3COM CORP
Form 10-Q/A
January 17, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

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

For the Quarterly Period Ended August 30, 2002

OR

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

For the transition period from _____________ to _____________

Commission File No. 0-12867

3Com Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**94-2605794** (I.R.S. Employer Identification No.)
5500 Great America Parkway **Santa Clara, California** (Address of principal executive offices)	**95052** (Zip Code)

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

Former name, former address and former fiscal year, if changed since last report:
5400 Bayfront Plaza, Santa Clara, California, 95052

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

Yes ý No o

As of October 1, 2002, 367,548,579 shares of the Registrant's Common Stock were outstanding.

This report contains a total of 44 pages of which this page is number 1.

Explanatory Note

This Form 10-Q/A amends the Registrant's quarterly report on Form 10-Q for the quarter ended August 30, 2002 as filed on October 9, 2002 and is being filed to reflect the impact of goodwill impairment in the amount of $65.6 million resulting from the goodwill impairment test in accordance with the initial adoption of Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets." The loss has been recognized as a cumulative effect of change in accounting principle and the goodwill, retained earnings (deficit), net loss and loss per share amounts have been adjusted accordingly. Except for "Item 1: Financial Statements Condensed Consolidated Statement of Operations for the Three Months Ended August 30, 2002, Condensed Consolidated Balance Sheet as of August 30, 2002, Condensed Consolidated Statement of Cash flows for the Three Months Ended August 30, 2002, Notes to Condensed Consolidated Financial Statements, and Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations" of Part I: Financial Information, of 3Com's Quarterly Report on Form 10-Q for the quarterly period ended August 30, 2002, no other information included in the original report on Form 10-Q is amended by this Form 10-Q/A. This report speaks as of the original filing date and, except as indicated, has not been updated to reflect events occurring subsequent to the original filing date. For the most recent information concerning the Registrant and updated Risk Factors, please see the Registrant's Quarterly Report on Form 10-Q for the quarter ended November 29, 2002.

3Com Corporation

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PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

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

	Three Months Ended	
	August 30, 2002	**August 31, 2001**
Sales	$ 304,722	$ 389,589
Cost of sales	159,257	326,821
Gross margin	145,465	62,768
Operating expenses:		
Sales and marketing	66,981	106,224
Research and development	50,929	85,881
General and administrative	26,906	40,999
Amortization and write down of intangibles	2,452	16,484
Restructuring charges	23,157	57,515
Loss on land and facilities, net	1,152	
Total operating expenses	171,577	307,103
Operating loss	(26,112)	(244,335)
Losses on investments, net	(11,465)	(2,650)
Interest and other income, net	9,597	19,158
Loss before income taxes and cumulative effect of change in accounting principle	(27,980)	(227,827)
Income tax provision	4,000	4,557
Loss before cumulative effect of change in accounting principle	(31,980)	(232,384)
Cumulative effect of change in accounting principle	(65,601)	

	Three Months Ended	
Net loss	$ (97,581)	$ (232,384)
Basic and diluted loss per share:		
Loss before cumulative effect of change in accounting principle	$ (0.09)	$ (0.67)
Cumulative effect of change in accounting principle	(0.18)	
Net loss	$ (0.27)	$ (0.67)
Shares used in computing per share amounts:		
Basic and diluted:	357,437	344,313

See notes to condensed consolidated financial statements.

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

	August 30, 2002	May 31, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and equivalents	$ 418,470	$ 679,055
Short-term investments	968,824	702,993
Accounts receivable, net	138,205	147,113
Inventories	48,176	61,777
Other current assets	55,883	72,106
Total current assets	1,629,558	1,663,044
Property and equipment, net	628,489	676,154
Deposits and other assets	68,886	87,213
Deferred income taxes	6,055	6,192
Intangible assets, net	25,237	27,689
Goodwill	899	66,500
Total assets	$ 2,359,124	$ 2,526,792
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 101,876	$ 125,903
Accrued liabilities and other	260,550	275,965
Current portion of debt	81,248	101,354

	August 30, 2002	May 31, 2002
Total current liabilities	443,674	503,222
Long-term debt	53,492	68,404
Other long-term obligations	5,199	4,961
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000 shares authorized; none outstanding		
Common stock, $.01 par value, 990,000 shares authorized; shares issued: 365,313 and 365,449, respectively	2,126,019	2,126,583
Treasury stock, at cost, 6,596 and 7,743 shares, respectively	(161,994)	(182,341)
Notes receivable from sale of warrants	(21,052)	(21,052)
Unamortized stock-based compensation	(5,554)	(5,030)
Retained earnings (deficit)	(77,878)	35,814
Accumulated other comprehensive loss	(2,782)	(3,769)
Total stockholders' equity	1,856,759	1,950,205
Total liabilities and stockholders' equity	$ 2,359,124	$ 2,526,792

See notes to condensed consolidated financial statements.

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3Com Corporation
Condensed Consolidated Statements of Cash Flows

(In thousands)
(Unaudited)

	Three Months Ended	
	August 30, 2002	August 31, 2001
Cash flows from operating activities:		
Net loss	$ (97,581)	$ (232,384)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	32,189	78,241
Write down of intangibles, including cumulative effect of change in accounting principle	65,601	3,473
Loss on fixed assets	9,015	10,657
Loss on investments, net	11,465	2,650
Deferred income taxes	(325)	(4,369)
Stock-based compensation	1,586	3,824
Changes in current assets and liabilities:		
Accounts receivable	8,908	89,036
Inventories	10,955	49,668
Other assets	19,860	26,459

	Three Months Ended	
Accounts payable	(24,027)	(101,620)
Accrued liabilities and other	(24,641)	(109,690)
Income taxes payable	8,917	(5,518)
Net cash provided by (used in) operating activities	21,922	(189,573)
Cash flows from investing activities:		
Purchase of investments	(484,595)	(76,869)
Proceeds from maturities and sales of investments	220,799	189,440
Purchase of property and equipment	(4,862)	(10,670)
Proceeds from sale of property and equipment	18,743	3,198
Net cash provided by (used in) investing activities	(249,915)	105,099
Cash flows from financing activities:		
Issuance of common stock	1,562	1,620
Net repayments on line of credit	(20,000)	
Repayments of long-term borrowings	(15,018)	(24)
Other, net	864	227
Net cash provided by (used in) financing activities	(32,592)	1,823
Decrease in cash and equivalents	(260,585)	(82,651)
Cash and equivalents, beginning of period	679,055	897,797
Cash and equivalents, end of period	$ 418,470	$ 815,146

See notes to condensed consolidated financial statements.

3Com Corporation
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared by 3Com Corporation (3Com), pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of 3Com's financial position as of August 30, 2002, and results of operations and cash flows for the three months ended August 30, 2002 and August 31, 2001. Certain amounts from the prior period have been reclassified to conform to the current period presentation. Such reclassifications had no effect on net loss as previously reported.

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

Revenue Recognition

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

Recent Accounting Pronouncements

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

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

indefinite-lived intangible assets that arise due to the initial application of SFAS 142 are to be reported as a change in accounting principle.

The Company adopted SFAS 142 on June 1, 2002 and ceased amortization of net goodwill totaling $66.5 million, which includes $0.7 million of acquired workforce intangible previously classified as purchased intangible assets; amortization continues on net finite-lived intangible assets, with remaining useful lives of generally two to four years and totaling $25.2 million as of August 30, 2002 as discussed in Note 7. 3Com completed the transitional goodwill impairment evaluation prescribed by SFAS 142 in the second quarter of fiscal 2003, and has amended its Quarterly Report on Form 10-Q for the quarterly period ended August 30, 2002 to record a charge totaling $65.6 million as a change in accounting principle effective June 1, 2002 to write off goodwill of $45.4 million in the Enterprise Networking segment and $20.2 million in the CommWorks segment. The remaining recorded goodwill for 3Com after this impairment charge was $0.9 million as of August 30, 2002, and related solely to the Connectivity segment. A reconciliation of previously reported net loss and net loss per share to the amounts adjusted for the exclusion of goodwill and acquired workforce amortization follows (in thousands, except per share amounts):

	Three Months Ended	
	August 30, 2002	**August 31, 2001**
Reported net loss	$ (97,581)	$ (232,384)
Add back goodwill amortization		8,321
Add back acquired workforce amortization		666
Adjusted net loss	$ (97,581)	$ (223,397)
Reported net loss per share-basic and diluted	$ (0.27)	$ (0.67)
Add back goodwill amortization		0.02

	Three Months Ended	
Add back acquired workforce amortization		0.00
Adjusted net loss per share-basic and diluted	$ (0.27)	$ (0.65)

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

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

2.

Restructuring Charges

In fiscal 2001, 3Com began the restructuring of its business to enhance the focus and cost effectiveness of its business units in serving their respective markets. 3Com implemented a reduction in workforce and other actions aimed at reducing costs, expenses and assets; exited its consumer Internet appliance and cable and digital subscriber line (DSL) modem product lines; and outsourced the manufacturing of

certain high volume server, desktop and mobile connectivity products in a contract manufacturing arrangement as part of this restructuring effort.

In the first quarter of fiscal 2003, 3Com announced it would merge its Business Connectivity Company (BCC) into its Business Networks Company (BNC) to leverage common infrastructure in order to drive additional cost out of the business, resulting in three ongoing operating segments as listed in Note 8 Enterprise Networking, Connectivity, and CommWorks. Additionally, the Company entered into an agreement to outsource certain information technology (IT) functions. Components of accrued restructuring charges, which are included in accrued liabilities and other in the accompanying balance sheet, and changes in accrued amounts related to this restructuring program during the first quarter of fiscal 2003 and as of August 30, 2002 were as follows (in thousands):

	Employee Separation Expenses	Long term Asset Write-downs	Facilities-related Charges	Other Restructuring Costs	Total
Balance at May 31, 2002	$ 4,953	$	$ 5,354	$ 3,447	$ 13,754
Provision	14,427	1,894	6,196	640	23,157
Deductions	(9,859)	(1,894)	(6,217)	(859)	(18,829)
Balance at August 30, 2002	$ 9,521	$	$ 5,333	$ 3,228	$ 18,082
Estimated remaining cash payments	$ 9,521	$	$ 4,800	$ 3,228	$ 17,549

Employee separation expenses are comprised of severance pay, outplacement services, medical and other related benefits. Affected employee groups include corporate services, manufacturing and logistics, product organizations, research and development, sales, customer support and administrative positions. The total reduction in workforce since the inception of this restructuring program through August 30, 2002 includes approximately 5,800 employees who have been separated or were in the separation process. There were an additional 80 employees who have been notified but have not yet worked their last day. Since the inception of this restructuring program, $144.3 million of separation payments have been made.

Long term asset write-downs include items identified as no longer needed to support ongoing operations for 3Com. During the first quarter of fiscal 2003, 3Com recorded a charge of $1.9 million, primarily for equipment sold as a result of the outsourcing of certain IT operations.

Facilities-related charges include write down of land and buildings held for sale and lease terminations. In the first quarter of fiscal 2003, 3Com recorded $6.2 million in facilities-related charges, including a $5.3 million write down of a Santa Clara, California facility and a net $0.4 million credit related to the gain on the sale of its Mount Prospect, Illinois manufacturing facility that it sold in the first quarter of fiscal 2003. As the consolidation of its operations continues, 3Com expects to incur additional expenses related to facilities in fiscal 2003.

Other restructuring costs include expenses associated with terminating other contractual arrangements.

3.

Comprehensive Loss

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

	Three Months Ended	
	August 30, 2002	**August 31, 2001**
Net loss	$ (97,581)	$ (232,384)
Other comprehensive income (loss):		
Change in unrealized gain on available-for-sale securities	(388)	(2,216)
Change in accumulated translation adjustments	1,376	144
Total comprehensive loss	$ (96,593)	$ (234,456)

4.

Net Loss Per Share

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

	Three Months Ended	
	August 30, 2002	**August 31, 2001**
Net loss	$ (97,581)	$ (232,384)
Weighted average shares-basic	357,437	344,313
Effect of dilutive securities:		
Employee stock options		
Restricted stock		
Weighted average shares-diluted	357,437	344,313
Net loss per share-basic and diluted	$ (0.27)	$ (0.67)

Common stock equivalents, including employee stock options and restricted stock, totaling 3.2 million and 5.9 million shares were not included in the diluted weighted average shares calculation for the three months ended August 30, 2002 and August 31, 2001, respectively, as the effects of these securities were antidilutive.

5. Inventories

Inventories consist of (in thousands):

	August 30, 2002	May 31, 2002
Finished goods	$ 20,437	$ 29,730
Work-in-process	12,311	15,458
Raw materials	15,428	16,589
Total inventory	$ 48,176	$ 61,777

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6. Sale of Facilities

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

7. Intangible Assets, Net

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

	As of August 30, 2002			
	Enterprise Networking Segment	Connectivity Segment	CommWorks Segment	Total
Developed and core technology, carrying value	$ 24,780	$ 20,992	$ 14,041	$ 59,813
Accumulated amortization	(12,372)	(13,258)	(10,320)	(35,950)
Net developed and core technology	12,408	7,734	3,721	23,863
Customer relationships, carrying value	420	56	4,864	5,340
Accumulated amortization	(256)	(24)	(3,686)	(3,966)
Net customer relationships	164	32	1,178	1,374
Total net intangible assets	$ 12,572	$ 7,766	$ 4,899	$ 25,237

	As of May 31, 2002			
	Enterprise Networking Segment	Connectivity Segment	CommWorks Segment	Total
Developed and core technology, carrying value	$ 24,780	$ 20,992	$ 14,041	$ 59,813
Accumulated amortization	(11,449)	(12,236)	(9,934)	(33,619)

	As of May 31, 2002			
Net developed and core technology	13,331	8,756	4,107	26,194
Customer relationships, carrying value	420	56	4,864	5,340
Accumulated amortization	(221)	(20)	(3,604)	(3,845)
Net customer relationships	199	36	1,260	1,495
Total net intangible assets	$ 13,530	$ 8,792	$ 5,367	$ 27,689

8.

Business Segment Information

As discussed in Note 2, effective the first quarter of fiscal 2003, 3Com merged BCC into BNC; newly integrated BNC is managed as two separate segments: Connectivity, which includes the majority of BCC products, and Enterprise Networking. As part of the combination, 802.11 PC cards, Bluetooth, certain security software, and Network Jack product lines and their associated expenses were moved into the Enterprise Networking segment. Consistent with the prior year, Commworks Corporation continues to be a separate segment, and exited product lines are also reported separately. Historical

segment information has been restated to conform to the current organization structure. The following tables display information on 3Com's reportable segments (in thousands):