3COM CORP
Form 10-Q
October 06, 2009

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

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

For the quarterly period ended August 28, 2009

OR

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

For the transition period from to

Commission File No. 0-12867

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

Delaware	**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 þ No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

As of September 25, 2009, 392,168,650 shares of the registrant s common stock were outstanding.

3COM CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED AUGUST 28, 2009
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We use a 52 or 53 week fiscal year ending on the Friday nearest to May 31, with each fiscal quarter ending on the Friday generally nearest August 31, November 30 and February 28. For presentation purposes, the periods are shown as ending on August 31, November 30, February 28 and May 31, as applicable. Our H3C legal entity (H3C) follows a calendar year basis of reporting and therefore results for our China-based sales segment are consolidated on a two-month time lag.

3Com, the 3Com logo, H3C, Digital Vaccine, NBX, OfficeConnect, Comware, IRF, TippingPoint, TippingPoint Technologies and VCX are registered trademarks or trademarks of 3Com Corporation or one of its wholly owned subsidiaries. Other product and brand names may be trademarks or registered trademarks of their respective owners.

This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements regarding the following aspects of our business: global economic slowdown and effects and strategy; core business strategy to leverage China and emphasize larger enterprise business; China-based sales region strategy, growth, dependence, expected benefits, tax rate, sales from China, expected decline in sales to Huawei and manage operations; impact of recent accounting regulations; expected annual amortization expense; environment for enterprise networking equipment; challenges relating to sales growth; trends and goals for segments and regions; pursuit of termination fee; supply of components; research and development focus; execution of our strategy; strategic product and technology development plans; goal of sustaining profitability; short-term management of cash during economic slowdown; intercompany dividends from China; ability to satisfy cash requirements for at least the next twelve months; stock repurchase program; restructuring activities and expected charges to be incurred; expected cost savings from restructuring activities and integration; potential acquisitions and strategic relationships; future contractual obligations; recovery of deferred tax assets and balance of unrecognized tax benefits; reserves; market risk; outsourcing; competition and pricing pressures; expectation regarding base interest rates; impact of foreign currency fluctuations; belief regarding meritorious defenses to litigation claims and effects of litigation; and you can identify these and other forward-looking statements by the use of words such as may, can, should, expects, plans, antic believes, estimates, predicts, intends, continue, or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any forward-looking statements.

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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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
3COM CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)	Three Months Ended August 31, 2009	Three Months Ended August 31, 2008
Sales	$ 290,502	$ 342,650
Cost of sales	123,931	153,023
Gross profit	166,571	189,627
Operating expenses (income):		
Sales and marketing	84,788	87,482
Research and development	38,968	47,147
General and administrative	21,370	24,454
Amortization	17,071	25,164
Patent dispute resolution		(70,000)
Restructuring charges	1,133	1,997
Operating expenses, net	163,330	116,244
Operating income	3,241	73,383
Interest expense, net	(1,088)	(1,251)
Other income, net	11,547	12,871
Income before income taxes	13,700	85,003
Income tax provision	(6,239)	(5,166)
Net income	$ 7,461	$ 79,837
Basic and diluted net income per share	$ 0.02	$ 0.20
Shares used in computing per share amounts:		
Basic	389,774	402,889
Diluted	396,266	404,072

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

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3COM CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	August 31, 2009	May 31, 2009
ASSETS		
Current assets:		
Cash and equivalents	$ 625,908	$ 545,818
Short-term investments	39,915	98,357
Notes receivable	46,926	40,590
Accounts receivable, less allowance for doubtful accounts of $9,072 and $9,645 respectively	101,536	112,771
Inventories	86,232	90,395
Other current assets	47,229	56,982
Total current assets	947,746	944,913
Property and equipment, less accumulated depreciation and amortization of $179,616 and $172,717 respectively	38,228	40,012
Goodwill	609,297	609,297
Intangible assets, net	181,578	198,624
Deposits and other assets	24,860	22,511
Total assets	$ 1,801,709	$ 1,815,357
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 67,928	$ 68,350
Current portion of long-term debt	88,000	48,000
Accrued liabilities and other	360,369	394,103
Total current liabilities	516,297	510,453
Deferred taxes and long-term obligations	41,328	40,729
Long-term debt	112,000	152,000
Stockholders equity:		
Preferred stock, $0.01 par value, 10,000 shares authorized; none outstanding		
Common stock, $0.01 par value, 990,000 shares authorized; shares issued and outstanding: 391,828 and 389,284 respectively	2,348,180	2,336,961
Retained deficit	(1,283,061)	(1,290,522)
Accumulated other comprehensive income	66,965	65,736
Total stockholders equity	1,132,084	1,112,175
Total liabilities and stockholders equity	$ 1,801,709	$ 1,815,357

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

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

	Three Months Ended August 31,	
(In thousands)	**2009**	**2008**
Cash flows from operating activities:		
Net income	$ 7,461	$ 79,837
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	21,657	33,131
Stock-based compensation expense	4,885	6,442
Loss on property and equipment disposals	38	13
Deferred income taxes	(1,522)	(3,377)
Changes in assets and liabilities:		
Accounts and notes receivable	4,948	(50,684)
Inventories	4,633	(18,566)
Other assets	7,175	(1,483)
Accounts payable	(85)	6,941
Other liabilities	(32,327)	(12,940)
Net cash provided by operating activities	16,863	39,314
Cash flows from investing activities:		
Proceeds from maturities and sales of investments	58,699	
Purchases of property and equipment	(2,970)	(7,598)
Proceeds from sale of property and equipment	8	68
Net cash provided by (used in) investing activities	55,737	(7,530)
Cash flows from financing activities:		
Issuances of common stock	7,631	286
Repurchases of common stock	(1,216)	(543)
Net cash provided by (used in) financing activities	6,415	(257)
Effect of exchange rate changes on cash and equivalents	1,075	6,257
Net change in cash and equivalents during period	80,090	37,784
Cash and equivalents, beginning of period	545,818	503,644
Cash and equivalents, end of period	$ 625,908	$ 541,428

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

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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 28, 2009 and May 29, 2009, our results of operations for the three months ended August 28, 2009 and August 29, 2008 and our cash flows for the three months ended August 28, 2009 and August 29, 2008.

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, 2009 ended on August 28, 2009, the three months ended August 31, 2008 ended on August 29, 2008, and the year ended May 31, 2009 ended on May 29, 2009. The results of operations for the three months ended August 28, 2009 may not be indicative of the results to be expected for the fiscal year ending May 28, 2010 or any future periods. Our wholly-owned subsidiary, H3C, follows a calendar year basis of reporting and our China-based sales region segment is therefore consolidated on a two-month-lag. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended May 30, 2008.

Certain prior period amounts have been reclassified to conform to the current year presentation. Specifically, in the condensed consolidated statements of operations we have reclassified $2.6 million from general and administrative expenses to sales and marketing and research and development expenses, $1.2 million and $1.4 million, respectively, for the three months ended August 31, 2008.

Recently issued accounting pronouncements

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS 141R) to improve reporting and to create greater consistency in the accounting and financial reporting of business combinations. The standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS No. 141R amends SFAS 109, Accounting for Income Taxes , such that adjustments made to valuation allowances on deferred income taxes and acquired income tax contingencies associated with acquisitions that closed prior to the effective date of SFAS No. 141R would apply the provisions of SFAS No. 141R. The Company adopted SFAS 141R on May 30, 2009. Since we have had no acquisition activity the adoption of SFAS 141R has not had a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements to improve the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report noncontrolling (minority) interests in subsidiaries in the same way as required in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring that they be treated as equity transactions. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of SFAS No. 160 has not had a material impact on our consolidated financial position, results of operations or cash flows.

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In February 2008, the FASB issued FASB Staff Position No. SFAS 157-2, Effective Date of FASB Statement No. 157 , which provides a one-year deferral of the effective date of FAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Effective June 1, 2008, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities recorded at fair value, which had no material impact on our consolidated financial position, results of operations or cash flow. Effective May 30, 2009, we adopted the portion of SFAS No. 157, for which the implementation had been deferred, which had no material impact on our consolidated financial position, results of operations or cash flow. Under SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159), entities are permitted to choose to measure many financial instruments and certain other items at fair value that previously were not required to be measured at fair value. We did not elect the fair value measurement option under SFAS No. 159 for any of these financial assets or liabilities.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS No. 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS No. 142-3). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS No. 142, Goodwill and Other Intangible Assets (FAS No. 142). The intent of FSP FAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141R Business Combinations , and other accounting principles generally accepted in the United States of America. FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FSP FAS No. 142-3 has not had a material impact on our consolidated financial position, results of operations or cash flow.

In June 2008, the FASB issued FSP EITF 03-6-1 (FSP EITF 03-6-1), Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which became effective in 2009 via retrospective application. Under FSP EITF 03-6-1, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The company adopted FSP EITF 03-6-1 on May 30, 2009. The impact of adopting FSP EITF 03-6-1 had no material effect on basic or diluted EPS for the three months ended August 31, 2009 or 2008.

In May 2009, the FASB issued FASB Statement No. 165, Subsequent Events (SFAS 165). SFAS 165 intends to establish general standards of accounting for and disclosures of subsequent events that occurred after the balance sheet date but prior to the issuance of financial statements. SFAS 165 is effective for financial statements issued for interim or fiscal years ending after June 15, 2009. The adoption of SFAS 165 did not have a significant impact on our financial position, results of operations or cash flows.

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (the Codification) . The Codification, which was launched on July 1, 2009, became the single source of authoritative non-governmental U.S. generally accepted accounting principles (GAAP), superseding various existing authoritative accounting pronouncements. The Codification eliminates the GAAP hierarchy contained in Statement 162 and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We will adopt the Codification in the second quarter of fiscal 2010. There will be no change to our consolidated financial statements due to the implementation of the Codification other than changes in reference to various authoritative accounting pronouncements in our consolidated financial statements.

On September 23, 2009, the FASB reached a consensus on two new pronouncements; EITF No. 08-1, Revenue Arrangements with Multiple Deliverables (previously titled, Revenue Recognition for a Single Unit of Accounting) and EITF No. 09-3, Applicability of Statement of Position 97-2 to Certain Arrangements That Include Software Elements . These new pronouncements are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted only at the beginning of the company s fiscal year 2011. The Company is currently evaluating the impact that adoption of these EITFs will have on its consolidated financial statements.

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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. 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 time-based vesting awards for stock options, restricted stock awards, restricted stock units, and stock issued under the employee stock purchase plan. Certain of the stock options may vest on an accelerated basis and certain restricted stock units are earned contingent on the future achievement of financial performance metrics. Performance metrics for the performance period are determined by the Compensation Committee of the Board of Directors in its sole discretion. For unvested stock options outstanding as of May 31, 2006, we continue to recognize stock-based compensation expense using the accelerated 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, 2009, total unrecognized stock-based compensation expense relating to unvested employee stock options, restricted stock awards, restricted stock units and stock issued under employee stock purchase plan, adjusted for estimated forfeitures, was $6.8 million, $2.1 million, $22.1 million and $0.1 million, respectively. These amounts are expected to be recognized over a weighted-average period of 2.2 years for stock options, 1.6 years for restricted stock awards, 2.3 years for restricted stock units and 0.1 years for stock issued under the employee stock purchase plan. If actual forfeitures differ from current estimates, total unrecognized stock-based compensation expense will be adjusted for future changes in estimated forfeitures.

Stock-based compensation expense recognized and disclosed is based on the Black-Scholes option pricing model for estimating the fair value of options granted under the company s equity incentive plans. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The underlying weighted-average assumptions used in the Black-Scholes model for options and employee stock purchase plan and the estimates of the weighted average grant date fair value per share were as follows for options, restricted stock awards and restricted stock units granted during the three months ended August 31, 2009 and 2008:

	Three Months Ended August 31,	
	2009	**2008**
Employee stock options:		
Volatility	57.0%	48.8%
Risk-free interest rate	2.1%	3.1%
Dividend yield	0.0%	0.0%
Expected life (years)	4.1	4.0
Weighted average grant date fair value	$1.83	$1.02
Restricted stock awards:		
Weighted average grant date fair value	*	$2.48
Restricted stock units:		
Weighted average grant date fair value	$4.04	$2.56
Employee stock purchase plan:	*	*

* No grants during the

period

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

	Three Months Ended August 31,	
	2009	**2008**
Cost of sales	$ 540	$ 758
Sales and marketing	1,590	1,758
Research and development	476	884
General and administrative	2,279	3,042
Stock-based compensation expense before tax	$ 4,885	$ 6,442

Stock Options. Stock option activity for the three months ended August 31, 2009 and 2008, was as follows (shares in thousands):

	Three Months Ended August 31,			
	2009		**2008**	
	Number of shares	**Weighted average exercise price**	**Number of shares**	**Weighted average exercise price**
Outstanding May 31, 2009 and 2008	28,361	$ 4.92	43,925	$ 4.98
Granted	2,419	4.00	300	2.48
Exercised	(1,916)	3.98	(191)	1.50
Forfeited	(111)	4.10	(1,554)	4.75
Expired	(1,802)	5.54	(2,174)	5.99
Outstanding August 31, 2009 and 2008	26,951	$ 4.86	40,306	$ 4.93

As of August 31, 2009, there were approximately 17.1 million options exercisable with a weighted-average exercise price of $5.70 per share. By comparison, there were approximately 27.3 million options exercisable as of August 31, 2008 with a weighted-average price of $5.58 per share.

During the three months ended August 31, 2009 and 2008 approximately 1.9 million and 0.2 million options were exercised at an aggregate intrinsic value of $1.6 million and $0.1 million, respectively. The exercise intrinsic value is calculated as the difference between the market value on the exercise date and the exercise price of the options. The closing market value as of August 28, 2009 was $4.39 per share as reported by the NASDAQ Global Select Market. The aggregate intrinsic value of options outstanding and options exercisable as of August 31, 2009 was $19.0 million and $9.2 million, respectively. The weighted-average remaining contractual life of options outstanding and options exercisable were 3.9 and 2.8 years, respectively. The aggregate options outstanding and options exercisable intrinsic value is calculated for options that are in-the-money as the difference between the market value as of August 31, 2009 and the exercise price of the options.

Options outstanding that are vested and are expected to vest as of August 31, 2009 are as follows:

	Number of Shares	**Weighted average Grant-Date**	**Weighted Average Remaining**	**Aggregate**

	(in thousands)	Fair Value	Contractual Life (in years)	Intrinsic Value (in thousands)
Vested and expected to vest at August 31, 2009	23,833	$ 5.05	3.6	$ 15,968

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Restricted Stock Awards. Restricted stock award activity during the three months ended August 31, 2009 and 2008 was as follows (shares in thousands):

	Three Months Ended August 31,					
	2009			2008		
	Number of Shares (unvested)	Weighted average Grant-Date Fair Value		Number of Shares (unvested)	Weighted average Grant-Date Fair Value	
Outstanding May 31, 2009 and 2008	1,459	$	2.94	3,095	$	3.43
Granted				75		2.48
Vested	(115)		4.04	(305)		4.19
Forfeited	(7)		5.05	(420)		3.80
Outstanding August 31, 2009 and 2008	1,337	$	2.84	2,445	$	3.24

During the three months ended August 31, 2009 and 2008 approximately 0.1 million and 0.3 million restricted awards with an aggregate fair value of $0.5 million and $0.6 million, respectively, became vested. Total aggregate intrinsic value of restricted stock awards outstanding as of August 31, 2009 was $5.9 million.

Restricted Stock Units. Restricted stock unit activity during the three months ended August 31, 2009 and 2008 was as follows (shares in thousands):

	Three Months Ended August 31,					
	2009			2008		
	Number of Shares (unvested)	Weighted average Grant-Date Fair Value		Number of Shares (unvested)	Weighted average Grant-Date Fair Value	
Outstanding May 31, 2009 and 2008	6,161	$	2.78	5,744	$	3.59
Granted	5,542		4.04	1,743		2.56
Vested	(933)		3.01	(673)		3.70
Forfeited	(201)		3.01	(326)		3.54
Outstanding August 31, 2009 and 2008	10,569	$	3.42	6,488	$	3.30

During the three months ended August 31, 2009 and 2008 approximately 0.9 million and 0.7 million restricted awards with an aggregate fair value of $3.7 million and $1.3 million, respectively, became vested. Total aggregate intrinsic value of restricted stock units outstanding at August 31, 2009 was $46.4 million. Restricted stock units outstanding at August 31, 2009 had a weighted-average remaining contractual life of 1.6 years. Total aggregate intrinsic value of restricted stock units outstanding and expected to vest at August 31, 2009 was $31.8 million. Restricted stock units outstanding and expected to vest at August 31, 2009 had a weighted-average remaining contractual life of 1.4 years.

Employee Stock Purchase Plan. We have an employee stock purchase plan (ESPP) under which eligible employees may authorize payroll deductions of up to ten percent of their compensation, as defined, to purchase common stock at a price of 85 percent of the lower of the fair market value as of the beginning or the end of the six-month offering period. In September 2008, our stockholders approved an increase of eight million shares available for issuance under the ESPP. We recognized $0.4 million and $0.5 million of stock-based compensation expense in the three months ended August 31, 2009 and 2008, respectively, associated with the ESPP. Employee stock purchases generally occur only in the quarters ended November 30 and May 31.

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NOTE 3: FAIR VALUE

Fair Value Hierarchy

The Company s financial instruments consist primarily of cash and cash equivalents, short-term investments, accounts receivable, notes receivable, accounts payable, and long-term debt. The carrying value of cash, short-term investments, accounts receivable, notes receivable and accounts payable approximates their fair market values due to their short-term nature. The Company believes that the carrying value of its outstanding debt approximates fair value. SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. A financial instrument s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

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

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

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

In accordance with SFAS 157, we measure our cash equivalents at fair value and classify them within Level 1 or Level 2 of the fair value hierarchy. The classification has been determined based on the manner in which we value our cash equivalents, primarily using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

Assets Measured at Fair Value on a Recurring Basis

Assets measured at fair value on a recurring basis consisted of the following types of instruments and were reported as cash equivalents as of August 31, 2009:

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance
	(In thousands)			
Assets				
Cash equivalents:				
Time deposits and bank deposits with a maturity less than 3 months	$	$ 288,382	$	$ 288,382
Money market fund deposits	245,741			245,741
China government bonds and bank bills with a maturity of less than 3 months	91,785			91,785
Total assets measured at fair value	$ 337,526	$ 288,382	$	$ 625,908

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

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NOTE 4. REALTEK PATENT DISPUTE RESOLUTION

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

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

Under the terms of the agreements, the payments are non-refundable and the Company has no future performance obligations, apart from certain customary covenants not to sue Realtek, its customers or its suppliers on the licensed technology, and non-material notice and tax assistance obligations. Accordingly the $70.0 million was recognized as income in the three months ended August 31, 2008 in the operating expense (income) section of the condensed consolidated statement of operations.

NOTE 5. RESTRUCTURING CHARGES

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

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

- reduced our workforce;
- continued efforts to consolidate and dispose of excess facilities; and
- shifting the focus of our direct-touch sales force to accommodate our shift to the enterprise market

Restructuring charges related to these various initiatives were $1.1 million in the three months ended August 31, 2009 compared to $2.0 million in the three months ended August 31, 2008. The $1.1 million of net expense in the first quarter of fiscal 2010 consists of severance and outplacement costs of $1.0 million and $0.1 million of facilities and other restructuring items. The severance and outplacement costs primarily relate to a decrease in headcount of sales and marketing employees as the Company continues to shift our sales force to the enterprise market. The net restructuring charge in the first quarter of fiscal 2009 resulted from severance, outplacement and other costs of $1.9 million and a $0.1 million charge for facilities-related charges. The severance and outplacement costs in the first quarter of fiscal 2009 primarily relate to a decrease in headcount of research and development employees as the Company eliminated duplicate testing activities.

Accrued liabilities associated with restructuring charges total $1.8 million as of August 31, 2009 and are included in the caption Accrued liabilities and other in the accompanying consolidated balance sheets. These liabilities are classified as current because we expect to satisfy such liabilities in cash within the next 12 months.

Fiscal 2010 Actions

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

	Employee Separation Expense	Other Restructuring Costs	Total
Balance as of May 31, 2009	$	$	$
Provisions	1,064	139	1,203
Payments and non-cash charges	(404)	(139)	(543)
Balance as of August 31, 2009	$ 660	$	$ 660

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Employee separation expenses include severance pay, outplacement services, medical and other related benefits. The reduction in workforce affected employees involved in research and development, sales and marketing, customer support, and general and administrative functions. Through August 31, 2009, the total reduction in workforce associated with actions initiated during fiscal 2010 included approximately 35 employees who had been separated or were currently in the separation process. Non-cash charges include depreciation against restructured assets, and stock-based compensation charges as applicable.

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

Fiscal 2007 through 2009 Actions

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

	Employee Separation Expense	Facilities-related Charges	Total
Balance as of May 31, 2009	$ 1,477	$ 47	$ 1,524
Provisions (benefits)	(75)	5	(70)
Payments and non-cash charges	(321)	(8)	(329)
Balance as of August 31, 2009	$ 1,081	$ 44	$ 1,125

Employee separation expense includes severance pay, outplacement services, medical and other related benefits. Facilities-related charges related to revised future lease obligations.

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

NOTE 6. INCOME TAXES

The Company provides for income taxes during interim periods based on our estimate of the effective tax rate for the year. Discrete items and changes in our estimate of the annual effective tax rate are recorded in the period in which they occur. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. During the three months ended August 31, 2009, the balance of unrecognized tax benefits increased by $1.4 million. As of August 31, 2009, we had unrecognized tax benefits, including interest and penalties, of $23.3 million, all of which, if recognized, would affect our effective tax rate. As of August 31, 2009, the accrued interest and penalties related to uncertain tax positions were $2.9 million and $0, respectively, which has been recorded within the balance of unrecognized tax benefits.

As of August 31, 2009 we estimate that the balance of unrecognized tax benefits will decrease by approximately $4.8 million over the next twelve months as a result of the expiration of various statutes.

See footnote 16 Subsequent Event for discussion of the finalization of the calendar year 2008 China tax rate.

NOTE 7. COMPREHENSIVE INCOME

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

	Three Months Ended August 31,	
	2009	2008
Net income	$ 7,461	$ 79,837
Other comprehensive income:		
Change in accumulated translation adjustments	1,229	7,685
Total comprehensive income	$ 8,690	$ 87,522

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NOTE 8. NET INCOME PER SHARE

The following represents a reconciliation from basic earnings per common share to diluted earnings per common share. Stock options and restricted stock (awards and units) of 23.9 million and 8.4 million, respectively, were outstanding at August 31, 2009 but were not included in the computation of diluted earnings per share because they were antidilutive. Stock options and restricted stock (awards and units) of 39.3 million and 8.7 million, respectively, were outstanding at August 31, 2008, but were not included in the computation of diluted earnings per share because they were antidilutive.

	Three Months Ended August 31,	
(in thousands except per share data)	2009	2008
Determination of shares:		
Weighted average shares outstanding	389,774	402,889
Assumed conversion of dilutive stock options	3,021	968
Assumed conversion of dilutive restricted stock (awards and units)	3,471	215
Diluted weighted average shares outstanding	396,266	404,072
Basic earnings per share	$ 0.02	$ 0.20
Diluted earnings per share	$ 0.02	$ 0.20

On June 30, 2009 the Company adopted FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities . This FSP did not have a material impact on our financial statements.

NOTE 9. INVENTORIES

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

	August 31, 2009	May 31, 2009
Finished goods	$ 62,533	$ 69,860
Work-in-process	3,686	3,420
Raw materials	20,013	17,115
Total	$ 86,232	$ 90,395

NOTE 10. GOODWILL AND INTANGIBLE ASSETS, NET

We apply the provisions of SFAS No. 142 Goodwill and Other Intangible Assets to goodwill and intangible assets with indefinite lives which are not amortized but are reviewed annually for impairment or more frequently if impairment indicators arise. We test our goodwill for impairment annually during our third fiscal quarter. There were no triggering events in the first quarter of fiscal year 2010 that required an additional impairment test.

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

August 31, 2009				May 31, 2009			
Weighted Average Remaining Amortization Period	Gross	Accumulated Amortization	Net	Weighted Average Remaining Amortization Period	Gross	Accumulated Amortization	Net
3.3	$398,204	$(286,101)	$112,103	3.6	$398,178	$(272,460)	$125,718

Existing technology								
Trademark	NA	55,502		55,502	NA	55,502		55,502
Huawei non-compete	0.0	37,288	(37,288)		0.0	37,283	(37,283)	
OEM agreement	0.8	26,853	(20,165)	6,688	1.0	23,777	(14,852)	8,925
Maintenance agreements	1.5	19,000	(14,516)	4,484	1.7	19,000	(13,724)	5,276
Other	1.8	22,698	(19,897)	2,801	2.0	22,697	(19,494)	3,203
		$559,545	$(377,967)	$181,578		$556,437	$(357,813)	$198,624

During the three months ended August 31, 2009 our gross intangible assets increased by $3.1 million due to the appreciation on the Renminbi affecting the value of certain intangible assets tied to our H3C subsidiary. Net intangible assets at August 31, 2009 in our China-based sales region were $167.6 million and in our TippingPoint segment were $14.0 million.

NOTE 11. ACCRUED WARRANTY

Most products are sold with varying lengths of limited warranty ranging from 90 days to 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, 2009 and 2008 (in thousands):

	Three Months Ended August 31,	
	2009	2008
Accrued warranty, beginning of period	$ 29,587	$ 36,897
Cost of warranty claims processed during the period	(6,280)	(8,217)
Provision for warranties related to products sold during the period	5,029	6,771
Accrued warranty, end of period	$ 28,336	$ 35,451

NOTE 12. LONG-TERM DEBT

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

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

Leverage Ratio	LIBOR +	Base Rate +
>3.0:10	2.25%	1.25%
≤3.0:1.0 but > 2.0:1.0	2.00%	1.00%
≤2.0:1.0 but > 1.0:1.0	1.75%	0.75%
≤1.0:1.0	1.50%	0.50%

All amounts outstanding under the Tranche B Term Facility will bear interest, at the Borrower s option, at the (i) LIBOR plus 3 percent or (ii) Base Rate (i.e., prime rate) plus 2 percent. We have elected to use LIBOR as the reference rate for borrowings to date. Applicable LIBOR rates at August 31, 2009 were 1.79 percent and the effective interest rate at August 31, 2009 was 3.29 percent for the Tranche A Term Facility and 4.79 percent for the Tranche B Term Facility.

Required payments under the loan are generally expected to be serviced by cash flows from the H3C Group.

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

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H3C and all other existing and future subsidiaries of the Borrower (other than PRC subsidiaries or small excluded subsidiaries) will guarantee all obligations under the loans and are referred to as Guarantors . The loan obligations are secured by (1) first priority security interests in all assets of the Borrower and the Guarantors, including their bank accounts, and (2) a first priority security interest in 100 percent of the capital stock of the Borrower and H3C and the PRC subsidiaries of H3C. The debt bears interest at floating rates therefore the carrying value approximates fair value. The Borrower must maintain a minimum debt service coverage, minimum interest coverage, maximum capital expenditures and a maximum total leverage ratio. Negative covenants restrict, among other things, (i) the incurrence of indebtedness by the Borrower and its subsidiaries, (ii) the making of dividends and distributions to the Company outside of the H3C Group, (iii) the ability to make investments including in new subsidiaries, (iv) the ability to undertake mergers and acquisitions and (v) sales of assets. As of August 31, 2009, the H3C Group s net assets were $858.5 million and are subject to these dividend restrictions. Also, cash dividends from the PRC subsidiaries to H3C, and H3C to the Borrower, will be subject to restricted use pending payment of principal, interest and excess cash flow prepayments. Standard events of default apply.

Remaining payments of the $200 million principal are due on September 28, of each year as follows, (in thousands):

Calendar Year	3Com Fiscal Year	Tranche A	Tranche B
2009	2010	$46,000	$ 2,000
2010	2011	46,000	2,000
2011	2012		20,000
2012	2013		84,000

On September 28, 2009, in addition to our regular principal payment the Company made a voluntary prepayment of $40.0 million of principal, which the Company did not incur a penalty for, all of which was applied to reduce our fiscal year 2013 Tranche B principal balance. The prepayment amount was classified as current debt in the condensed consolidated balance sheet as of August 31, 2009.

On September 28, 2009 our applicable LIBOR rates reset to 0.64 percent and the effective interest rate for the next six months will be 2.14 percent for the Tranche A Term Facility and 3.64 percent for the Tranche B Term Facility.

NOTE 13. SEGMENT INFORMATION

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

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

Management evaluates the China-based sales region and the Rest of World sales region performance based on segment contribution profit. Segment contribution profit is standard margin less segment direct sales and marketing expenses. Standard margin for these regions is sales less standard costs of sales. Our TippingPoint Security business segment is measured on segment income. Segment income is segment contribution profit less research and development expenses. Eliminations and other include intercompany sales eliminations, stock-based compensation expense, amortization of

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intangible assets and restructuring in all periods as well as proceeds from the Realtek patent dispute resolution in the first quarter of fiscal 2009, as these costs are not included in the Company s segment contribution profit and segment income.

Summarized financial information of our results of operations by segment for the three months ended August 31, 2009 and 2008 is as follows.

	Three Months Ended August 31, 2009					
	Networking Business			TippingPoint Security Business		
(in thousands)	China-based sales region	Rest of World Sales Region	Central Functions(a)	Tipping Point(b)	Eliminations/ Other	Total
Sales	$ 152,013	$ 107,202	$	$ 32,596	$ (1,309)*c*	$ 290,502
Standard margin	104,900	62,995		27,772	(540)*d*	195,127
Direct sales & marketing expenses	35,039	23,327		11,028	1,590 *d*	70,984
Segment contribution profit (loss)	69,861	39,668		16,744	(2,130)	124,143
Research & development expenses			32,177	6,315	476 *d*	38,968
Segment income	$	$	$	$ 10,429	$	
Other operating expenses			56,047	5,404	20,483 *e*	81,934
Operating income						$ 3,241

	Three Months Ended August 31, 2008					
	Networking Business			TippingPoint Security Business		
(in thousands)	China-based sales region	Rest of World Sales Region	Central Functions(a)	Tipping Point(b)	Eliminations/ Other	Total
Sales	$ 175,397	$ 140,314	$	$ 28,199	$ (1,260)*c*	$ 342,650
Standard margin	115,527	82,253		23,396	(758)*d*	220,418

Direct sales & marketing expenses	33,600	28,152		10,073	1,758 *d*	73,583
Segment contribution profit (loss)	81,927	54,101		13,323	(2,516)	146,835
Research & development expenses			39,317	6,946	884 *d*	47,147
Segment income	$	$	$	$ 6,377	$	
Other operating expenses (income)			60,022	6,080	(39,797)*e*	26,305
Operating income						$ 73,383

a *Included in our Central Function results were depreciation expenses of $4.1 million and $6.6 million for the three months ended August 31, 2009 and 2008, respectively.*

b *Included in our TippingPoint segment profit were depreciation expenses of $1.1 million and $0.8 million for the three months ended August 31, 2009 and 2008, respectively.*

c *Represents eliminations for*

inter-company revenue between Networking and TippingPoint during the respective periods.

d *Represents stock-based compensation in all periods.*

e *Includes stock based compensation, amortization, and restructuring in all periods plus proceeds from the Realtek patent dispute resolution in the three months ended August 31, 2008.*

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Identifiable assets (in thousands)	**August 31, 2009**	**May 31, 2009**
China-based sales region(1)(2)	$ 1,341,733	$ 1,378,059
Rest of World sales region(1)	1,014,757	875,788
TippingPoint	226,462	228,440
Eliminations(3)	(781,243)	(666,930)
Total	$ 1,801,709	$ 1,815,357

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

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

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

Total Expenditures for Additions to Property and Equipment (in thousands)	Three Months Ended August 31, 2009	2008
China-based sales region(1)	$ 1,018	$ 2,767
Rest of World sales region(1)	1,637	4,004
TippingPoint	315	827
Total	$ 2,970	$ 7,598

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

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

	Three Months Ended August 31, 2009		2008	
Switches and routers	$ 195,211	67.2%	$ 254,176	74.2%
Other networking equipment	42,395	14.6	41,117	12.0
Security	41,052	14.1	36,339	10.6

Services	11,844	4.1	11,018	3.2
Total	$ 290,502	100%	$ 342,650	100%

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NOTE 14. GEOGRAPHIC INFORMATION

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

	Three Months Ended August 31,	
	2009	2008
China	$ 146,362	$ 167,527
Europe, Middle East and Africa	49,050	69,377
North America	51,669	52,031
Asia Pacific Rim (excluding-China)	25,246	30,109
Latin and South America	18,175	23,606
Total	$ 290,502	$ 342,650

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

NOTE 15. LITIGATION

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

On December 5, 2001, TippingPoint and two of its current and former officers and directors, as well as the managing underwriters in TippingPoint s initial public offering, were named as defendants in a purported class action lawsuit filed in the United States District Court for the Southern District of New York. The lawsuit, which is part of a consolidated action that includes over 300 similar actions, is captioned *In re Initial Public Offering Securities Litigation, Brian Levey vs. TippingPoint Technologies, Inc., et al.* (Civil Action Number 01-CV-10976). The principal allegation in the lawsuit is that the defendants participated in a scheme to manipulate the initial public offering and subsequent market price of TippingPoint s stock (and the stock of other public companies) by knowingly assisting the underwriters requirement that certain of their customers had to purchase stock in a specific initial public offering as a condition to being allocated shares in the initial public offerings of other companies. In relation to TippingPoint, the purported plaintiff class for the lawsuit is comprised of all persons who purchased TippingPoint stock from March 17, 2000 through December 6, 2000. The suit seeks rescission of the purchase prices paid by purchasers of shares of TippingPoint common stock. On September 10, 2002, TippingPoint s counsel and counsel for the plaintiffs entered into an agreement pursuant to which the plaintiffs dismissed, without prejudice, TippingPoint s former and current officers and directors from the lawsuit. In March 2009, TippingPoint signed a settlement agreement with the plaintiffs. On April 2, 2009, all the parties to the lawsuit (including all plaintiffs, issuers, and underwriters) filed settlement documents with the District Court. On June 10, 2009 the District Court issued its preliminary approval of the settlement and on September 10, 2009 held a Settlement Fairness Hearing. On October 6, 2009 the District Court approved the settlement in all substantive respects. Any direct financial impact of the settlement is expected to be borne by TippingPoint s insurers. The settlement remains subject to numerous conditions. If the settlement does not occur for any reason and the litigation against TippingPoint continues, we intend to defend this action vigorously, but cannot make any predictions about the outcome. To the extent necessary, we will seek indemnification and/or contribution from the underwriters in TippingPoint s initial public offering pursuant to its underwriting agreement with the underwriters. However, there can be no assurance that indemnification or contribution will be available to TippingPoint or enforceable against the underwriters.

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

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NOTE 16. SUBSEQUENT EVENT

Under special agreement with the tax authorities certain of our annual Chinese income tax filings for the calendar year ended December 31, 2008 were not filed until August 14, 2009, pending the resolution of the calendar 2008 applicable tax rate. Calendar year 2008 was the final year of certain tax concessions that our main operating company in China, Hangzhou H3C, was entitled to. The Company provided for taxes for calendar 2008 at a 15 percent rate (the rate that will be in effect on a go forward basis), however in July 2009 the Tax Bureau of Hangzhou Binjiang District notified the Company that we could use a tax rate of 9 percent for calendar 2008. This government approval occurred subsequent to the end of our China subsidiaries reporting period of June 30, 2009. Accordingly, it will be reflected in our China subsidiaries results for the reporting period of July 1, 2009 through September 30, 2009, which falls within our second fiscal quarter. The impact of this discrete income tax benefit will be approximately $11 million and will be reflected in our fiscal second quarter results.

The Company has evaluated subsequent events through October 6, 2009, which is the filing date of this report on Form 10-Q.

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

INTRODUCTION

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

BUSINESS OVERVIEW

We are a global enterprise networking solutions provider incorporated in Delaware. A pioneer in the computer networking industry, we have three global product and solutions brands H3C, 3Com, and TippingPoint that offer high-performance networking and security solutions to enterprises large and small. These organizations range across a number of vertical industries, including education, finance, government, healthcare, insurance, manufacturing and real estate. The H3C® enterprise networking portfolio one of the leading large enterprise networking equipment brands in China includes products that span from the data center to the edge of the network and is targeted at large enterprises. The 3Com® family of products offers a strong price/performance value proposition for small and medium businesses. Our TippingPoint® security brand features network-based intrusion prevention systems (IPS) and network access control (NAC) solutions, which deliver in-depth, no-compromise application, infrastructure and performance protection.

We believe our portfolio of products and services enables customers to deploy and manage business-critical voice, video, data and other advanced networking technologies in a secure, scalable, reliable and efficient network environment. We believe we offer customer-driven technology solutions that help enterprises optimize their budgets and resources, increase productivity, and realize their business goals. 3Com designs its solutions to offer customers a unique value proposition: lower total cost of ownership (TCO) and expert, responsive service. Our data center-to-edge enterprise networking solutions offer a common operating system to streamline system management, and are based on open standards to enable the use of best-of-breed applications from other vendors. We believe we offer a broad, fresh portfolio of products and solutions that disrupt the industry status quo and deliver true no-compromise networking.

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

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

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

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

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

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

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

Headquartered in Marlborough, Massachusetts, we have worldwide operations, including sales, marketing, research and

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

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

- Switches and routers;
- Other networking equipment;
- Security; and
- Services.

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

Business Environment and Future Trends

We operate today in a rapidly changing business environment due to the severe credit and adverse market conditions in many of the world s economies. The current global financial crisis has led to significant business slowdowns around the world. It is therefore increasingly difficult to predict future business conditions in the market for enterprise networking equipment. Our business is highly dependent on the Chinese economy, which has experienced strong growth in recent years. Our success in China has been due to the success of the direct-touch enterprise model, a mixture of core and new products and solution selling, and value creation for customers. While we believe that China may have been less affected than other regions by the global economic slowdown, it is now experiencing the effects of the downturn and our growth has slowed in China. It is difficult to predict the extent of the slowdown on our China business at this time. Additionally, we expect a continued significant reduction in sales to our largest customer, Huawei Technologies, during fiscal year 2010. For our operations outside of China, which we call Rest of World, we expect the challenging business environment to continue in the foreseeable future. In Rest of World, we are experiencing reduced demand for our products, delayed or cancelled purchases and longer sales cycles. Our Rest of World operations have been adversely impacted by the global economic crisis.

Our strategy to address these adverse business conditions is to market our solutions as providing exceptional quality for a good value and to remain competitive in the enterprise market. At the same time, we recognize that global spending on networking products and solutions is likely to continue to be under significant pressure for the foreseeable future. While the timing of a recovery is unclear we saw some stabilization in certain markets in our first quarter of fiscal 2010 and we strive to be well positioned when the recovery occurs.

Networking industry analysts and participants differ widely in their assessments concerning the prospects for mid to long-term industry growth, especially in light of the current weakness in many of the major global economies. Industry factors and trends also present significant challenges in the medium-term. Such factors and trends include intense competition in the market for higher end, enterprise core routing and switching products and aggressive product pricing by competitors targeted at gaining share in the small to medium-sized business market.

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

Technology Strategy

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

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Revenue and Market Share Goals

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

We intend to execute on three regional strategies as follows:

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

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

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

Developed global markets Our goal in developed markets is to increase our market share. Our strategy is to focus on large enterprise and government accounts and to implement this strategy we intend to increase go to market resources. We intend to offer these customers our comprehensive end to end solutions and highlight our products price to performance value proposition and energy efficiency. Our goal is to be well positioned for the economic recovery and in fact we saw some stabilization in certain markets in our first fiscal quarter of 2010.

Profitability and Cash Generation Objectives

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

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

Segment Reporting

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

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

Summary of Three Months Ended August 31, 2009 Financial Performance

Our sales in the three months ended August 31, 2009 were $290.5 million, compared to sales of $342.7 million in the three months ended August 31, 2008, a decrease of $52.2 million, or 15.2 percent.

Our gross margin improved to 57.3 percent in the three months ended August 31, 2009 from 55.3 percent in the three months ended August 31, 2008.

Our operating expenses (income) in the three months ended August 31, 2009 were $163.3 million, compared to $116.2 million in the three months ended August 31, 2008, a net increase of $47.1 million, or 40.5 percent. Included in the three months ended August 31, 2008 operating expenses (income) is $70.0 million of income related to the Realtek patent dispute resolution.

Our net income in the three months ended August 31, 2009 was $7.5 million, compared to net income of $79.8 million in the three months ended August 31, 2008. Included in the three months ended August 31, 2008 net income is $70.0 million of income related to the Realtek patent dispute resolution.

Our balance sheet contains cash and equivalents and short term investments of $665.8 million as of August 31, 2009, compared to cash and equivalents and short term investments of $644.2 million at the end of fiscal 2009. The balance sheet also includes debt of $200 million with $88 million classified as a current liability as of August 31, 2009 and $48 million classified as a current liability as of May 31, 2009.

CRITICAL ACCOUNTING POLICIES

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

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RESULTS OF OPERATIONS

THREE MONTHS ENDED AUGUST 31, 2009 AND 2008

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:

	Three Months Ended August 31,	
	2009	**2008**
Sales	100.0%	100.0%
Cost of sales	42.7	44.7
Gross profit margin	57.3	55.3
Operating expenses (income):		
Sales and marketing	29.1	25.5
Research and development	13.4	13.8
General and administrative	7.4	7.1
Amortization	5.9	7.3
Realtek patent resolution		(20.4)
Restructuring charges	0.4	0.6
Operating expenses, net	56.2	33.9
Operating income	1.1	21.4
Interest expense, net	(0.4)	(0.4)
Other income, net	4.0	3.8
Income before income taxes	4.7	24.8
Income tax provision	(2.1)	(1.5)
Net income	2.6%	23.3%

<u>Sales</u>

Consolidated sales for the three months ended August 31, 2009 and 2008 by segment were as follows (dollars in millions):

	Three Months Ended August 31,	
	2009	**2008**
China-based sales region	$ 152.0	$ 175.4
Rest of World sales region	107.2	140.3
TippingPoint security business	32.6	28.2
Eliminations and other	(1.3)	(1.2)
Consolidated sales	$ 290.5	$ 342.7

Sales in our China-based sales region decreased $23.4 million, or 13.3 percent, in the three months ended August 31, 2009 compared to the same period in the previous fiscal year. The decrease is primarily attributable to decreased sales to Huawei of $37.7 million as compared to the same quarter in the prior fiscal year, partially offset by an increase of $16.5 million of China direct-touch sales. The increase in direct-touch sales primarily relate to increased sales in our

WLAN products and growth in the finance and banking industries as well as the internet service provider industry. Sales in our Rest of World sales region segment decreased $33.1 million, or 23.6 percent, in the three months ended August 31, 2009 compared to the same period in the previous fiscal year. The decrease in sales in the three months ended August 31, 2009 is primarily attributable to decreased sales volume in all regions as we are experiencing longer sales cycles, delayed or cancelled purchases and reduced incoming orders because of the global economic downturn. Sales in our TippingPoint segment increased $4.4 million, or 15.6 percent, in the three months ended August 31, 2009 compared to the same period in the previous fiscal year. This increase is primarily attributable to increased maintenance revenue of $3.8 million due to an increased number of maintenance contracts and a higher maintenance renewal rate in the period.

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Consolidated revenues decreased by $52.2 million or 15.2 percent in the three months ended August 31, 2009 compared to the same period in the previous fiscal year. The decrease is primarily due to a decrease of $37.7 million in sales to Huawei. When compared to our fourth quarter of fiscal 2009, however, our first quarter of fiscal 2010 consolidated revenues decreased by 1.5 percent, reflecting some recent stabilization in certain markets we experienced in our first quarter of fiscal 2010.

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

	Three Months Ended August 31,			
	2009		2008	
Switches and routers	$195.2	67%	$254.2	74%
Other networking equipment	42.4	15%	41.1	12%
Security	41.1	14%	36.4	11%
Services	11.8	4%	11.0	3%
Total	$290.5	100%	$342.7	100%

Switches and routers revenue includes sales of our Layer 2 and Layer 3 stackable 10/100/1000 managed switching lines, our modular switching lines and routers. Sales of these products in the three months ended August 31, 2009 decreased $55.2 million, or 24.7 percent, from the same period in the previous fiscal year. The decrease in sales was primarily driven by decreased sales volume to Huawei as well as decreased volume in our other regions.

Other networking equipment revenue includes sales of our VCX and NBX® voice-over-internet protocol, or VoIP, IP storage, IP surveillance and our WLAN products. Sales of our other networking products in the three months ended August 31, 2009 remained essentially flat from the same period in the previous fiscal year.

Security revenue includes our TippingPoint products and services, as well as other security products, such as our embedded firewall, or EFW and virtual private network, or VPN, products. Sales of our security products in the three months ended August 31, 2009 increased $4.7 million, or 12.9 percent, from the same period in the previous fiscal year. The increase is primarily attributable to increased maintenance revenue of $3.8 million in our TippingPoint business due to an increased number of maintenance contracts and higher maintenance renewal rates in the period.

Services revenue includes professional services and maintenance contracts, excluding TippingPoint maintenance which is included in security revenue. Services revenue in the three months ended August 31, 2009 increased $0.8 million, or 7.3 percent, from the same period in the previous fiscal year. The increase was driven primarily by increased service sales tied to growth in our China direct-touch sales.

Gross Margin

Gross margin for the three months ended August 31, 2009 and 2008 by business were as follows:

	Three Months Ended August 31,	
	2009	2008
Networking business	55.2%	54.1%
TippingPoint security business	72.2%	69.4%
Consolidated margin	57.3%	55.3%

Gross margin in our Networking business improved 1.1 points to 55.2 percent in the three months ended August 31, 2009 from 54.1 percent in the same period in the previous fiscal year. The improvement in gross profit margin is primarily explained by a change of channel mix with the decline of the lower margin Huawei revenue.

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Gross margin in our TippingPoint Security business improved 2.8 points to 72.2 percent in the three months ended August 31, 2009 from 69.4 percent in the same period in the previous fiscal year. The improvement in gross profit margin is primarily explained by improved standard margins due to the recognition of previously deferred revenue as well as improved product mix of higher margin new security products.

Gross margin on a consolidated basis increased 2.0 points to 57.3 percent in the three months ended August 31, 2009 from 55.3 percent in the same period in the previous fiscal year. This increase is mainly due to the items discussed above.

Operating Expenses (Income)

	Three Months Ended August 31,		Change	
(Dollars in millions, except percentages)	2009	2008	$	%
Sales and marketing	$ 84.8	$ 87.5	$ (2.7)	(3)%
Research and development	38.9	47.1	(8.2)	(17)%
General and administrative	21.4	24.4	(3.0)	(12)%
Amortization	17.1	25.2	(8.1)	(32)%
Patent dispute resolution		(70.0)	70.0	*
Restructuring charges, net	1.1	2.0	(0.9)	(45)%
Operating expenses, net	$ 163.3	$ 116.2	$ 47.1	(41)%

* *percentage calculation not meaningful.*

Sales and Marketing

The most significant factor in the decrease in the three months ended August 31, 2009 compared to the same period in fiscal 2009 was decreased headcount as part of our restructuring efforts, partially offset by increased agent commissions on higher China direct-touch sales.

Research and Development

The most significant factor contributing to the decrease in the three months ended August 31, 2009 compared to the same period in fiscal 2009 was continued savings from integration and consolidation of our Networking research and development to China.

General and Administrative

The most significant factor in the decrease in the three months ended August 31, 2009 compared to the same period in fiscal 2009 was lower compensation charges due to headcount reductions and lower discretionary spending, specifically in travel and entertainment.

Amortization of Intangible Assets

Amortization of intangible assets decreased $8.1 million in the three months ended August 31, 2009 when compared to the previous fiscal year due primarily to our Huawei non-compete agreement becoming fully amortized during fiscal 2009.

Patent Dispute Resolution

The Company and Realtek Group reached an agreement with respect to certain networking technologies of the Company that resolved a long-standing patent dispute between the companies. Under the terms of the agreement, Realtek paid the Company $70.0 million, all of which was received in the three months ended August 31, 2008. The Company recognized the full $70.0 million as operating income in the first quarter of fiscal 2009.

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Restructuring Charges

Restructuring charges in the three months ended August 31, 2009 included $1.0 million for severance and outplacement costs and a $0.1 million charge for other restructuring costs primarily related to the change in our sales force as we transition to more enterprise business.

Restructuring charges in the three months ended August 31, 2008 included $1.9 million for severance and outplacement costs and a $0.1 million benefit for facilities-related and other restructuring charges primarily related to a decrease in headcount of research and development employees as the Company eliminated duplicate testing activities.

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

Interest Expense, Net

In the three months ended August 31, 2009, the Company incurred $1.1 million in net interest expense, compared to net interest expense of $1.3 million in the same period of the prior fiscal year. The decrease in net interest expense is primarily due to decreased interest income due to lower interest rates as well as due to a lower LIBOR rate on the Company s H3C loan during the first quarter of fiscal 2010 as compared to the same period in the previous fiscal year.

Other Income, Net

Other income, net was $11.5 million in the three months ended August 31, 2009, a decrease of $1.3 million compared to the three months ended August 31, 2008. The decrease was primarily due to a decrease in foreign currency gains. Included in other income, net is an operating subsidy program by the Chinese VAT authorities in the form of a partial refund of VAT taxes collected by our China-based sales region from purchasers of software products. The subsidy payments are taken into income on a cash basis. The timing of the receipt, and the continuation of the program, are subject to the discretion of the Chinese VAT authorities. This program is scheduled to terminate on December 31, 2010.

Income Tax Provision

Our income tax provision was $6.2 million for the three months ended August 31, 2009, an increase of $1.1 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 the prevailing statutory tax rates.

See footnote 16 Subsequent Event for discussion of the finalization of the calendar year 2008 China tax rate.

Segment Analysis (tables in thousands)

In the first quarter of fiscal 2010, we changed the measures of segment profit and segment income to align to how we currently manage our business and report internally. Accordingly, our previously reported segment information has been revised to reflect our new measures of segment profit and segment income. The results of our regional Networking segments, Central Functions, and our TippingPoint Security business as our CODM reviews their profitability are presented below.

China-based sales region:

	Three months ended August 31,	
	2009	2008
Sales	$ 152,013	$ 175,397
Standard margin	104,900	115,527
Direct sales and marketing expenses	35,039	33,600
Segment contribution profit	$ 69,861	$ 81,927

Segment contribution profit in the three months ended August 31, 2009 decreased $12.1 million to $69.9 million when compared to the same period of the prior fiscal year. Segment contribution profit is standard profit less segment direct sales and marketing expenses. The decrease in segment contribution profit was primarily driven by decreased sales to Huawei of $37.7 million partially offset by increased direct-touch sales of $16.5 million and improved channel mix, particularly decreased lower margin Huawei sales.

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Rest of World sales region:

	Three months ended August 31,	
	2009	2008
Sales	$ 107,202	$ 140,314
Standard margin	62,995	82,253
Direct sales and marketing expenses	23,327	28,152
Segment contribution profit	$ 39,668	$ 54,101

Segment contribution profit in the three months ended August 31, 2009 decreased $14.4 million to $39.7 million when compared to the same period of the prior fiscal year. Segment contribution profit is standard profit less segment direct sales and marketing expenses. The decrease primarily relates to decreased sales in all regions due primarily to decreased volume as we are experiencing longer sales cycles, delayed or cancelled purchases and reduced incoming orders because of the global economic downturn, partially offset by lower sales and marketing expenses.

Central Functions:

	Three months ended August 31,	
	2009	2008
Research and development expenses	$ 32,177	$ 39,317
Other operating expenses	56,047	60,022
Total cost and expenses	$ 88,224	$ 99,339

Total costs and expenses in the three months ended August 31, 2009 decreased $11.1 million to $88.2 million when compared to the same period of the prior fiscal year. Other operating expenses include supply chain costs, general and administrative costs and central marketing costs excluding those included in Eliminations and Other. The decrease was primarily related to continued savings from integration of research and development, lower compensation charges due to headcount reductions and lower discretionary spending, specifically in travel and entertainment.

TippingPoint Security business:

	Three months ended August 31,	
	2009	2008
Sales	$ 32,596	$ 28,199
Standard margin	27,772	23,396
Direct sales and marketing expenses	11,028	10,073
Segment contribution profit	16,744	13,323
Research and development expenses	6,315	6,946
Segment income	$ 10,429	$ 6,377

TippingPoint segment income in the three months ended August 31, 2009 increased $4.1 million to $10.4 million when compared to the same period of the prior fiscal year. Segment income is standard margin less direct sales and marketing and research and development expenses, excluding those included in Eliminations and Other. The increase was due primarily to higher standard margins due to the recognition of previously deferred revenue as well as improved product mix of higher margin new security products and an increased number of maintenance contracts in the current period.

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LIQUIDITY AND CAPITAL RESOURCES

Cash and equivalents and short-term investments as of August 31, 2009 were $665.8 million, an increase of $21.6 million compared to the balance of $644.2 million as of May 31, 2009. These balances were comprised of the following (in millions):

	August 31, 2009	May 31, 2009
Cash and equivalents	$ 625.9	$ 545.8
Short-term investments	39.9	98.4
Cash and equivalents and short term investments	$ 665.8	$ 644.2

The following table shows the major components of our condensed consolidated statements of cash flows for the three months ended August 31, 2009 and 2008 (in millions):

	Three Months Ended August 31, 2009	2008
Cash and equivalents, beginning of period	$ 545.8	$ 503.6
Net cash provided by operating activities	16.9	39.3
Net cash provided by (used in) investing activities	55.7	(7.5)
Net cash provided by (used in) financing activities	6.4	(0.3)
Effect of exchange rate changes on cash	1.1	6.3
Cash and equivalents, end of period	$ 625.9	$ 541.4

Net cash provided by operating activities was $16.9 million for the three months ended August 31, 2009 compared to $39.3 million in the three months ended August 31, 2008. The decrease was primarily due to a decrease in net income of $72.4 million and $48 million of payments under the Equity Appreciation Rights Plan (EARP) and long term incentives in China, partially offset by improvements in working capital, specifically accounts and notes receivable and inventories as compared to the same quarter last year.

In the current quarter, accounts receivable decreased in China as the Huawei sales decreased and in the first quarter of fiscal 2009 accounts and notes receivable and inventories both increased due to significant sales increases in the first and second quarters of fiscal 2009.

Net cash provided by investing activities was $55.7 million for the three months ended August 31, 2009, consisting primarily of $58.7 million of proceeds from the sale of short-term investments, partially offset by net outflows related to purchases of property and equipment of $3.0 million. The majority of capital expenditures were information technology related.

Net cash provided by financing activities was $6.4 million in the three months ended August 31, 2009. During the three months ended August 31, 2009, we had proceeds of $7.6 million from issuances of our common stock upon exercise of stock options, partially offset by $1.2 million of repurchases of shares of restricted stock awards and units upon vesting from employees, including those shares to satisfy the tax withholding obligations that arise in connection with such vesting.

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

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

Calendar Year	3Com Fiscal Year	Tranche A	Tranche B
2010	2011	46,000	2,000
2011	2012		20,000
2012	2013		44,000

On September 28, 2009 our applicable LIBOR rates reset to 0.64 percent and the effective interest rate for the next six months will be 2.14 percent for the Tranche A Term Facility and 3.64 percent for the Tranche B Term Facility.

As of August 31, 2009, bank-issued standby letters of credit and guarantees totaled $7.1 million, including $6.1 million relating to potential foreign tax, custom, and duty assessments. We provide the bank with cash collateral for 100 percent of these amounts.

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

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

In recent years, we have generated most of our positive cash flow from our China operations. Our capital requirements in Rest of World have been met from cash flow from operations as well as from existing cash balances and permitted dividends from China. Dividends from our China operations to our Rest of World operations are generally subject to the following restrictions: (1) a 10 percent reserve requirement imposed by PRC law (capped at 50% of registered capital), which was $43.9 million at August 31, 2009), (2) a 5% withholding tax imposed by the PRC on profits earned on or after January 1, 2008 and (3) a credit agreement restriction limiting our ability to dividend cash outside of the H3C Group and requiring that a specified percentage of excess cash flow from China be annually used to prepay debt. There are also administrative requirements for making dividends out of China that involve filings with government agencies seeking approval to pay a dividend. Government officials can dictate when we can pay a dividend and can specify specific terms or conditions for making the payment. As of June 30, 2009 the H3C Group s net assets were $858.5 million and are subject to these dividend restrictions.

An important exception to the credit agreement restriction permits us to annually dividend from China to Rest of World the percentage of H3C s excess cash flow that is not required to be prepaid to the banks under the terms of the agreement, provided that certain conditions are met. In the three months ended August 31, 2009 we used this exception and made dividend payments of $155.0 million. No dividends were made to our parent company. We have no prepayment penalty on our loan and at this time our cash and cash equivalents balances significantly exceed our outstanding principal loan balance.

In Rest of World we currently do not generate positive cash flow and are experiencing adverse impacts from the global economic slowdown. As a result of these factors, we intend to more aggressively and prudently manage cash and monitor discretionary cash spending, especially in periods prior to receipt of any available and permitted annual dividend payments from China.

On May 25, 2007, our subsidiary H3C Holdings Limited (Borrower) entered into an amended and restated credit agreement with various lenders, including Goldman Sachs Credit Partners L.P., as Mandated Lead Arranger, Bookrunner, Administrative Agent and Syndication Agent, and Industrial and Commercial Bank of China (Asia) Limited, as Collateral Agent (the Credit Agreement). Under the original credit agreement, the Borrower borrowed $430 million in the form of a senior secured term loan with two tranches (Tranche A and Tranche B) to finance a portion of the purchase price for 3Com s acquisition of 49 percent of H3C Technologies Co., Limited, or H3C. Remaining principal is $200 million as of May 31, 2009 and the final loan maturity date is on September 28, 2012. Interest on borrowings is payable semi-annually on March 28 and September 28. All amounts outstanding under the Tranche A Term Facility will bear interest, at the Borrower s option, at the (i) LIBOR, or (ii) Base Rate (i.e., prime rate), in each case plus the applicable margin percentage set forth in the table below, which is based on a leverage ratio of consolidated indebtedness of the Borrower and its subsidiaries to EBITDA (as defined in the Credit Agreement) for the relevant twelve-month period:

Leverage Ratio	LIBOR +	Base Rate +
>3.0:10	2.25%	1.25%
≤3.0:1.0 but > 2.0:1.0	2.00%	1.00%
≤2.0:1.0 but > 1.0:1.0	1.75%	0.75%
≤1.0:1.0	1.50%	0.50%

All amounts outstanding under the Tranche B Term Facility will bear interest, at the Borrower s option, at the (i) LIBOR plus 3 percent or (ii) Base Rate (i.e., prime rate) plus 2 percent. We have elected to use LIBOR as the reference rate for borrowings to date, and expect to do so for the foreseeable future. Applicable LIBOR rates at August 31, 2009 were 1.79 percent and the effective interest rate is currently 3.29 percent for the Tranche A Term Facility and 4.79 percent for the Tranche B Term Facility.

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

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

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

The final cash payment requirement under the H3C EARP is expected to occur in the spring of calendar 2010 in the amount of approximately $10 million.

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

EFFECTS OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141R, Business Combinations (SFAS 141R) to improve reporting and to create greater consistency in the accounting and financial reporting of business combinations. The standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS No. 141R amends SFAS 109, Accounting for Income Taxes , such that adjustments made to valuation allowances on deferred income taxes and acquired income tax contingencies associated with acquisitions that closed prior to the effective date of SFAS No. 141R would apply the provisions of SFAS No. 141R. The Company adopted SFAS 141R on May 30, 2009. Since we have had no acquisition activity the adoption of SFAS 141R has not had a material impact on our consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements to improve the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report noncontrolling (minority) interests in subsidiaries in the same way as required in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring that they be treated as equity transactions. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of SFAS No. 160 has not had a material impact on our consolidated financial position, results of operations or cash flows.

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In February 2008, the FASB issued FASB Staff Position No. SFAS 157-2, Effective Date of FASB Statement No. 157 , which provides a one-year deferral of the effective date of FAS No. 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Effective June 1, 2008, we adopted the provisions of SFAS No. 157 with respect to our financial assets and liabilities recorded at fair value, which had no material impact on our consolidated financial position, results of operations or cash flow. Effective May 30, 2009, we adopted the portion of SFAS No. 157, for which the implementation had been deferred, which had no material impact on our consolidated financial position, results of operations or cash flow. Under SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159), entities are permitted to choose to measure many financial instruments and certain other items at fair value that previously were not required to be measured at fair value. We did not elect the fair value measurement option under SFAS No. 159 for any of these financial assets or liabilities.

In April 2008, the FASB issued FASB Staff Position (FSP) FAS No. 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS No. 142-3). FSP FAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS No. 142, Goodwill and Other Intangible Assets (FAS No. 142). The intent of FSP FAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under FAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under FAS No. 141R Business Combinations , and other accounting principles generally accepted in the United States of America. FSP FAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FSP FAS No. 142-3 has not had a material impact on our consolidated financial position, results of operations or cash flow.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which became effective in 2009 via retrospective application. Under the FSP, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The company adopted the FSP on May 30, 2009. The impact of adopting the FSP had no material effect on basic or diluted EPS for the three months ended August 31, 2009 or 2008.

In May 2009, the FASB issued FASB Statement No. 165, Subsequent Events (SFAS 165). SFAS 165 intends to establish general standards of accounting for and disclosures of subsequent events that occurred after the balance sheet date but prior to the issuance of financial statements. SFAS 165 is effective for financial statements issued for interim or fiscal years ending after June 15, 2009. The adoption of SFAS 165 did not have a significant impact on our financial position, results of operations or cash flows.

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162 (the Codification) . The Codification, which was launched on July 1, 2009, became the single source of authoritative non-governmental U.S. generally accepted accounting principles (GAAP), superseding various existing authoritative accounting pronouncements. The Codification eliminates the GAAP hierarchy contained in Statement 162 and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We will adopt the Codification in the second quarter of fiscal 2010. There will be no change to our consolidated financial statements due to the implementation of the Codification other than changes in reference to various authoritative accounting pronouncements in our consolidated financial statements.

On September 23, 2009, the FASB reached a consensus on two new pronouncements; EITF No. 08-1, Revenue Arrangements with Multiple Deliverables (previously titled, Revenue Recognition for a Single Unit of Accounting) and EITF No. 09-3, Applicability of Statement of Position 97-2 to Certain Arrangements That Include Software Elements . These new pronouncements are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted only at the beginning of the company s fiscal year 2011. The Company is currently evaluating the impact that adoption of these EITFs will have on its consolidated financial statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity. Interest to be paid by us on our senior secured loan is at an interest rate based, at our option, on either the LIBOR or the prime rate, plus an applicable margin. We expect the base interest rate generally to be based on the published LIBOR rate, which is subject to change on a periodic basis. Recently, interest rates have trended downwards in major global financial markets, stabilizing at relatively low levels over the past few months. If these interest rate trends were to reverse, this will result in increased interest expense as a result of higher LIBOR rates. We believe a ten percent increase in LIBOR would not have a material effect on our financial position or results of operations. Continued increases beyond ten percent 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.

Foreign Currency Exchange Risk. A significant portion of our sales and a portion of our costs are denominated in Renminbi, the Chinese currency. At the same time, our senior secured bank loan which we intend to service and repay primarily through cash flow from H3C s PRC operations is denominated in US dollars. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The Renminbi could appreciate or depreciate relative to the U.S. dollar. Any movement of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position, and may make it more difficult for us to service our U.S. dollar-denominated senior secured bank loan. More specifically, if the Renminbi appreciates in value as compared with the U.S. dollar, our reported revenues will derive a beneficial increase due to currency translation; and if the Renminbi depreciates, our revenues will suffer due to such depreciation. This currency translation impacts our expenses as well, but to a lesser degree.

Outside of China, most of our sales are invoiced and collected in US dollars, while selling and administrative expenses are incurred in local currency. A depreciation of the US dollar will result in higher selling and administrative expenses outside of the United States, while an appreciation of the US dollar will reduce the reported selling and administrative expenses. With the exception of China, changes in currency valuations should not have a significant impact on our revenue or margin. We believe that a sudden or significant change in foreign exchange rates would not have a material impact on future net income or cash flows other than with respect to the Chinese Renminbi.

ITEM 4. CONTROLS AND PROCEDURES

Our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Form 10-Q pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of August 28, 2009, our disclosure controls and procedures were effective.

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

There have been no changes in our internal control over financial reporting that occurred during the three months ended August 28, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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ITEM 1A. RISK FACTORS

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

Risk Related to Current Severe Global Economic Conditions and Related Credit Crisis

Our Operating Results Have Been Adversely Affected by Current Unfavorable Economic and Credit Conditions in Many Regions of the World and We May Continue to Experience These Conditions.

The business conditions in which we operate are subject to rapid and unpredictable change due to the global economic crisis. Many of the world s economies are in turmoil and severe recession. Very tight credit conditions have made it harder for businesses to access needed capital. These factors have contributed to significant slowdowns in the technology industry in general, and in many of the specific markets and geographies in which we operate, resulting in:

- reduced demand for our products in many regions as a result of constraints on information technology-related capital spending by our customers;
- risk of excess and obsolete inventories;
- longer sales cycles;
- delayed and/or cancelled purchases due to factors such as tight credit conditions and unfavorable local currency translation (noting that we denominate sales in USD in most locations outside of China); and
- risk of longer cash cycles as customers take longer to pay us for products and services and some customers deal with insolvency issues.

Our business is heavily dependent on China, a country whose historic strong growth rates have slowed significantly over the last year. In addition, the challenges we have seen in the developed world largely continue. The worldwide slowdown is also impacting many countries in other geographies in which we operate.

We cannot predict the duration or severity of the current global economic crisis, and we cannot know the ultimate extent of its impact on our industry. These factors make it more challenging to predict our future performance. If global economic and credit conditions in the major regions in which we operate, particularly in China, persist, spread, or deteriorate further, or if we cannot respond with strategies that maximize our ability to perform in this challenging business environment, we may continue to experience a material and negative impact on our business, operating results and financial condition.

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

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

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

- declining sales in certain regions;
- operating expenses that, as a percentage of sales, have exceeded our desired financial model;
- significant senior leadership and other management changes;
- significant non-cash accounting charges;
- increased sales and marketing expense as part of a strategy to help grow our market share; and
- disruptions and expenses resulting from our workforce reductions and employee attrition.

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To sustain and increase our profitability, we must maintain or increase our sales, and if we cannot do that, we may need to further reduce costs. As we have implemented significant cost reduction programs over the last several years, it may be difficult to make significant further cost reductions without in turn impacting our sales. In addition, we may choose to reinvest some or all of any realized cost savings in future growth opportunities. Any of these events or occurrences will likely cause our expense levels to continue to be at levels above our desired model.
If we cannot overcome these challenges, reduce our expenses and/or increase our revenue, we may not be able to sustain and increase our profitability.
Our indebtedness could adversely affect our financial condition and ability to grow our business.
We now have, and for the foreseeable future will continue to have, a significant amount of indebtedness. As of August 28, 2009, our total debt balance was $200 million, of which $88 million is classified as a current liability.
While we currently have cash and cash equivalents in excess of our total borrowings, our indebtedness could have significant negative consequences to us. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to obtain additional financing;
- require the dedication of a substantial portion of our cash flow from operations to satisfy debt obligations, reducing the availability of capital to finance operations and growth;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry; and
- place us at a competitive disadvantage relative to our competitors with less debt.

Covenants in the agreements governing our senior secured loan materially restrict our H3C subsidiary s operations based in China, including H3C s ability to incur debt, pay dividends, make certain investments and payments, make acquisitions of other businesses and encumber or dispose of assets. In addition, in the event H3C s financial results do not meet our plans, the failure to comply with the financial covenants contained in the loan agreements could lead to a default. An event of default, if not cured or waived, could have a material adverse effect on us because the lenders will be able to accelerate all outstanding amounts under the loan or foreclose on the collateral (which consists primarily of our H3C business). In addition, if the LIBOR rate increases, our interest obligations, which are based on LIBOR, will increase. Our interest obligations are also dependent on our H3C group leverage ratio, as defined under the credit agreement; if the ratio increases above specified levels (i.e., because H3C financial results decrease), our interest obligations will increase. Any of these actions could result in a material adverse effect on our business and financial condition.
In recent years, we have generated most of our positive cash flow from operations from our China business, and our operations outside of China have been mostly cash flow negative. The credit agreement limits our ability to dividend cash outside of China (i.e., outside of the H3C group) and requires that a substantial portion of H3C s cash flow be used to pay down debt obligations. Accordingly, we cannot use cash generated in China to fund our operations outside of China (except under certain conditions we are permitted to dividend outside of China a portion of H3C s annual excess cash flow (as defined by the credit agreement)). Because available and permitted dividends under the credit agreement are determined by H3C s consolidated excess cash flow and leverage ratio (as defined under the Credit Agreement), if H3C s results decrease, the permitted dividends, if any, we can make to our operations outside of China will likely decrease. If we do not generate or maintain appropriate cash on hand on a worldwide basis to finance operations and make investments where needed or desired, our business results and growth objectives may suffer; in particular, our cash balances outside of China could fall below our desired levels, particularly if we do not meet the conditions necessary to dividend cash up from China.

Risks Related to China-based Sales region and Dependence Thereon

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

For the fiscal quarter ended August 28, 2009, our China-based sales region was profitable, accounted for approximately 52 percent of our consolidated revenue and generated the majority of our positive cash flow from operations. Our China-based sales region is subject to specific risks relating to its ability to:

- maintain a leading position in the networking equipment market in China;
- develop and execute strategies to operate successfully in the current global economic downturn, which has negatively impacted the Chinese economy;
- build profitable operations in other emerging markets throughout the world, but particularly in the Asia Pacific region;
- offer new and innovative products and services to attract and retain a larger customer base;
- increase awareness of the H3C brand and continue to develop customer loyalty;
- respond to rapidly changing competitive market conditions;
- respond to changes in the regulatory environment;
- manage risks associated with intellectual property rights;
- maintain effective control of costs and expenses; and
- attract, retain and motivate qualified personnel.

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

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

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

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

We historically have and currently derive a material portion of our sales from Huawei, which formerly held a significant investment in our H3C subsidiary. In the three months ended August 28, 2009, which includes results from our China-based sales region s June 30, 2009 quarter, Huawei accounted for approximately 19 percent of the revenue for our China-based sales region and approximately 10 percent of our consolidated revenue. Huawei s percentage of our China-based sales region s revenues has been trending downward from 46 percent during the 3 months ended November 30, 2006, to the current level. This decrease has recently begun to accelerate. We expect Huawei to continue to reduce its business with us and we believe that its purchases in absolute dollars will likely continue to decrease significantly. Huawei does not have any minimum purchase requirements under our existing OEM agreement, which expires in November 2010. We believe Huawei has begun to sell, and likely will continue to sell, internally-developed networking equipment with respect to some of the products it formerly purchased from us. We further believe Huawei also has access to other networking equipment vendors that sell products comparable to our solutions. If and to the extent any of these events occur and/or continue, it will likely have an adverse impact on our sales and business performance. In order to minimize any adverse impact on our results from any decreased sales to Huawei, we need to successfully execute on our business strategies including, without limitation, increasing direct touch sales of networking products inside and outside of China. If we are not successful in these efforts, the risks described above, including adverse impacts to our financial results, may be heightened.

Risk Related to Core Business Strategy

If we cannot increase our enterprise account business outside of China, leveraging China as our home market, we likely will not reach our growth and profitability goals.

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

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

Increasing our enterprise business will likely require a greater investment in sales and marketing, as well as the provision and maintenance of a global service organization that can respond to these customers. The sales cycle is generally longer for enterprise accounts (possibly yielding uneven and unpredictable revenue from quarter to quarter) when compared to our small-and-medium-size business. We also expect intense competition from larger industry participants, many of whom possess a significantly larger market share and installed base than us. We will also need to be perceived by decision making officers of large enterprises as committed for the long-term to the high-end networking business. We will also need to compete favorably on the offering of features and functionality that these enterprise customers demand; if our competitors are more effective at such efforts our ability to convert pipeline opportunities into sales will suffer. We seek to develop and expand the global channel for our H3C product portfolio, in particular outside of China. Our push to further expand sales to large enterprises may be disruptive in a variety of ways, including the risk our increased direct-touch sales efforts are perceived by existing channel partners as competitive or viewed by market participants as indicating a diminished focus on the small-and-medium business market. We will need to maintain an infrastructure that permits us to effectively document, process, manage, ship and account for these larger transactions. To gain market share, our global branding strategy (H3C for enterprise, 3Com for small-and-medium business and TippingPoint for security solutions) must be positively received by our customers, potential customers and channel partners. This strategy is relatively new. Finally, our recent increased efforts in marketing, public relations and investor relations involve risks such as management diversion and additional expense; it is possible these efforts may not prove successful.

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

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

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Risk Related to Personnel

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

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

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

Risks Related to Competition

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

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

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

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

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

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

As Huawei expands its operations, offerings and markets, there could be increasing instances where we compete directly with Huawei in the enterprise networking market. As a significant customer of our China-based segment, Huawei has had, and continues to have, access to H3C products for resale. This access enhances Huawei s current ability to compete directly with us both in China and in the rest of the world. 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 products recently expired. Accordingly, we risk increased competition from enterprise products that Huawei internally develops and markets or sources from our equipment manufacturer competitors. Huawei has historically sold our networking products to carrier customers (who purchase for themselves and their own enterprise customers). We believe Huawei has begun to sell internally developed products to meet carrier demand for these products and it is possible Huawei may also use these products to market and sell more directly to enterprise customers in the future. We also sell carrier class products in China through our direct-touch sales force in competition with Huawei and other carrier market equipment providers.

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

Risks Related to Business and Technology Strategy

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

Our success depends on our ability to:

- identify new market and product opportunities;
- predict which technologies and markets will see declining demand;
- develop and introduce new products and solutions (and new features and functionality for existing products and solutions) in a timely manner;
- gain market acceptance of new products and solutions; and
- rapidly and efficiently transition our customers from older to newer enterprise networking technologies.

Accordingly, our business will likely suffer if:

- there is a delay in introducing new products, features or functionality;
- we lose key channel partners;
- our products do not satisfy customers in terms of features, functionality or quality; or
- our products cost more to produce than we expect.

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

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

Risks Related to Operations and Distribution Channels

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

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

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

We distribute many of our products through two-tier distribution channels that include distributors and VARs. In some instances, we also use a system integrator. A significant portion of our sales is concentrated among a few distributors; our two largest distributors accounted for a combined 18 percent of our consolidated revenue for the three months ended August 28, 2009. If either of these distributors reduces its business with us, our sales and overall results of operations could be adversely affected.

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

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

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

- our ability to accurately forecast demand for our products and services;
- our reliance on, and long-term arrangements with, third-party manufacturers (which places much of the supply chain process out of our direct control, heightens the need for accurate forecasting and reduces our ability to transition quickly to alternative supply chain strategies); and
- our ability to minimize disruptions to our logistics and effectively manage disruptions that do occur.

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

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

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

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

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

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

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

- the promulgation of new laws and regulations and the interpretation of those laws and regulations;
- enforcement and application of rules and regulations by the Chinese government;
- the introduction of measures to control growth or inflation or stimulate growth;
- any actions that limit our ability to develop, manufacture, import or sell our products in China, or export our products outside of China, or to finance and operate our business in China; or
- laws, rules or regulations that negatively impact our ability to pay dividends from China to outside of China, or impose restrictions (including conditions or timing restrictions) or additional taxes on such dividends.

Due to our dependence on China, if China were to experience a broad and prolonged economic slowdown or period of political or social unrest, our results of operations would likely suffer. China has been adversely impacted by the global economic slowdown, and government efforts to restore growth rates may not be effective. The Chinese government has also from time-to-time 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.

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

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

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

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

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

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

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

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

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

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

Approximately 50 percent of our sales and a portion of our costs are denominated in Renminbi, the Chinese currency. At the same time, our senior secured bank loan which we intend to service and repay primarily through cash flow from our China-based operations is denominated in U.S. dollars. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The Renminbi could appreciate or depreciate relative to the U.S. dollar. Any movement of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position, and may make it more difficult for us to service our U.S. dollar-denominated senior secured bank loan. More specifically, if the Renminbi appreciates in value as compared with the U.S. dollar, our reported revenues will derive a beneficial increase due to currency translation; and if the Renminbi depreciates, our revenues will suffer due to such depreciation. This currency translation impacts our expenses as well, but to a lesser degree. In some of our historical periods, we have benefited from the currency translation of Renminbi, but our results may in the future be harmed by it.

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

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

Risks Related to Intellectual Property

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

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

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

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

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

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

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

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

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

Many of our networking products use open source software, or OSS, licenses. Because OSS is often compiled from multiple components developed by numerous independent parties and usually comes as is and without indemnification, OSS is more vulnerable to third party intellectual property infringement claims. Some of the more prominent OSS licenses, such as the GNU General Public License, are the subject of litigation. It is possible that a court could hold such licenses to be unenforceable or someone could assert a claim for proprietary rights in a program developed and distributed under them. Any ruling by a court that these licenses are not enforceable or that open source components of our product offerings may not be liberally copied, modified or distributed may have the effect of preventing us from selling or developing all or a portion of our products. If any of the foregoing occurred, it could cause a material adverse impact on our business.

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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;
- our ability to execute on our strategic plan, including our core business strategy to emphasize larger enterprise and government account business;
- general economic conditions, such as the current global economic crisis;
- variations between our actual financial results and published analysts expectations; and
- announcements by our competitors, and announcements by, sales to or loss of significant customers.

Over the past several years, the stock market has experienced significant price and volume fluctuations that have affected the stock prices of many technology companies. These factors, as well as general economic and political conditions or investors concerns regarding the credibility of corporate financial statements and the accounting profession, may have a material adverse affect on the market price of our stock in the future. For example, many companies have recently experienced sharp decreases and/or downward pressure on their stock prices as a result of the current global economic downturn.

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

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

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

The following table summarizes repurchases of our stock, including shares returned to satisfy employee tax withholding obligations, in the three months ended August 31, 2009:

	Total Number of Shares	Average Price Paid	Total Number of Shares Purchased as Part of Publicly Announced Plans or	Approximate Dollar Value of Shares that May yet Be Purchased Under the

Period	Purchased	per Share	Programs(1)	Plans or Programs (2)
May 30, 2009 through June 26, 2009	2,199(3)	$4.87		$ 50,046,813
June 27, 2009 through July 24, 2009	54,986(3)	4.79		50,046,813
July 25, 2009 through August 28, 2009	240,579(3)	3.91		50,046,813
Total	297,764	$4.08		$ 50,046,813

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(1) On September 24, 2008, our Board of Directors approved a stock repurchase program providing for repurchases of up to $100.0 million through September 23, 2009.

(2) Program expired on September 23, 2009.

(3) Consists of shares surrendered to us to satisfy tax withholding obligations that arose upon the vesting of restricted stock awards and units of 2,199 in June 2009, 54,986 in July 2009 and 240,579 in August 2009.

ITEM 6. EXHIBITS

		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
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	10-Q	002-92053	2.11	4/4/00	

	Palm, Inc.					
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 Shenzen Huawei Investment & Holding Co., Ltd., dated as of October 28, 2005	8-K/A	000-12867	2.1	3/30/06	
2.5	Stock Purchase Agreement by and between Shenzhen Huawei Investment & Holding Co., Ltd. and 3Com Technologies, dated as of December 22, 2006	8-K	000-12867	10.1	12/27/06	
2.6	Agreement and Plan of Merger by and among 3Com Corporation, Diamond II Holdings Inc. and Diamond II Acquisition Corp., dated September 28, 2007	8-K/A	000-12867	2.1	9/28/07	
3.1	Amended and Restated Certificate of Incorporation filed with the Secretary of State of the State of Delaware on September 23, 2009	8-K	000-12867	3.1	9/24/09	
3.2	Registrant s Bylaws, as amended on December 10, 2008	8-K	000-12867	3.1	12/16/08	
4.1	Third Amended and Restated Preferred Shares Rights Agreement, dated as of November 4, 2002 (Rights Agreement)	8-A/A	000-12867	4.1	11/27/02	
4.2	Amendment No. 1 to Rights Agreement, dated as of September 28, 2007	8-K/A	000-12867	4.1	9/28/07	
10.1	Form of Performance-Based Restricted Stock Unit Agreement 2003 Stock Plan*					X
10.2	3Bonus Plan for Executive Officers (approved July 7, 2009)*					X
10.3	Employment Agreement, signed on July 20, 2009 and effective as of April 27, 2009, by and between Hangzhou H3C Technologies Co., Ltd. And Dr. Shusheng Zheng*	8-K	000-12867	10.1	7/20/09	
10.4	Amended and Restated Office Lease made and entered into as of the 1st day of June, 2009, by and between Bel Marlborough I LLC, a Delaware limited liability company,	8-K	000-12867	10.1	6/10/09	

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		Incorporated by Reference				
Exhibit Number	**Exhibit Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
	having an office at c/o Eaton Vance Management, 2 International Place, Boston, Massachusetts 02110 as landlord and 3Com Corporation, a Delaware corporation having an office at 350 Campus Drive, Marlborough, Massachusetts 01752 as tenant					
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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	3Com Corporation (Registrant)
Dated: October 6, 2009	By: /s/ Jay Zager Jay Zager Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer and a duly authorized officer of the registrant)

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EXHIBIT INDEX

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		Incorporated by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Exhibit	Filing Date	Filed Herewith
	Marlborough, Massachusetts 01752 as tenant					
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