

3COM CORP  
Form 10-Q  
April 08, 2009

**Table of Contents**

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

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

**For the quarterly period ended February 27, 2009**

**or**

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

**For the transition period from to**

**Commission File No. 0-12867**

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

**Delaware**

**94-2605794**

(State or other jurisdiction of incorporation or organization)

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

**350 Campus Drive**

**Marlborough, Massachusetts**

**01752**

(Address of principal executive offices)

(Zip Code)

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

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

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer, 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

Accelerated Filer

Non-Accelerated Filer

Smaller reporting

(Do not check if a smaller reporting company)

company

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

Yes  No

As of March 27, 2009, 387,471,015 shares of the registrant's common stock were outstanding.



**3COM CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTER ENDED FEBRUARY 27, 2009**  
**TABLE OF CONTENTS**

	<b>Page</b>
<u><b>PART I. FINANCIAL INFORMATION</b></u>	1
<u>Item 1. Financial Statements</u>	1
<u>Condensed Consolidated Statements of Operations (unaudited) <i>Three and Nine Months Ended February 28, 2009 and 2008</i></u>	1
<u>Condensed Consolidated Balance Sheets (unaudited) <i>February 28, 2009 and May 31, 2008</i></u>	2
<u>Condensed Consolidated Statements of Cash Flows (unaudited) <i>Nine Months Ended February 28, 2009 and 2008</i></u>	3
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	19
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	33
<u><b>PART II. OTHER INFORMATION</b></u>	33
<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	44
<u>Item 5. Other Information</u>	44
<u>Item 6. Exhibits</u>	45
<u><b>SIGNATURES</b></u>	47
<u><b>EXHIBITS</b></u>	48
<u>EX-10.6 2005 Deferred Compensation Plan</u>	
<u>EX-10.7 Section 16 Officer Severance Plan</u>	
<u>EX-10.8 First Amendment to Employment Agreement - Mao</u>	
<u>EX-10.9 First Amendment to Employment Agreement - Sege</u>	
<u>EX-10.10 Form of First Amendment to Severance Benefits Agreement</u>	
<u>EX-10.11 Form of Second Agreement to Severance Benefits Agreement</u>	
<u>EX-10.12 Form of First Amendment to Management Retention Agreement</u>	
<u>EX-10.13 Form of First Amendment</u>	
<u>EX-10.14 Form of Second Agreement to Management Retention Agreement</u>	
<u>EX-31.1 SECTION 302 CERTIFICATION OF CEO</u>	
<u>EX-31.2 SECTION 302 CERTIFICATION OF CFO</u>	
<u>EX-32.1 SECTION 906 CERT OF CEO AND CFO</u>	

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

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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, and resources needed to comply with Sarbanes-Oxley 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, anticipates, believes, estimates, predicts, intends, continue, or the negative of other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any forward-looking statements.

Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under 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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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****3COM CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(In thousands, except per share data)	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>February 28,</b>		<b>February 28,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Sales	\$ 324,707	\$ 336,390	\$ 1,021,919	\$ 973,625
Cost of sales	138,878	156,716	446,671	492,895
Gross profit	185,829	179,674	575,248	480,730
Operating expenses (income):				
Sales and marketing	84,241	82,428	259,143	237,617
Research and development	43,729	50,530	137,330	155,039
General and administrative	30,393	26,268	88,799	78,806
Amortization	23,106	25,778	73,330	78,044
Patent dispute resolution			(70,000)	
Restructuring charges	2,860	736	7,361	4,308
Operating expenses, net	184,329	185,740	495,963	553,814
Operating income (loss)	1,500	(6,066)	79,285	(73,084)
Interest expense, net	(3,333)	(2,879)	(5,131)	(10,412)
Other income, net	16,528	10,591	45,298	33,345
Income (loss) before income taxes	14,695	1,646	119,452	(50,151)
Income tax provision	(12,828)	(9,486)	(24,878)	(11,967)
Net income (loss)	\$ 1,867	\$ (7,840)	\$ 94,574	\$ (62,118)
Basic and diluted net income (loss) per share	\$ 0.00	\$ (0.02)	\$ 0.24	\$ (0.16)
Shares used in computing per share amounts:				
Basic	384,679	400,142	393,868	398,724
Diluted	386,377	400,142	395,232	398,724

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

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

(Unaudited)

(In thousands, except per share data)	<b>February 28, 2009</b>	<b>May 31, 2008</b>
<b>ASSETS</b>		
Current assets:		
Cash and equivalents	\$ 559,961	\$ 503,644
Notes receivable	85,795	65,116
Accounts receivable, less allowance for doubtful accounts of \$14,750 and \$12,253, respectively	114,083	116,281
Inventories	107,103	90,831
Other current assets	55,881	34,033
Total current assets	922,823	809,905
Property and equipment, less accumulated depreciation and amortization of \$193,494 and \$205,835, respectively	43,828	54,314
Goodwill	609,297	609,297
Intangible assets, net	203,838	278,385
Deposits and other assets	21,941	23,229
Total assets	\$ 1,801,727	\$ 1,775,130
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 71,636	\$ 90,280
Current portion of long-term debt	61,000	48,000
Accrued liabilities and other	415,068	366,181
Total current liabilities	547,704	504,461
Deferred taxes and long-term obligations	40,129	22,367
Long-term debt	152,000	253,000
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: 387,269 and 405,656, respectively	2,323,511	2,353,688
Retained deficit	(1,310,672)	(1,405,247)
Accumulated other comprehensive income	49,055	46,861
Total stockholders' equity	1,061,894	995,302
Total liabilities and stockholders' equity	\$ 1,801,727	\$ 1,775,130

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

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

	<b>Nine Months Ended</b>	
	<b>February 28,</b>	
(In thousands)	<b>2009</b>	<b>2008</b>
Cash flows from operating activities:		
Net income (loss)	\$ 94,574	\$ (62,118)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	97,156	102,731
Stock-based compensation expense	18,187	15,413
Impairment of property and equipment	1,150	
Loss on property and equipment disposals	581	2,227
Gain on investments, net		(185)
Deferred income taxes	(7,466)	(448)
Changes in assets and liabilities:		
Accounts and notes receivable	(13,560)	(59,344)
Inventories	(22,006)	22,704
Other assets	6,771	7,733
Accounts payable	(20,929)	(13,447)
Other liabilities	41,874	(25,297)
Net cash provided by (used in) operating activities	196,332	(10,031)
Cash flows from investing activities:		
Proceeds from maturities and sales of investments		442
Purchases of property and equipment	(12,778)	(13,269)
Proceeds from sale of property and equipment	223	944
Net cash used in investing activities	(12,555)	(11,883)
Cash flows from financing activities:		
Issuances of common stock	3,022	6,124
Repurchases of common stock	(51,383)	(2,321)
Repayment of long term debt	(88,000)	(94,000)
Net cash used in financing activities	(136,361)	(90,197)
Effect of exchange rate changes on cash and equivalents	8,901	18,924
Net change in cash and equivalents during period	56,317	(93,187)
Cash and equivalents, beginning of period	503,644	559,217
Cash and equivalents, end of period	\$ 559,961	\$ 466,030



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

3

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

(Unaudited)

**NOTE 1. BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these unaudited condensed consolidated financial statements include all adjustments necessary for a fair presentation of our financial position as of February 27, 2009 and May 30, 2008, our results of operations for the three and nine months ended February 27, 2009 and February 29, 2008 and our cash flows for the nine months ended February 27, 2009 and February 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 and nine months shown as ended February 28, 2009 actually ended on February 27, 2009, the three and nine months shown as ended February 28, 2008 actually ended on February 29, 2008, and the balance sheet presented as of May 31, 2008 is actually as of May 30, 2008. The results of operations for the three and nine months ended February 28, 2009 may not be indicative of the results to be expected for the fiscal year ending May 29, 2009 or any other future periods. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended May 30, 2008.

*Goodwill*

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 performed our annual goodwill impairment review as of February 27, 2009 for our TippingPoint segment and December 31, 2008 for our China-based region (as our China-based region reports on a two month lag), and noted no impairment of goodwill or intangible assets with indefinite lives. In making this assessment, we rely on a number of factors including operating results, business plans, economic projections, anticipated future cash flows, and transactions and marketplace data. There are inherent uncertainties related to these factors and our judgment in applying them to the analysis of goodwill impairment. Reporting unit valuations have been calculated using a combination of an income approach based on the present value of future cash flows of each reporting unit and a market approach. The income approach incorporates many assumptions including future growth rates, discount factors, expected capital expenditures and income tax cash flows. Changes in economic and operating conditions impacting these assumptions could result in a goodwill impairment in future periods. In conjunction with our annual goodwill impairment tests, we reconcile the sum of the valuations of all of our reporting units to our market capitalization as of such dates.

*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

**Table of Contents**

the effective date of SFAS No. 141R would apply the provisions of SFAS No. 141R. An entity may not apply SFAS No. 141R before that date. Given that SFAS No. 141R relates to prospective and not historical business combinations, the Company cannot currently determine the potential effects of adoption of SFAS No. 141R may have on its consolidated financial statements.

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 Company is currently evaluating whether the adoption of SFAS No. 160 will have an effect on its consolidated financial position, results of operations or cash flows.

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. We have not yet determined the impact, if any, of the portion of SFAS No. 157, for which the implementation has been deferred, will have on our consolidated financial position, results of operations or cash flow.

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 accepted 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. We are currently evaluating the potential impact of FSP FAS No. 142-3 on our consolidated results of operations and financial position.

In May 2008, the FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS No. 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411,

*The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. The adoption of SFAS No. 162 is not expected to have a material impact on our consolidated results of operations and financial position.

In October 2008, the FASB issued FSP 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active, and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active, and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS No. 157. The adoption of FSP 157-3 did not have a significant impact on our consolidated financial statements or the fair values of our financial assets and liabilities.

**Table of Contents****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 the employee stock purchase plan. 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 February 28, 2009, total unrecognized stock-based compensation expense relating to unvested employee stock options, restricted stock awards, restricted stock units and employee stock purchase plan, adjusted for estimated forfeitures, was \$13.7 million, \$4.4 million, \$14.1 million and \$0.1 million, respectively. These amounts are expected to be recognized over a weighted-average period of 2.4 years for stock options, 2.0 years for restricted stock awards, 2.0 years for restricted stock units and 0.1 years for 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 and nine months ended February 28, 2009 and February 28, 2008:

	<b>Three Months Ended February 28, 2009</b>	<b>Three Months Ended February 28, 2008</b>	<b>Nine Months Ended February 28, 2009</b>	<b>Nine Months Ended February 28, 2008</b>
<b><i>Employee stock options:</i></b>				
Volatility	51.3%	*%	51.3%	40.5%
Risk-free interest rate	1.9%	*%	2.6%	4.7%
Dividend yield	0.0%	*%	0.0%	0.0%
Expected life (years)	6.0	*	4.7	3.8
Weighted average grant date fair value	\$ 1.28	\$ *	\$ 1.04	\$ 1.49
<b><i>Restricted stock awards:</i></b>				
Weighted average grant date fair value	\$ *	\$ *	\$ 2.28	\$ 3.90
<b><i>Restricted stock units:</i></b>				
Weighted average grant date fair value	\$ 2.51	\$ *	\$ 2.35	\$ 3.72
<b><i>Employee Stock Purchase Plan:</i></b>				
Volatility	*%	*%	77.7%	61.1%
Risk-free interest rate	*%	*%	1.2%	4.0%

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Dividend yield	*%	*%	0.0%	0.0%
Expected life (years)	*	*	0.5	0.5
Weighted average grant date fair value	\$ *	\$ *	\$ 0.90	\$ 1.60

\* *No grants  
during the  
period*

6

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**Table of Contents**

The following table presents stock-based compensation expense included in the accompanying Condensed Consolidated Statements of Operations (in thousands):

	<b>Three Months Ended February 28, 2009</b>	<b>Three Months Ended February 28, 2008</b>	<b>Nine Months Ended February 28, 2009</b>	<b>Nine Months Ended February 28, 2008</b>
Cost of sales	\$ 596	\$ 496	\$ 1,916	\$ 1,403
Sales and marketing	1,599	1,753	4,970	4,146
Research and development	768	1,100	2,545	2,794
General and administrative	3,144	2,195	8,756	7,070
Stock-based compensation expense before tax	\$6,107	\$ 5,544	\$ 18,187	\$ 15,413

*Stock Options.* As of February 28, 2009, our outstanding stock options as a percentage of outstanding shares were approximately 7.7 percent. Stock option activity for the nine months ended February 28, 2009, was as follows (shares in thousands):

	<b>Number of shares</b>	<b>Weighted average exercise price</b>
Outstanding May 31, 2008	43,925	\$ 4.98
Granted	1,403	2.30
Exercised	(979)	1.48
Cancelled	(14,581)	5.16
Outstanding February 28, 2009	29,768	\$ 4.88

As of February 28, 2009, there were approximately 20.0 million options exercisable with a weighted-average exercise price of \$5.69 per share. By comparison, there were approximately 25.3 million options exercisable as of February 28, 2008 with a weighted-average exercise price of \$5.97 per share.

During the nine months ended February 28, 2009 approximately 1.0 million options were exercised at an aggregate intrinsic value of \$0.7 million. The exercise intrinsic value above 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 February 27, 2009 was \$2.22 per share as reported by the NASDAQ Global Select Market. The aggregate intrinsic value of options outstanding and options exercisable as of February 28, 2009 was \$1.3 million and \$1.3 million, 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 February 28, 2009 and the exercise price of the options.

Options outstanding that are vested and expected to vest as of February 28, 2009 are as follows:

<b>Number of Shares</b>	<b>Weighted average Grant-Date</b>	<b>Weighted Average Remaining Contractual</b>	<b>Aggregate Intrinsic Value</b>
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	<b>(in thousands)</b>	<b>Fair Value</b>	<b>Life (in years)</b>	<b>(in thousands)</b>
Vested and expected to vest at February 28, 2009	27,105 7	\$ 5.08	3.3	\$ 1,325

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**Table of Contents**

*Restricted Stock Awards.* Restricted stock award activity during the nine months ended February 28, 2009 was as follows (shares in thousands):

	<b>Number of Shares (unvested)</b>	<b>Weighted average Grant-Date Fair Value</b>
Outstanding May 31, 2008	3,095	\$ 3.43
Granted	325	2.28
Vested	(734)	3.94
Forfeited	(745)	3.75
Outstanding February 28, 2009	1,941	\$ 2.92

During the nine months ended February 28, 2009 approximately 0.7 million restricted awards with an aggregate fair value of \$1.6 million became vested. Total aggregate intrinsic value of restricted stock awards outstanding as of February 28, 2009 was \$4.3 million.

*Restricted Stock Units.* Restricted stock unit activity during the nine months ended February 28, 2009 was as follows (shares in thousands):

	<b>Number of Shares (unvested)</b>
Outstanding May 31, 2008	5,744
Granted	5,071
Vested	(2,445)
Forfeited	(1,246)
Outstanding February 28, 2009	7,124

The weighted average exercise price for all restricted stock units for all periods was \$0.00. Total aggregate intrinsic value of restricted stock units outstanding at February 28, 2009 was \$15.8 million.

During the nine months ended February 28, 2009 approximately 2.4 million restricted stock units with an aggregate intrinsic value of \$5.4 million became vested.

*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. We recognized \$1.0 million of stock-based compensation expense related to the ESPP in the nine months ended February 28, 2009. Employee stock purchases generally occur only in the quarters ended November 30 and May 31.

**NOTE 3. FAIR VALUE***Fair Value Hierarchy*

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:



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- 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.

8

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**Table of Contents**

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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 February 28, 2009:

	Fair Value Measurements at Reporting Date Using			Total Balance
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
(In thousands)				
<b>Assets</b>				
Cash equivalents:				
Time deposits and government bonds with a maturity less than 3 months	\$	\$ 406,118	\$	\$ 406,118
Money market fund deposits	136,634			136,634
<b>Total assets measured at fair value</b>	<b>\$ 136,634</b>	<b>\$ 406,118</b>	<b>\$</b>	<b>\$ 542,752</b>

**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 first quarter of fiscal 2009 in the operating expense (income) section of the Consolidated Statements 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.

In fiscal 2004, we continued a broad restructuring of our business to enhance the focus and cost effectiveness of our segments in serving their respective markets. These restructuring efforts continued through fiscal 2009. We took the following specific actions in fiscal 2004 through 2009 (the Fiscal 2004 2009 Actions):

reduced our workforce; and

continued efforts to consolidate and dispose of excess facilities



**Table of Contents**

Restructuring charges related to these various initiatives resulted in a charge of \$2.9 million in the third quarter of fiscal 2009 and a net charge of \$0.7 million in the third quarter of fiscal 2008. Net restructuring charges in the third quarter of fiscal 2009 consisted of \$2.9 million for severance and outplacement costs. \$2.0 million of these costs relate to the integration of our TippingPoint segment. The net restructuring charge in the third quarter of fiscal 2008 resulted from severance, outplacement and other costs of \$0.8 million and a net benefit of \$0.1 million for adjustments to facilities-related charges. Restructuring charges for the first nine months of fiscal 2009 were \$7.4 million, and restructuring charges for the first nine months of fiscal 2008 were \$4.3 million. Net restructuring charges in the first nine months of fiscal 2009 consisted of \$6.0 million for severance and outplacement costs and \$1.4 million related to vacating part of our Marlborough, MA facility for which we ceased use during the second quarter of fiscal 2009. Net restructuring charges in the first nine months of fiscal 2008 consisted of \$4.2 million for severance and outplacement costs and \$0.1 million related to facilities-related charges.

Accrued liabilities associated with restructuring charges totaled \$3.1 million as of February 28, 2009 and are included in the caption *Accrued liabilities and other* in the accompanying condensed consolidated balance sheet. These liabilities are classified as current because we expect to satisfy such liabilities in cash within the next 12 months.

***Fiscal 2008 and 2009 Actions***

Activity and liability balances related to the fiscal 2008 and 2009 restructuring actions, which were all approved by management as part of the fiscal 2008 and 2009 corporate restructuring plans, are as follows (in thousands):

	<b>Employee Separation Expense</b>	<b>Facilities-related Charges</b>	<b>Other Restructuring Costs</b>	<b>Total</b>
Balance as of May 31, 2008	\$ 687	\$	\$	\$ 687
Provisions	5,965	1,283	68	7,316
Payments and non-cash charges	(4,859)	(319)	(68)	(5,246)
Balance as of February 28, 2009	\$ 1,793	\$ 964	\$	\$ 2,757

Employee separation expense includes severance pay, outplacement services, medical and other related benefits. Through February 28, 2009, the total reduction in workforce associated with actions initiated during fiscal 2008 included approximately 122 employees who had been separated. In addition, during the nine months ended February 28, 2009, the reduction in workforce was extended with actions initiated in fiscal 2009 to include approximately 82 employees who had been separated. The expense associated with restructuring actions is recognized as severed employees are terminated or over the remaining service period following their notification of termination. Facilities-related charges relate to vacating part of our Marlborough facility for which we ceased use during the second quarter of fiscal 2009.

We expect to complete any remaining activities related to these actions during the coming twelve months.

***Fiscal 2004 through 2007 Actions***

Activity and liability balances related to the fiscal 2004 - 2007 restructuring actions are as follows (in thousands):

	<b>Employee Separation Expense</b>	<b>Facilities- related Charges</b>	<b>Total</b>
Balance as of May 31, 2008	\$ 28	\$ 687	\$ 715
Provisions (benefits)	(6)	51	45
Payments and non-cash charges	11	(440)	(429)

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Balance as of February 28, 2009	\$	33	\$	298	\$	331
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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 these actions during the coming twelve months.

**Table of Contents****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. As of February 28, 2009, we had unrecognized tax benefits, including interest and penalties, of \$20.5 million, all of which, if recognized, would affect our effective tax rate. The unrecognized tax benefits are recorded in Deferred taxes and long-term obligations on the balance sheet, none of which are expected to be settled in cash in the next twelve months. This balance represents an increase of \$2.3 million over the balance at the end of our last fiscal year. In the third quarter the balance decreased by \$2.8 million, primarily as a result of the lapsing of the statute of limitations in certain overseas jurisdictions. The increase from the last day of our last fiscal year is due to the recording of approximately \$9.1 million related to new uncertain tax positions, partially offset by the settlement of previous positions and the lapsing of the statute of limitations for tax audits in certain overseas jurisdictions. As of February 28, 2009 the accrued interest and penalties related to uncertain tax positions was \$2.1 million and zero, respectively, which have been recorded within the balance of unrecognized tax benefits.

During the three months ended August 31, 2008, we effectively settled the examination of a Hong Kong subsidiary's returns for fiscal years 2000 to 2002, and during the current quarter, we effectively settled the examination of our Israel subsidiary's returns for fiscal years 2004 to 2006. As a result of these settlements, we recognized previously unrecognized tax benefits of \$1.4 million.

We estimate that the balance of unrecognized tax benefits will decrease by approximately \$0.1 million over the next twelve months as a result of the expiration of various statutes of limitations.

We have now qualified under the new PRC tax law, effective January 1, 2009, as a new and high technology enterprise, which entitles us to a long-term tax rate of 15 percent in China. Under the previous tax law, we had qualified for tax concessions which entitled our China entity to a zero tax rate for 2004 and 2005, and a rate equal to half of our normal rate for 2006 to 2008. We expect our rate for calendar year 2008 and beyond will be 15%. The impact of the change in the tax rate in China to 15 percent resulted in a \$12.1 million charge to our income tax provision for the quarter.

**NOTE 7. COMPREHENSIVE (LOSS) INCOME**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>February 28,</b>		<b>February 28,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net income (loss)	\$ 1,867	\$ (7,840)	\$ 94,574	\$ (62,118)
Other comprehensive income:				
Net unrealized loss on investments				(210)
Change in accumulated translation adjustments	(2,307)	11,822	2,194	26,071
Total comprehensive (loss) income	\$ (440)	\$ 3,982	\$ 96,768	\$ (36,257)

**Table of Contents****NOTE 8. NET INCOME (LOSS) PER SHARE**

The following represents a reconciliation from basic earnings (loss) per common share to diluted earnings (loss) per common share. Stock options and restricted stock (awards and units) of 29.0 million and 8.2 million, respectively, were outstanding at February 28, 2009, but were not included in the computation of diluted earnings (loss) per share because they were antidilutive. Stock options and restricted stock (awards and units) of 54.7 million and 3.0 million, respectively, were outstanding at February 28, 2008, but were not included in the computation of diluted earnings (loss) per share because they were antidilutive.

(in thousands except per share data)	Three Months Ended		Nine Months Ended	
	February 28,		February 28,	
	2009	2008	2009	2008
Determination of shares:				
Weighted average shares outstanding	384,679	400,142	393,868	398,724
Assumed conversion of dilutive stock options and restricted stock (awards and units)	1,698		1,364	
Diluted weighted average shares outstanding	386,377	400,142	395,232	398,724
Basic earnings (loss) per share	\$ 0.00	\$ (0.02)	\$ 0.24	\$ (0.16)
Diluted earnings (loss) per share	\$ 0.00	\$ (0.02)	\$ 0.24	\$ (0.16)

**NOTE 9. INVENTORIES**

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

	February 28, 2009	May 31, 2008
Finished goods	\$ 86,516	\$ 62,055
Work-in-process	4,004	6,119
Raw materials	16,583	22,657
Total	\$ 107,103	\$ 90,831

**NOTE 10. INTANGIBLE ASSETS, NET**

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

	Weighted Average Remaining Amortization Period	February 28, 2009			May 31, 2008			
		Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net	
Existing technology	3.0	\$ 382,050	\$(252,802)	\$ 129,248	3.6	\$ 380,254	\$(198,682)	\$ 181,572
Trademark	NA	55,502		55,502	NA	55,502		55,502
Huawei non-compete	0.0	33,016	(33,016)		0.5	33,650	(22,072)	11,578
OEM agreement	1.2	24,663	(14,166)	10,497	2.0	24,844	(7,947)	16,897

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Maintenance agreements	2.0	19,000	(12,931)	6,069	2.7	19,000	(10,556)	8,444
Other	1.2	20,474	(17,952)	2,522	2.0	22,176	(17,784)	4,392
		\$534,705	\$(330,867)	\$203,838		\$535,426	\$(257,041)	\$278,385



**Table of Contents****NOTE 11. ACCRUED WARRANTY**

Most products are sold with varying lengths of limited warranty ranging from 90 days to limited lifetime. Allowances for estimated warranty obligations are recorded as part of cost of sales in the period of sale, and are based on historical experience related to product failure rates and actual warranty costs incurred during the applicable warranty period. 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 nine months ended February 28, 2009 and 2008 (in thousands):

	<b>Nine Months Ended February 28,</b>	
	<b>2009</b>	<b>2008</b>
Accrued warranty, beginning of period	\$ 36,897	\$ 40,596
Cost of warranty claims processed during the period	(23,613)	(31,040)
Provision for warranties related to products sold during the period	19,308	29,122
Accrued warranty, end of period	\$ 32,592	\$ 38,678

**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 original 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. 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. The applicable LIBOR rate at February 28, 2009 was 3.70% and, based on the credit spread mandated by the Credit Agreement, the effective interest rate for Tranche A is 5.20% while the effective interest rate for Tranche B is 6.70%. On March 30, 2009, the six month LIBOR rate reset and the new effective rates are 3.29% and 4.79% on Tranches A and B, respectively.

The Borrower's principal asset is 100 percent of the shares of H3C Technologies Co., Limited. Covenants and other restrictions under the Credit Agreement apply to the H3C Group. Required payments under the loan are generally expected to be serviced by cash flows from the H3C Group, while the loan is secured by assets at the H3C level. 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.

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.

**Table of Contents**

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 February 28, 2009, the H3C Group's net assets were \$836.9 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 \$213 million principal are due as follows on September 28, of each year as follows, (in thousands):

<b>Calendar year</b>	<b>3Com fiscal year</b>	<b>Tranche A</b>	<b>Tranche B</b>
2009	2010	\$46,000	\$ 2,000
2010	2011	46,000	2,000
2011	2012		20,000
2012	2013		97,000

Accrued interest at February 27, 2009 related to the long-term debt was \$3.5 million and was paid on March 30, 2009. As of February 27, 2009, we were in compliance with all of our debt covenants.

On March 30, 2009, the Company made a voluntary prepayment of \$13.0 million of principal, for which the Company did not incur a penalty. The prepayment was applied to reduce our fiscal year 2013 Tranche B principal balance. This prepayment constitutes the entire estimated amount we believe we will be required to pay in September 2009 as part of the mandatory excess cash flow prepayment. The prepayment amount was classified as current debt in the consolidated balance sheet as of February 28, 2009.

**NOTE 13. SEGMENT INFORMATION**

In the prior fiscal year we reported H3C, Data and Voice Business Unit ( DVBU ), TippingPoint Security business ( TippingPoint ) and Corporate as segments. In the first quarter of fiscal 2009, we realigned the manner in which we manage our business and internal reporting, and 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. Accordingly, our previously reported segment information has been restated to reflect our new operating and reporting structure. Our Networking business consists of the following sales regions as operating segments: China-based, 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.

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 Functions consist of indirect cost of sales, such as supply chain operations expenses, and centralized operating expenses, such as research and development, indirect sales and marketing, and general and administrative support. Management evaluates the China-based sales region and the Rest of World sales region performance based on segment contribution profit. Segment contribution profit for these regions is defined as gross profit (as defined in the next sentence) less segment direct sales and marketing expenses. Gross profit for these regions is defined as sales less standard cost of sales. Our TippingPoint Security business segment is measured on segment profit (loss). Gross profit for the TippingPoint segment is defined as sales less cost of sales. This measure includes all operating costs except those items included in Eliminations and Other . Eliminations and other include intercompany sales eliminations, stock-based compensation expense, amortization of intangible assets, restructuring in all periods as well as purchase accounting inventory related adjustments and Realtek patent dispute resolution where applicable.



**Table of Contents**

Summarized financial information of our results of operations by segment for the three and nine months ended February 28, 2009 and 2008 is as follows.

	<b>Three Months Ended February 28, 2009</b>					<b>Total</b>	
	<b>Networking Business</b>		<b>Central</b>	<b>TippingPoint Security Business</b>			<b>Eliminations/</b>
	<b>China-based Sales</b>	<b>Rest of World Sales</b>		<b>Tipping</b>	<b>Other</b>		
(in thousands)	<b>Region</b>	<b>Region</b>	<b>Functions</b>	<b>Point</b>	<b>Other</b>	<b>Total</b>	
Sales	\$ 190,385	\$ 102,836	\$	\$ 33,284	\$ (1,798) <i>a</i>	\$ 324,707	
Gross profit	128,160	61,365	(25,326)	22,226	(596) <i>b</i>	185,829	
Direct sales & marketing expenses	36,581	23,360		10,282	1,371 <i>b</i>	71,594	
Segment contribution profit (loss)	91,579	38,005	(25,326)	11,944	(1,967)	114,235	
Other operating expenses			68,394	11,129	33,212 <i>c</i>	112,735	
Segment income	\$	\$	\$	\$ 815	\$		
Operating income						\$ 1,500	

	<b>Three Months Ended February 28, 2008</b>					<b>Total</b>	
	<b>Networking Business</b>		<b>Central</b>	<b>TippingPoint Security Business</b>			<b>Eliminations/</b>
	<b>China-based Sales</b>	<b>Rest of World Sales</b>		<b>Tipping</b>	<b>Other</b>		
(in thousands)	<b>Region</b>	<b>Region</b>	<b>Functions</b>	<b>Point</b>	<b>Other</b>	<b>Total</b>	
Sales	\$ 179,668	\$ 134,531	\$	\$ 23,639	\$ (1,448) <i>a</i>	\$ 336,390	
Gross profit	114,600	77,523	(28,474)	16,578	(553) <i>b</i>	179,674	
Direct sales & marketing expenses	33,001	25,151		8,827	1,753 <i>b</i>	68,732	
Segment contribution profit (loss)	81,599	52,372	(28,474)	7,751	(2,306)	110,942	
Other operating expenses			75,701	8,510	32,797 <i>c</i>	117,008	



**Table of Contents****Nine Months Ended February 28, 2009**

	Networking Business		TippingPoint		Eliminations/ Other	Total
	China-based Sales Region	Rest of World Sales Region	Central Functions	Security Business Tipping Point		
(in thousands)						
Sales	\$ 565,597	\$ 368,838	\$	\$ 92,499	\$ (5,015) <i>a</i>	\$ 1,021,919
Gross profit	375,588	215,479	(76,707)	62,804	(1,916) <i>b</i>	575,248
Direct sales & marketing expenses	106,194	77,254		30,873	4,742 <i>b</i>	219,063
Segment contribution profit (loss)	269,394	138,225	(76,707)	31,931	(6,658)	356,185
Other operating expenses			219,593	31,181	26,126 <i>c</i>	276,900
Segment profit	\$	\$	\$	\$ 750	\$	
Operating income						\$ 79,285

**Nine Months Ended February 28, 2008**

	Networking Business		TippingPoint		Eliminations/
	China-based Sales Region	Rest of World Sales Region	Central Functions	Security Business Tipping Point	