3COM CORP
Form 10-Q
January 07, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended November 29, 2002

or

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

For the transition period from _____________ to _____________

Commission File No. 0-12867

3Com Corporation

(Exact name of registrant as specified in its charter)

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

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

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

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

Yes ý No o

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

Yes ý No o

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

This report contains a total of 46 pages of which this page is number 1.

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

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

See notes to condensed consolidated financial statements.

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

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

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

See notes to condensed consolidated financial statements.

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

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

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

See notes to condensed consolidated financial statements.

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

1.
Basis of Presentation

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

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

Revenue Recognition

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

Recent Accounting Pronouncements

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

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

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

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

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

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

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

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

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

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

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

2. Restructuring Charges

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

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

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

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

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

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

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

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

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

3.

Comprehensive Loss

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

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

4.

Net Loss Per Share

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

	Three Months Ended	Six Months Ended

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