increased \$18.0 million or 7% in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. The increase in the three months ended August 31, 2007 is primarily attributable to expansion in our global sales of H3C developed products.

Security revenue includes our TippingPoint® products and services, as well as other security products, such as virtual private network, or VPN, and network access control, or NAC, offerings. Sales of our security products increased \$6.0 million or 24% in the three months ended August 31, 2007 compared to the same period in the previous fiscal year. The increase is primarily driven by increased sales of our TippingPoint products on a global basis.

Voice revenue includes our VCX™ and NBX® voice-over-internet protocol, or VoIP, product lines, as well as voice gateway offerings. Sales of our Voice products increased \$0.4 million or 3% in the three months ended August 31, 2007 compared to the same period in the previous fiscal year due to increased demand in North America.

Services revenue includes professional services and maintenance contracts, excluding TippingPoint maintenance which is included in security revenue. Services revenue increased \$0.6 million or 7% in the three months ended August 31, 2007, when compared to the same period in the previous fiscal year. The increase was driven by increased service offerings tied to expanded networking sales.

Connectivity Products revenue in the three months ended August 31, 2007, was minimal compared to prior periods with continued revenue only expected to be from royalty arrangements. This decrease resulted from our exit of this product line.

**Table of Contents****Gross Margin**

Gross margin for the three months ended August 31, 2007 and 2006 by segment were as follows (dollars in millions):

	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
H3C	50.7%	47.1%
DVBU	31.2%	32.5%
TippingPoint	65.3%	65.1%
Intercompany eliminations and other	18.2%	1.2%
 Consolidated sales	 46.6%	 45.5%

Gross margin in our H3C segment improved 3.6 points to 50.7% in the three months ended August 31, 2007 from 47.1% in the same period in the previous fiscal year. The improvement in gross profit margin is explained by reduced cost of products, and improved pricing of products, including inter-company pricing.

Gross margin in our DVBU segment decreased 1.3 points to 31.2% in the three months ended August 31, 2007 from 32.5% in the same period in the previous fiscal year. The decline is explained by reduced pricing, primarily in the mid-range switching product-offerings, offset in part by product cost reductions.

Gross margin in our TippingPoint segment improved 0.2 points to 65.3% in the three months ended August 31, 2007 from 65.1% in the same period in the previous fiscal year.

**Operating Expenses**

(Dollars in millions)	<b>Three Months Ended August 31,</b>		<b>Change</b>	
	<b>2007</b>	<b>2006</b>	<b>\$</b>	<b>%</b>
Sales and marketing	\$ 74.4	\$ 77.1	\$ (2.7)	(4)%
Research and development	52.3	47.8	4.5	9%
General and administrative	21.5	20.3	1.2	6%
Amortization of intangible assets	26.0	12.2	13.8	113%
Restructuring	0.4	(0.1)	0.5	*
 Total	 \$ 174.6	 \$ 157.3	 \$ 17.3	 11%

\* - percentage calculation not meaningful.

*Sales and Marketing.* The most significant factors in the decrease in the three months ended August 31, 2007 compared to the same period in fiscal 2007 was the decrease in headcount of almost 100 sales and marketing employees in our DVBU segment partially offset by \$1.0 million of increased costs due to increased sales in our TippingPoint segment.

*Research and Development.* The most significant factor contributing to the increase in the three months ended August 31, 2007 compared to the same period in fiscal 2007 was continued investment in our China based development efforts and increased headcount of 239 employees.

*General and Administrative.* The most significant factor in the increase in the three months ended August 31, 2007 compared to the same period in fiscal 2007 was \$1.2 million of increased stock-based compensation expenses. The increase in stock-based compensation from the same period in fiscal 2007 is attributable to the absence of CEO stock based compensation charges in the first quarter of fiscal 2007.

*Amortization of Intangible Assets.* Amortization of intangible assets increased \$13.8 million in the three months ended August 31, 2007 when compared to the previous fiscal year due to the increase in intangibles and additional amortization related to the acquisition of the final 49% of H3C in March 2007.

**Table of Contents***Restructuring Charges*

Restructuring charges in the three months ended August 31, 2007 included \$0.9 million for severance and outplacement costs and a \$0.5 million benefit for facilities-related charges.

Restructuring charges in the three months ended August 31, 2006 included \$7.6 million for severance and outplacement costs and \$0.3 million for facilities-related charges and long-term asset write-downs more than offset by an \$8.0 gain on the sale of our Santa Clara facility.

See Note 4 to Condensed Consolidated Financial Statements for a more detailed discussion of restructuring charges.

*Gain on Investments, Net*

Net gains on investments were \$0.3 million in the three months ended August 31, 2007 and \$2.3 million in the three months ended August 31, 2006 which resulted from gains on our remaining investment portfolios.

*Interest Expense/Income, Net*

In the three months ended August 31, 2007, the Company incurred \$3.6 million in net interest expense, versus net interest income of \$10.1 million in same period of the prior fiscal year. The change was directly attributable to the reduced cash balance and increased debt levels, both resulting from the use of funds and borrowings for the acquisition of the final 49% of H3C in March 2007.

*Other Income, Net*

Other income, net was \$12.1 million in the three months ended August 31, 2007, an increase of \$7.4 million compared to the three months ended August 31, 2006. The increase was primarily due to a \$5.0 million gain from the sale of a patent no longer used in our business.

*Income Tax Provision*

Our income tax provision was \$1.8 million for the three months ended August 31, 2007, an increase of \$0.4 million when compared to the corresponding period in the previous fiscal year. The income tax provision in both periods was the result of providing for taxes in certain foreign jurisdictions at various statutory rates. H3C is currently entitled to tax concessions which began in 2004 and exempted it from the PRC income tax for its initial two years and entitle it to a 50% reduction in income tax in the following three years. Consequently, subject to the possible effects of the new PRC tax discussed in *Risk Factors* below, we currently expect the H3C statutory rate in China to be 7.5% for the calendar years 2007 and 2008, and 15% thereafter.

The company has US Federal net operating loss carryforwards in the amount of \$2.5 billion as of May 31, 2007.

*Minority Interest of Huawei in the Income of Consolidated Huawei-3Com Joint Venture*

There is no minority interest in the three months ended August 31, 2007 as H3C is now a wholly-owned subsidiary. In the three months ended August 31, 2006 we recorded an allocation to minority interest of \$8.9 million representing Huawei's 49% interest in the net income reported by the H3C joint venture for the three months ended June 30, 2006.

*Net Loss*

Our net loss in the three months ended August 31, 2007 was \$18.7 million, a \$4.6 million increase in net loss when compared to the previous fiscal period. The increase was primarily driven by increased amortization expenses of \$13.2 million due to the acquisition of the remaining 49% of H3C and increased R&D expenses of \$4.5 million, partially offset by increased gross profits during the quarter.



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

Cash and equivalents as of August 31, 2007 were \$501.0 million, a decrease of \$58.2 million compared to the balance of \$559.2 million as of May 31, 2007. The following table shows the major components of our condensed consolidated statements of cash flows for the three months ended August 31, 2006 and 2005:

(In millions)	<b>Three Months Ended August 31,</b>	
	<b>2007</b>	<b>2006</b>
Cash and equivalents, beginning of period	\$ 559.2	\$ 501.1
Net cash (used in) provided by operating activities	(59.0)	3.3
Net cash provided by (used in) investing activities	(4.5)	17.3
Net cash provided by (used in) financing activities	0.6	2.7
Other	4.7	0.8
Cash and equivalents, end of period	\$ 501.0	\$ 525.2

Net cash used in operating activities was \$59.0 million in the three months ended August 31, 2007, primarily reflecting our net loss of \$18.7 million, and increased deferred income taxes of \$0.8 million, more than offset by \$34.7 million of depreciation and amortization and \$3.9 million of stock based compensation. Changes in assets and liabilities resulted in a net use of cash of \$77.9 million, with other liabilities decreasing \$65.0 million primarily due to a \$95 million previously accrued payment related to the change-in-control EARP plan triggered by the acquisition of the remaining 49% of H3C. Additionally accounts receivable increased \$29.6 million, partially offset by a reduction in notes receivable of \$12.5 million.

Net cash used in investing activities was \$4.5 million for the three months ended August 31, 2007, consisting primarily of \$5.0 million of net outflows related to purchases of property and equipment.

Net cash provided by financing activities was \$0.7 million in the three months ended August 31, 2007. During the three months ended August 31, 2007, we repurchased \$.2 million of shares of restricted stock awards upon vesting from employees including those shares to satisfy the tax withholding obligations that arise in connection with such vesting. This was offset by proceeds of \$0.8 million from issuances of our common stock upon exercise of stock options.

As of August 31, 2007, bank-issued standby letters of credit and guarantees totaled \$6.2 million, including \$5.2 million relating to potential foreign tax, custom, and duty assessments.

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

In the second quarter of fiscal 2008 we will make our first principal and interest payment related to the \$430 million long-term debt. The total amount for this annual principal payment and semi-annual interest payment will be approximately \$105 million.

We currently believe that our existing cash, cash equivalents and short-term investments will be sufficient to satisfy our anticipated cash requirements for at least the next 12 months.

**EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ), that clarifies the accounting and recognition for income tax positions taken or expected to be taken in our tax returns. FIN 48 provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of FIN 48 on June 2, 2007 which resulted in no adjustment to the beginning of the year retained earnings balance. As of the adoption date, the Company has unrecognized tax benefits of \$24.8 million and valuation allowances of \$937.1 million, for a total of \$961.9 million in tax benefits. The valuation allowance of \$937.1 million includes \$143.5 million attributable to the tax benefit of stock option deductions, which, if recognized, will be allocated directly to paid-in-capital. In addition, the valuation

allowance includes approximately \$59.3 million for acquired net operating loss carryforwards which, if realized, would result in a decrease in goodwill. The remaining tax benefits, if recognized would affect our effective tax rate. There was no significant change to the balance of unrecognized tax benefits during the first quarter of fiscal 2008.

**Table of Contents**

The Company files a consolidated U.S. income tax return and tax returns in various state and local jurisdictions, and our subsidiaries file tax returns in various foreign jurisdictions. In addition to the U.S., our major taxing jurisdictions include China, the United Kingdom and Singapore. For each of the major taxing jurisdictions, the tax years fiscal 1999 through fiscal 2007 remain open to examination by the respective taxing authorities.

We are currently subject to examination in certain foreign jurisdictions in relation to transfer pricing and other issues. It is possible that certain of these examinations will be settled within the next twelve months. As a result it is reasonably possible that there could be a material change in the balance of unrecognized tax benefits, however it is not possible to estimate the amount of the potential change.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of June 2, 2007, the combined amount of accrued interest and penalties related to uncertain tax positions was \$2.1 million, which has been recorded within the balance of unrecognized tax benefits. There was no significant change to this amount during the three months ended August 31, 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by 3Com in the first quarter of fiscal 2009. We have not yet determined the impact, if any, that the implementation of SFAS No. 157 will have on our results of operations or financial condition.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 ( SFAS 159 ). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by 3Com in the first quarter of fiscal 2009. 3Com currently is determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its consolidated results of operations and financial condition.

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin 108

Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements , which expresses the staff's views regarding the process of quantifying financial statement misstatements. The Bulletin is effective at our fiscal year end 2008. The Company believes the implementation will have no impact on our results of operations, cash flow or financial position.

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

We no longer hold any marketable equity traded securities as of August 31, 2007.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

Our management carried out an evaluation, under the supervision and with the participation of our President and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of our quarter ended August 31, 2007 pursuant to Exchange Act Rule 13a-15(b). The term disclosure controls and procedures, as defined under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of our quarter ended August 31, 2007, our disclosure controls and procedures were effective.

There have been no changes in our internal control over financial reporting that occurred during the three months ended August 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 14 to the Notes to the Condensed Consolidated Financial Statements is incorporated by reference herein.

**ITEM 1A. RISK FACTORS**

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

**Risk Related to Announced Acquisition by an entity controlled by an affiliate of Bain Capital**

On September 28, 2007, we announced an agreement to be acquired by an entity controlled by an affiliate of Bain Capital. We cannot provide any assurance that the proposed acquisition will be consummated.

Consummation of the proposed acquisition is subject to the satisfaction of various conditions, including approval of the acquisition by a vote of a majority of the outstanding shares of our common stock, expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and other non-U.S. competition laws,

and other customary closing conditions described in the acquisition agreement. We cannot guarantee that these closing conditions will be satisfied, that we will receive the required approvals or that the proposed acquisition will be successfully completed. In the event that the proposed acquisition is not completed or is delayed:

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

we may lose key employees;

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

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

under certain circumstances, if the proposed acquisition is not completed we may be required to pay a termination (break-up) fee of up to \$66 million; and

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

## **Table of Contents**

In addition, the Committee on Foreign Investment in the United States, or CFIUS, will review this transaction and could recommend that the transaction be changed, or blocked by the President, on national security grounds. On October 4, 2007 we announced that we will make a joint voluntary filing (with Bain Capital) of this transaction with CFIUS.

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

### **Risks Related to Historical Losses, Financial Condition and Substantial Indebtedness**

***We have incurred significant net losses in recent fiscal periods, including \$19 million for the quarter ended August 31, 2007 and \$14 million for the quarter ended August 31, 2006, and we may not be able to return to profitability.***

We cannot provide assurance that we will return to profitability. While we continue to take steps designed to improve our results of operations, we have incurred significant net losses in recent periods. We face a number of challenges that have affected our operating results during the current and past several fiscal years. Specifically, we have experienced, and may continue to experience, the following:

declining sales due to price competition and reduced incoming order rate;

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

management changes;

disruptions and expenses resulting from our workforce reductions, management changes and employee attrition;

risk of increased excess and obsolete inventories; and

interest expense resulting from our senior secured loan.

If we cannot overcome these challenges, reduce our expenses and/or increase our revenue, we may not become profitable.

***We may not be able to compensate for lower sales or unexpected cash outlays with cost reductions sufficient to generate positive net income or cash flow.***

If we do not increase our sales, we may need to further reduce costs in order to achieve profitability. As we have implemented significant cost reduction programs over the last several years, it may be difficult to make significant further cost reductions without in turn reducing our sales. If we are not able to effectively reduce our costs and expenses, particularly in our DVBU and Corporate segments, we may not be able to generate positive net income. If we continue to experience negative cash flow from operations from our DVBU and Corporate segments over a prolonged period of time or if we suffer unexpected cash outflows, our liquidity and ability to operate our business effectively could be adversely affected.

We are unable to predict the exact amount of increased sales and/or cost reductions required for us to generate positive net income because it is difficult to predict the amount of our future sales and gross margins. Moreover, the amount of our future sales depends, in part, on future economic and market conditions, which are difficult to forecast accurately.

***Efforts to reduce operating expenses have involved, and could involve further, workforce reductions, closure of offices and sales or discontinuation of businesses, leading to reduced sales and other disruptions in our business; if these efforts are not successful, we may experience higher expenses than we desire.***

Our operating expenses as a percent of sales continue to be higher than our desired long-term financial model. We have taken, and will continue to take, actions to reduce these expenses. For example, in June 2006 we announced a restructuring plan which focused on reducing components of our DVBU segment cost structure, including the closure of certain facilities, a reduction in workforce and focused sales, marketing and services efforts. Such actions have and may in the future include integration of businesses and regions, reductions in our workforce, closure of facilities, relocation of functions and activities to lower cost locations, the sale or discontinuation of businesses, changes or modifications in information technology systems or applications, or process reengineering. As a result of these

actions, the employment of some employees with critical skills may be terminated and other employees have, and may in the future, leave our company voluntarily due to the uncertainties associated with our business environment and their job security. In addition, reductions in overall staffing levels could make it more difficult for us to sustain historic sales levels, to achieve our growth objectives, to adhere to our preferred business practices and to address all of our legal and regulatory obligations in an effective manner, which could, in

**Table of Contents**

turn, ultimately lead to missed business opportunities, higher operating costs or penalties. In addition, we may choose to reinvest some or all of our realized cost savings in future growth opportunities or in our H3C integration efforts. Any of these events or occurrences, including the failure to succeed in achieving net cost savings, will likely cause our expense levels to continue to be at levels above our desired model, which, in turn, could result in a material adverse impact on our ability to become profitable (and, if we become profitable, to sustain such profitability).

***Our substantial debt could adversely affect our financial condition; and the related debt service obligations may adversely affect our cash flow and ability to invest in and grow our businesses.***

We now have, and for the foreseeable future will continue to have, a significant amount of indebtedness. As of August 31, 2007, our total debt balance was \$430 million, of which \$94 million is due within one year and was classified as a current liability. These amounts represent borrowing under a senior secured loan incurred to finance a portion of the purchase price for the March 2007 acquisition of the remaining 49 percent equity interest in H3C. In addition, despite current debt levels, the terms of our indebtedness allow us or our subsidiaries to incur more debt, subject to certain limitations.

While our senior secured loan is outstanding, we will have annual debt service obligations (interest and principal) of between approximately \$48 million and \$172 million. The interest rate on this loan is floating based on the LIBOR rate; accordingly, if the LIBOR rate is increased, these amounts could be higher. The maturity date on this loan is September 28, 2012. We intend to fulfill our debt service obligations primarily from cash generated by our H3C segment operations, if any, and, to the extent necessary, from its existing cash and investments. Because we anticipate that a substantial portion of the cash generated by our operations will be used to service this loan during its term, such funds will not be available to use in future operations, or investing in our businesses. Further, a significant portion of the excess cash flow generated by our H3C segment, if any, must be used annually to prepay principal on the loan. The foregoing may adversely impact our ability to expand our businesses or make other investments. In addition, if we are unable to generate sufficient cash to meet these obligations and must instead use our existing cash or investments, we may have to reduce, curtail or terminate other activities of our businesses.

Our indebtedness could have significant negative consequences to us. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;

- limit our ability to obtain additional financing;

- require the dedication of a substantial portion of any cash flow from operations to the payment of principal of, and interest on, our indebtedness, thereby reducing the availability of such cash flow to fund growth, working capital, capital expenditures and other general corporate purposes;

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

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

***The restrictions imposed by the terms of our senior secured loan facility could adversely impact our ability to invest in and grow our H3C business.***

Covenants in the agreements governing our senior secured loan materially restrict our H3C operations, including H3C's ability to incur debt, pay dividends, make certain investments and payments, make acquisitions of other businesses and encumber or dispose of assets. These negative covenants restrict our flexibility in operating our H3C business. The agreements also impose affirmative covenants, including financial reporting obligations and compliance with law. In addition, in the event our H3C segment's financial results do not meet our plans, the failure to comply with the financial covenants contained in the loan agreements could lead to a default if we are unable to amend such financial covenants. Our lenders may attempt to call defaults for violations of financial covenants (or other items, even if the underlying financial performance of H3C is satisfactory) in an effort to extract waiver or consent fees from us or to force a refinancing. A default and acceleration under one debt instrument or other contract may also trigger cross-acceleration under other debt instruments or other agreements, if any. An event of default, if not cured or waived, could have a material adverse effect on us because the lenders will be able to accelerate all outstanding



amounts under the loan or foreclose on the collateral (which consists primarily of the assets of our H3C segment and could involve the lenders taking control over our H3C segment).. Any of these actions would likely result in a material adverse effect on our business and financial condition.

**Table of Contents*****An adverse change in the interest rates for our borrowings could adversely affect our financial condition.***

Interest to be paid by us on our senior secured loan is at an interest rate based on the LIBOR rate, plus an applicable margin. The published LIBOR rate is subject to change on a periodic basis. Recently, interest rates have trended upwards in major global financial markets. If these interest rate trends continue, this will result in increased interest rate expense as a result of higher LIBOR rates. Continued increases in interest rates could have a material adverse effect on our financial position, results of operations and cash flows, particularly if such increases are substantial. In addition, interest rate trends could affect global economic conditions.

***Rating downgrades may make it more expensive for us to refinance our debt or borrow money.***

Moody's Investors Service has assigned a Ba2 rating to our senior secured loans at H3C and a Ba2 corporate family rating (stable outlook) to H3C Holdings Limited, the borrower. Standard & Poor's Ratings Services assigned these loans a BB rating (with a recovery rating of 1) and assigned a BB- corporate credit rating (stable outlook) to H3C Holdings Limited. We are required to maintain a rating from each of these agencies during the term of the loan. These credit ratings are subject to change at the discretion of the rating agencies. If our credit ratings are downgraded, it would likely make it more expensive for us to refinance our existing loan or raise additional capital in the future. Such refinancing or capital raising may be on terms that may not be acceptable to us or otherwise not available. Any future adverse rating agency actions with respect to our ratings could have an adverse effect on the market price of our securities, our ability to compete for new business and our ability to access capital markets.

**Risks Related to H3C Segment and Dependence Thereon*****We are significantly dependent on our H3C segment; if H3C is not successful we will likely experience a material adverse impact to our business, business prospects and operating results.***

For the quarter ended August 31, 2007, H3C accounted for approximately 53 percent of our consolidated revenue and approximately 61 percent of our consolidated gross profit. H3C, which is domiciled in Hong Kong and has its principal operations in Hangzhou, China, is subject to all of the operational risks that normally arise for a technology company with global operations, including risks relating to research and development, manufacturing, sales, service, marketing, and corporate functions. Furthermore, H3C may not be successful in selling directly to Chinese customers, particularly those in the public sector, to the extent that such customers favor Chinese-owned competitors. Given the significance of H3C to our financial results, if H3C is not successful, our business will likely be adversely affected.

***Sales from our H3C segment, and therefore in China, constitute a material portion of our total sales, and our business, financial condition and results of operations will to a significant degree be subject to economic, political and social events in the PRC.***

Our sales are significantly dependent on China, with approximately 46 percent of our consolidated revenues attributable to sales in China for the fiscal quarter ended August 31, 2007. We expect that a significant portion of our sales will continue to be derived from China for the foreseeable future. As a result, our business, financial condition and results of operations are to a significant degree subject to economic, political, legal and social developments and other events in China and surrounding areas. We discuss risks related to the PRC in further detail below.

**Table of Contents**

***Our H3C segment is dependent on Huawei Technologies in several material respects, including as an important customer; should Huawei reduce its business with H3C, our business will likely be materially adversely affected.***

H3C derives a material portion of its sales from Huawei. In the three months ended August 31, 2007, Huawei accounted for approximately 33 percent of the revenue for our H3C segment and approximately 19 percent of our consolidated revenue. Huawei has no minimum purchase obligations with respect to H3C. Should Huawei reduce its business with H3C, H3C's sales will suffer. On March 29, 2007 we acquired Huawei's 49 percent interest in H3C for \$882 million, giving us 100 percent ownership of H3C. Since Huawei is no longer an owner of H3C, it is possible that over time Huawei will purchase fewer products and services from H3C. We will need to continue to provide Huawei with products and services that satisfy its needs or we risk the possibility that it sources products from another vendor or internally develops these products. Further, we have and expect to continue to incur costs relating to transition matters with respect to support that Huawei previously provided for H3C when it was a shareholder. In addition, our China headquarters in Hangzhou, PRC is owned by Huawei and leased to us under a lease agreement that expires in December 2008; if we cannot renew this lease on terms favorable to us or find alternate facilities, we may suffer disruption in our H3C business. If any of the above risks occur, it will likely have an adverse impact on H3C's sales and business performance.

***We must execute on a global strategy to leverage the benefits of our H3C acquisition, including integration activities we determine to undertake; if we are not successful in these efforts, our business will suffer.***

Our H3C acquisition presents unique challenges that we must address. We must successfully execute on managing our four business segments, and, to the extent we so choose, integrating these businesses, in order to fully benefit from this acquisition. As a joint venture owned by two separate companies, H3C operated in many ways independently from 3Com and Huawei. H3C's business is largely based in the PRC and therefore significant cultural, language, business process and other differences exist between our other segments and H3C. In order to more closely manage and, to the extent we choose, integrate H3C, we expect to incur significant transition costs, including management retention costs and other related items. There may also be business disruption as management and other personnel focus on global management activities and integration matters.

In order to realize the full benefits of this acquisition, we will need to manage our four business segments and employ strategies to leverage H3C. These efforts will require significant time and attention of management and other key employees at 3Com and H3C. Depending on the decisions we make on various strategic alternatives available to us, we may develop new or adjusted global design and development initiatives, go-to-market strategies, branding tactics or other strategies that take advantage and leverage H3C's and our other segments' respective strengths. If we are not successful at transitioning effectively to full ownership of H3C, or if we do not execute on a global strategy that enables us to leverage the benefits of this acquisition, our business will be substantially harmed.

**Risks Related to Personnel**

***Our success is dependent on continuing to hire and retain qualified managers and other personnel, including at our H3C segment, and reducing senior management turnover in our other segments; if we are not successful in attracting and retaining these personnel, our business will suffer.***

Competition for qualified employees is intense. If we fail to attract, hire, or retain qualified personnel, our business will be harmed. We have experienced significant turnover in our senior management team in the last several years and we may continue to experience change at this level. If we cannot retain qualified senior managers, our business may not succeed.

The senior management team at H3C has been highly effective since H3C's inception in 2003. We need to continue to incentivize and retain H3C management. We cannot be sure that we will be successful in these efforts. If we are not successful, our H3C business may suffer, which, in turn, will have a material adverse impact on our consolidated business. Many of these senior managers, and other key H3C employees, originally worked for Huawei prior to the inception of H3C. Subject to non-competition agreements with us (if applicable), these employees could return to work for Huawei at any time. Huawei is not subject to any non-solicitation obligations in respect of H3C or 3Com. Further, former Huawei employees that work for H3C may retain financial interests in Huawei.

## **Table of Contents**

### **Risks Related to Competition**

*If we do not respond effectively to increased competition caused by industry volatility and consolidation our business could be harmed.*

Our business could be seriously harmed if we do not compete effectively. We face competitive challenges that are likely to arise from a number of factors, including the following:

industry volatility resulting from rapid product development cycles;

increasing price competition due to maturation of basic networking technologies;

industry consolidation resulting in competitors with greater financial, marketing, and technical resources; and

the presence of existing competitors with greater financial resources together with the potential emergence of new competitors with lower cost structures and more competitive offerings.

*Our competition with Huawei in the enterprise networking market could have a material adverse effect on our sales and our results of operations; and after a contractual non-compete period expires, Huawei can increase its level of competition, which would likely materially and adversely affect our business.*

As Huawei expands its international operations, there could be increasing instances where we compete directly with Huawei in the enterprise networking market. As an OEM customer of H3C, Huawei has had, and continues to have, access to H3C's products for resale. This access enhances Huawei's current ability to compete directly with us. We could lose a competitive advantage in markets where we compete with Huawei, which in turn could have a material adverse effect on our sales and overall results of operations. In addition, Huawei's obligation not to offer or sell enterprise class, and small-to-medium size business (or SMB), routers and switches that are competitive with H3C's products continues until September 29, 2008. After that date, we are subject to the risk of increased competition from Huawei, which could materially harm our results of operations. More specifically, after the non-compete period expires, Huawei may offer and sell its own enterprise or SMB routers and switches, or resell products that it sources from our competitors. Huawei is not prohibited from developing (but not offering or selling) competing products during the non-compete period. Huawei is also not prohibited from currently selling products in ancillary areas such as security, voice over internet protocol and storage products that are also sold today by H3C.

Huawei's incentive not to compete with H3C or us, and its incentive to assist H3C, may diminish now that Huawei does not own any interest in H3C. In addition, Huawei maintains a strong presence within China and the Asia Pacific region and has significant resources with which to compete within the networking industry, including the assets of Harbour Networks, a China-based competitor of H3C. We cannot predict whether Huawei will compete with us. If competition from Huawei increases, our business will likely suffer.

Finally, if any of H3C's senior managers, and other key H3C employees that originally worked for Huawei prior to the inception of H3C, return to work for Huawei, the competitive risks discussed above may be heightened. Subject to non-competition agreements with us (if applicable), these employees could return to work for Huawei at any time. Huawei is not subject to any non-solicitation obligations in respect of H3C or 3Com. Further, former Huawei employees that work for H3C may retain financial interests in Huawei.

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

*We may not be successful at identifying and responding to new and emerging market and product opportunities, or at responding quickly enough to technologies or markets that are in decline.*

The markets in which we compete are characterized by rapid technology transitions and short product life cycles. Therefore, our success depends on our ability to do the following:

identify new market and product opportunities;

predict which technologies and markets will see declining demand;

develop and introduce new products and solutions in a timely manner;

gain market acceptance of new products and solutions, particularly in targeted emerging markets; and rapidly and efficiently transition our customers from older to newer enterprise networking technologies.

**Table of Contents**

Our financial position or results of operations could suffer if we are not successful in achieving these goals. For example, our business would suffer if any of the following occurs:

there is a delay in introducing new products;

we lose certain channels of distribution or key partners;

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

our products cost more to produce than we expect.

Because we will continue to rely on original design manufacturers to assist in product design of some of our products, we may not be able to respond to emerging technology trends through the design and production of new products as well as if we were working independently.

***We expect to utilize strategic relationships and other alliances as key elements in our strategy. If we are not successful in forming desired ventures and alliances or if such ventures and alliances are not successful, our ability to achieve our growth and profitability goals could be adversely affected.***

We have announced alliances with third parties, such as IBM and Trapeze Networks. In the future, we expect to evaluate other possible strategic relationships, including joint ventures and other types of alliances, and we may increase our reliance on such strategic relationships to broaden our sales channels, complement internal development of new technologies and enhancement of existing products, and exploit perceived market opportunities.

If we fail to form the number and quality of strategic relationships that we desire, or if such strategic relationships are not successful, we could suffer missed market opportunities, channel conflicts, delays in product development or delivery, or other operational difficulties. Further, if third parties acquire our strategic partners or if our competitors enter into successful strategic relationships, we may face increased competition. Any of these difficulties could have an adverse effect on our future sales and results of operations.

***Our strategy of outsourcing functions and operations may fail to reduce cost and may disrupt our operations.***

We continue to look for ways to decrease cost and improve efficiency by contracting with other companies to perform functions or operations that, in the past, we have performed ourselves. We have outsourced the majority of our manufacturing and logistics for our non H3C products. We now rely on outside vendors to meet the majority of our manufacturing needs as well as a significant portion of our IT needs for the non-H3C segments. Additionally, we outsource certain functions for technical support and product return services. We are currently transitioning our outsourced customer service and support functions from a single vendor to a combination of vendors complemented by internal sources. During this transition period, and under our new support model, if we do not provide our customers with a high quality of service, we risk losing customers and/or increasing our support costs. To achieve future cost savings or operational benefits, we may expand our outsourcing activities to cover additional services which we believe a third party may be able to provide in a more efficient or effective manner than we could do internally ourselves.

Although we believe that outsourcing will result in lower costs and increased efficiencies, this may not be the case. Because these third parties may not be as responsive to our needs as we would be ourselves, outsourcing increases the risk of disruption to our operations. In addition, our agreements with these third parties sometimes include substantial penalties for terminating such agreements early or failing to maintain minimum service levels. Because we cannot always predict how long we will need the services or how much of the services we will use, we may have to pay these penalties or incur costs if our business conditions change.

**Table of Contents**

***Our reliance on industry standards, technological change in the marketplace, and new product initiatives may cause our sales to fluctuate or decline.***

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

the convergence of technologies, such as voice, data and video on single, secure networks;

the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards; and

our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards.

Slow market acceptance of new technologies, products, or industry standards could adversely affect our sales or overall results of operations. In addition, if our technology is not included in an industry standard on a timely basis or if we fail to achieve timely certification of compliance to industry standards for our products, our sales of such products or our overall results of operations could be adversely affected.

***We focus on enterprise networking, and our results of operations may fluctuate based on factors related entirely to conditions in this market.***

Our focus on enterprise networking may cause increased sensitivity to the business risks associated specifically with the enterprise networking market and our ability to execute successfully on our strategies to provide superior solutions for larger and multi-site enterprise environments. To be successful in the enterprise networking market, we will need to be perceived by decision making officers of large enterprises as committed for the long-term to the high-end networking business. Also, expansion of sales to large enterprises may be disruptive in a variety of ways, such as adding larger systems integrators that may raise channel conflict issues with existing distributors, or a perception of diminished focus on the small and medium enterprise market.

**Risks Related to Operations and Distribution Channels**

***A significant portion of our DVBU and TippingPoint sales are derived from a small number of distributors. If any of these partners reduces its business with us, our business could be seriously harmed.***

We distribute many of our products through two-tier distribution channels that include distributors, systems integrators and value added resellers, or VARs. A significant portion of our sales is concentrated among a few distributors; our two largest distributors accounted for a combined 21 percent of our consolidated revenue for the three months ended August 31, 2007. If either of these distributors reduces its business with us, our sales and overall results of operations could be adversely affected.

***We depend on distributors who maintain inventories of our products. If the distributors reduce their inventories of our products, our sales could be adversely affected.***

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

**Table of Contents**

***If we are unable to successfully develop relationships with system integrators, service providers, and enterprise VARs, our sales may be negatively affected.***

As part of our sales strategy, we are targeting system integrators, or SIs, service providers, or SPs, and enterprise value-added resellers, or eVARs. In addition to specialized technical expertise, SIs, SPs and eVARs typically offer sophisticated services capabilities that are frequently desired by larger enterprise customers. In order to expand our distribution channel to include resellers with such capabilities, we must be able to provide effective support to these resellers. If our sales, marketing or services capabilities are not sufficiently robust to provide effective support to such SIs, SPs, and eVARs, we may not be successful in expanding our distribution model and current SI, SP, and eVAR partners may terminate their relationships with us, which would adversely impact our sales and overall results of operations.

***We may pursue acquisitions of other companies that, if not successful, could adversely affect our business, financial position and results of operations.***

In the future, we may pursue acquisitions of companies to enhance our existing capabilities. There can be no assurances that acquisitions that we might consummate will be successful. If we pursue an acquisition but are not successful in completing it, or if we complete an acquisition but are not successful in integrating the acquired company's technology, employees, products or operations successfully, our business, financial position or results of operations could be adversely affected.

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

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

in the past, some key components have had limited availability;

as integration of networking features on a reduced number of computer chips continues, we are increasingly facing competition from parties who are our suppliers;

our ability to accurately forecast demand is diminished;

our 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; and

we may experience disruptions to our logistics.

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.

There has been a trend toward consolidation of vendors of electronic components. Our reliance on a smaller number of vendors and the inability to quickly switch vendors increases the risk of logistics disruptions, unfavorable price fluctuations, or disruptions in supply, particularly in a supply-constrained environment.

Supplies of certain key components have become tighter as industry demand for such components has increased. If the resulting increase in component costs and time necessary to obtain these components persists, we may experience an adverse impact to gross margin.

If overall demand for our products or the mix of demand for our products is significantly different from our expectations, we may face inadequate or excess component supply or inadequate or excess manufacturing capacity. This would result in orders for products that could not be manufactured in a timely manner, or a buildup of inventory that could not easily be sold. Either of these situations could adversely affect our market share, sales, and results of operations or financial position.



**Table of Contents**

***Our strategies to outsource the majority of our manufacturing requirements to contract manufacturers may not result in meeting our cost, quality or performance standards. The inability of any contract manufacturer to meet our cost, quality or performance standards could adversely affect our sales and overall results from operations.***

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. 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 inventory. In addition, a significant component of maintaining cost competitiveness is the ability of our contract manufacturers to adjust their own costs and manufacturing infrastructure to compensate for possible adverse exchange rate movements. To the extent that the contract manufacturers are unable to do so, and we are unable to procure alternative product supplies, then our own competitiveness and results of operations could be adversely impacted.

In portions of our business we have implemented a program with our manufacturing partners to ship products directly from regional shipping centers to customers. Through this program, we are relying on these partners to fill customer orders in a timely manner. This program may not yield the efficiencies that we expect, which would negatively impact our results of operations. Any disruptions to on-time delivery to customers would adversely impact our sales and overall results of operations.

***If we fail to adequately evolve our financial and managerial control and reporting systems and processes, including the management of our H3C segment, our ability to manage and grow our business will be negatively affected.***

Our ability to successfully offer our products and implement our business plan in a rapidly evolving market depends upon an effective planning and management process. We will need to continue to improve our financial and managerial control and our reporting systems and procedures in order to manage our business effectively in the future. If we fail to implement improved systems and processes, our ability to manage our business and results of operations could be adversely affected. For example, now that we own all of H3C, we are spending additional time, resources and capital to manage its business, operations and financial results. If we are not able to successfully manage H3C, our business results could be adversely affected.

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

***China's governmental and regulatory reforms and changing economic environment may impact our ability to do business in China.***

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

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

enforcement and application of rules and regulations by the Chinese government;

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

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

If China's entry into the World Trade Organization, or the WTO, results in increased competition or has a negative impact on China's economy, our business could suffer. Since early 2004, the Chinese government has implemented certain measures to control the pace of economic growth. Such measures may cause a decrease in the level of economic activity in China, which in turn could adversely affect our results of operations and financial condition.

**Table of Contents*****Uncertainties with respect to the Chinese legal system may adversely affect us.***

We conduct our business in China primarily through H3C, a Hong Kong entity which in turn owns several Chinese entities. These entities are generally subject to laws and regulations applicable to foreign investment in China. In addition, there are uncertainties regarding the interpretation and enforcement of laws, rules and policies in China. Because many laws and regulations are relatively new and the Chinese legal system is still evolving, the interpretations of many laws, regulations and rules are not always uniform. Moreover, the interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. Finally, enforcement of existing laws or contracts based on existing law may be uncertain, and it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. Any litigation in China may be protracted and result in substantial costs and diversion of resources and management's attention.

***If PRC tax benefits available to H3C are reduced or repealed, our business could suffer.***

If the PRC government changes, removes or withdraws any of the tax benefits currently enjoyed by our H3C segment, it will likely adversely affect our results of operations. For example, H3C enjoys preferential income tax rates due to its status as a newly-formed high technology enterprise headquartered within a high tech zone in Hangzhou, PRC. In March 2007 the People's National Congress in the PRC approved a new tax reform law, effective on January 1, 2008, the broad intention of which is to align the tax regime applicable to foreign owned Chinese enterprises with that applicable to domestically-owned Chinese enterprises. If applicable to H3C, the effect of this new law would be to increase the statutory income tax rate for H3C in the PRC. It is proposed that some high-tech enterprises will be exempt from the increased rate; although much of the detail of the new law has yet to be issued in regulations, we currently believe that we will continue to qualify for the foreseeable future as a high-tech enterprise entitled to our existing tax concessions.

If H3C is not exempt from this new law, other tax benefits currently enjoyed by H3C are withdrawn or reduced, or new taxes are introduced which have not applied to H3C before, there would likely be a resulting increase to H3C's statutory tax rates in the PRC. Increases to tax rates in the PRC, where our H3C segment is profitable, could adversely affect our results of operations.

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

Chinese regulations currently permit payment of dividends only out of accumulated profits, as determined in accordance with Chinese accounting standards and regulations. H3C does business primarily through a Chinese entity that is required to set aside a portion of its after-tax profits—currently 10 percent—according to Chinese accounting standards and regulations to fund certain reserves. The Chinese government also imposes controls on the conversion of Renminbi into foreign currencies and the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency. These restrictions may in the future limit our ability to receive dividends or repatriate funds from H3C. In addition, the credit agreement governing our senior secured loan also imposes significant restrictions on H3C's ability to dividend or make other payments to our other segments.

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

A significant portion of our sales and a portion of our costs are made in China and denominated in Renminbi. At the same time, our senior secured bank loan—which we intend to service and repay primarily through cash flow from H3C's PRC operations—is denominated in US dollars. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The move initially revalued the Renminbi by 2.1 percent against the U.S. dollar; however, it is uncertain what further adjustments may be made in the future. The Renminbi-U.S. dollar exchange rate could float, and the Renminbi could appreciate or depreciate relative to the U.S. dollar. Any movement of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position, and may make it more difficult for us to service our U.S. dollar-denominated senior secured bank loan. We do not currently hedge the currency risk in H3C through foreign exchange forward contracts or otherwise and China employs currency controls restricting Renminbi conversion, limiting our ability to engage in currency hedging activities in China. Various foreign exchange controls are applicable to us in China, and such restrictions may in the future make it difficult for H3C or us to repatriate earnings, which could have an adverse

effect on our cash flows and financial position.

**Table of Contents****Risks Related to Intellectual Property**

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

High technology products sometimes contain undetected software or hardware errors when new products or new versions or updates of existing products are released to the marketplace. Undetected errors could result in higher than expected warranty and service costs and expenses, and the recording of an accrual for related anticipated expenses. From time to time, such errors or component failures could be found in new or existing products after the commencement of commercial shipments. These problems may have a material adverse effect on our business by causing us to incur significant warranty and repair costs, diverting the attention of our engineering personnel from new product development efforts, delaying the recognition of revenue and causing significant customer relations problems. Further, if products are not accepted by customers due to such defects, and such returns exceed the amount we accrued for defect returns based on our historical experience, our operating results would be adversely affected. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of hardware and software errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems would likely have a material adverse effect on our business, operating results and financial condition.

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

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

In addition, the legal systems of many foreign countries do not protect or honor intellectual property rights to the same extent as the legal system of the United States. For example, in China, the legal system in general, and the intellectual property regime in particular, are still in the development stage. It may be very difficult, time-consuming and costly for us to attempt to enforce our intellectual property rights, and those of H3C, in these jurisdictions.

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

Many of our competitors, such as telecommunications, networking, and computer equipment manufacturers, have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individual inventors have obtained or applied for patents in areas of technology that may relate to our business. The industry continues to be aggressive in assertion, licensing, and litigation of patents and other intellectual property rights.

**Table of Contents**

In the course of our business, we receive claims of infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. We evaluate the validity and applicability of these intellectual property rights, and determine in each case whether to negotiate licenses or cross-licenses to incorporate or use the proprietary technologies, protocols, or specifications in our products, and whether we have rights of indemnification against our suppliers, strategic partners or licensors. If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those that must comply with industry standard protocols and specifications to be commercially viable, our financial position or results of operations could be adversely affected. In addition, if we are alleged to infringe the intellectual property rights of others, we could be required to seek licenses from others or be prevented from manufacturing or selling our products, which could cause disruptions to our operations or the markets in which we compete. Finally, even if we have indemnification rights in respect of such allegations of infringement from our suppliers, strategic partners or licensors, we may not be able to recover our losses under those indemnity rights.

***OSN, our new open source strategy, subjects us to additional intellectual property risks, such as less control over development of certain technology that forms a part of this strategy and a higher likelihood of litigation.***

We recently announced Open Services Networking, or OSN, a new networking strategy that uses open source software, or OSS, licenses. The underlying source code for OSS is generally made available to the general public with either relaxed or no intellectual property restrictions. This allows users to create user-generated software content through either incremental individual effort, or collaboration. The use of OSS means that for such software we do not exercise control over many aspects of the development of the open source technology. For example, the vast majority of programmers developing OSS used by us are neither our employees nor contractors. Therefore, we cannot predict whether further developments and enhancements to OSS selected by us would be available. Furthermore, rival OSS applications often compete for market share. Should our choice of application fail to compete favorably, its OSS development may wane or stop. In addition, OSS has few technological barriers to entry by new competitors and it may be relatively easy for new competitors, who have greater resources than us, to enter our markets and compete with us. Also, because OSS is often compiled from multiple components developed by numerous independent parties and usually comes as is and without indemnification, OSS is more vulnerable to third party intellectual property infringement claims. Finally, some of the more prominent OSS licenses, such as the GNU General Public License, are the subject of litigation. It is possible that a court could hold such licenses to be unenforceable or someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable or that open source components of our product offerings may not be liberally copied, modified or distributed may have the effect of preventing us from selling or developing all or a portion of our products. If any of the foregoing occurred, it could cause a material adverse impact on our business.

**Risks Related to the Trading Market**

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

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

fluctuations in our quarterly results of operations and cash flow;

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

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

announcements by our competitors.

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

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

The following table summarizes repurchases of our stock, including shares returned to satisfy employee tax withholding obligations, in the three months ended August 31, 2007:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>
June 2, 2007 through June 29, 2007	5,668 <sup>(1)</sup>	\$ 4.52
June 30, 2007 through July 27, 2007	35,899 <sup>(1)</sup>	4.14
July 28, 2007 through August 31, 2007	2,820 <sup>(1)</sup>	4.00
<b>Total</b>	<b>44,387</b>	<b>\$ 4.18</b>

(1) Represents shares returned to us to satisfy tax withholding obligations that arose upon the vesting of restricted stock awards.

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

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
2.1	Master Separation and Distribution Agreement between the Registrant and Palm, Inc. effective as of December 13, 1999	10-Q	002-92053	2.1	4/4/00	
2.2	Indemnification and Insurance Matters Agreement between the Registrant and Palm, Inc.	10-Q	002-92053	2.11	4/4/00	
2.3	Agreement and Plan of Merger, dated December 13, 2004, by and among the Registrant, Topaz Acquisition Corporation and TippingPoint Technologies, Inc.	8-K	000-12867	2.1	12/16/04	
2.4	Securities Purchase Agreement by and among 3Com Corporation, 3Com Technologies, Huawei Technologies Co., Ltd. and Shenzhen Huawei Investment & Holding Co., Ltd., dated as of October 28, 2005	8-K/A	000-12867	2.1	3/30/06	
2.5	Stock Purchase Agreement by and between Shenzhen Huawei Investment & Holding Co., Ltd. and 3Com Technologies, dated as of December 22, 2006	8-K	000-12867	10.1	12/27/06	
3.1	Corrected Certificate of Merger filed to correct an error in the Certificate of Merger	10-Q	002-92053	3.4	10/8/99	
3.2	Registrant's Bylaws, as amended on March 23, 2005	8-K	000-12867	3.1	3/28/05	
3.3	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	10-Q	000-12867	3.6	10/11/01	
4.1	Third Amended and Restated Preferred Shares Rights Agreement, dated as of November 4, 2002	8-A/A	000-12867	4.1	11/27/02	
10.1	Stand Alone Stock Option Agreement dated July 3, 2007 by and between Jay Zager and 3Com Corporation *	S-8	333-144322	10.2	7/3/07	
10.2	Stand Alone Restricted Stock Agreement dated July 3, 2007 by and between Jay Zager and 3Com Corporation *	S-8	333-144322	10.3	7/3/07	
31.1	Certification of Principal Executive Officer					X

31.2	Certification of Principal Financial Officer	X
32.1	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	X

\* Indicates a management contract or compensatory plan



**Table of Contents**

**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: October 9, 2007

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

39

---

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

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
2.1	Master Separation and Distribution Agreement between the Registrant and Palm, Inc. effective as of December 13, 1999	10-Q	002-92053	2.1	4/4/00	
2.2	Indemnification and Insurance Matters Agreement between the Registrant and Palm, Inc.	10-Q	002-92053	2.11	4/4/00	
2.3	Agreement and Plan of Merger, dated December 13, 2004, by and among the Registrant, Topaz Acquisition Corporation and TippingPoint Technologies, Inc.	8-K	000-12867	2.1	12/16/04	
2.4	Securities Purchase Agreement by and among 3Com Corporation, 3Com Technologies, Huawei Technologies Co., Ltd. and Shenzhen Huawei Investment & Holding Co., Ltd., dated as of October 28, 2005	8-K/A	000-12867	2.1	3/30/06	
2.5	Stock Purchase Agreement by and between Shenzhen Huawei Investment & Holding Co., Ltd. and 3Com Technologies, dated as of December 22, 2006	8-K	000-12867	10.1	12/27/06	
3.1	Corrected Certificate of Merger filed to correct an error in the Certificate of Merger	10-Q	002-92053	3.4	10/8/99	
3.2	Registrant's Bylaws, as amended on March 23, 2005	8-K	000-12867	3.1	3/28/05	
3.3	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	10-Q	000-12867	3.6	10/11/01	
4.1	Third Amended and Restated Preferred Shares Rights Agreement, dated as of November 4, 2002	8-A/A	000-12867	4.1	11/27/02	
10.1	Stand Alone Stock Option Agreement dated July 3, 2007 by and between Jay Zager and 3Com Corporation *	S-8	333-144322	10.2	7/3/07	
10.2	Stand Alone Restricted Stock Agreement dated July 3, 2007 by and between Jay Zager and 3Com Corporation *	S-8	333-144322	10.3	7/3/07	
31.1	Certification of Principal Executive Officer					X

31.2	Certification of Principal Financial Officer	X
32.1	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	X

\* Indicates a management contract or compensatory plan