3COM CORP
Form 10-Q
April 05, 2005

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 February 25, 2005

OR

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

For the transition period from to

Commission File No. 0-12867

3Com Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-2605794**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
350 Campus Drive Marlborough, Massachusetts	**01752**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(508) 323-5000**

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 March 25, 2005, 383,668,086 shares of the registrant s Common Stock were outstanding.

3Com Corporation

Table of Contents

PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Operations *Three and Nine Months Ended February 25, 2005 and February 27, 2004*	3
	Condensed Consolidated Balance Sheets *February 25, 2005 and May 28, 2004*	4
	Condensed Consolidated Statements of Cash Flows *Nine Months Ended February 25, 2005 and February 27, 2004*	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	41
Item 4.	Controls and Procedures	41
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	42
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	42
Item 3.	Defaults Upon Senior Securities	43
Item 4.	Submission of Matters to a Vote of Security Holders	43
Item 5.	Other Information	43
Item 6.	Exhibits	43
Signatures		

PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

3Com Corporation

Condensed Consolidated Statements of Operations

(Unaudited)

(In thousands, except per share data)	**Three Months Ended February 25, 2005**	**Three Months Ended February 27, 2004**	**Nine Months Ended February 25, 2005**	**Nine Months Ended February 27, 2004**
Sales	$ 161,185	$ 171,769	$ 474,602	$ 515,539
Cost of sales	103,825	111,500	302,456	348,376
Gross margin	57,360	60,269	172,146	167,163
Operating expenses:				
Sales and marketing	59,358	61,846	173,851	190,090
Research and development	24,445	23,776	67,369	75,124
General and administrative	13,959	17,599	44,016	63,522
Amortization and write down of intangibles	1,716	1,071	4,905	5,553
In-process research and development	5,100		6,775	
Restructuring charges	9,093	39,534	16,374	147,050
Total operating expenses	113,671	143,826	313,290	481,339
Operating loss	(56,311)	(83,557)	(141,144)	(314,176)
Gain (loss) on investments, net	1,661	880	1,743	(11,314)
Interest and other income, net	4,853	3,612	10,667	11,364
Loss from continuing operations before income taxes and equity interest in loss of unconsolidated joint venture	(49,797)	(79,065)	(128,734)	(314,126)
Income tax benefit (provision)	(959)	(1,626)	(1,502)	2,909
Equity interest in loss of unconsolidated joint venture	(2,249)	(4,196)	(7,125)	(16,789)
Loss from continuing operations	(53,005)	(84,887)	(137,361)	(328,006)
Discontinued operations, net of taxes		(685)		(2,541)
Net loss	$ (53,005)	$ (85,572)	$ (137,361)	$ (330,547)
Basic and diluted loss per share:				
Continuing operations	$ (0.14)	$ (0.22)	$ (0.36)	$ (0.87)
Discontinued operations, net of taxes				(0.01)

Net loss	$ (0.14)	$ (0.22)	$ (0.36)	$ (0.88)
Shares used in computing per share amounts:				
Basic and diluted	379,946	385,019	382,075	376,077

See notes to condensed consolidated financial statements.

3Com Corporation

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except par value)		**February 25, 2005**		**May 28, 2004**
ASSETS				
Current assets:				
Cash and equivalents	$	226,979	$	476,274
Short-term investments		655,802		907,082
Accounts receivable, less allowance for doubtful accounts ($15,181 and $16,276, respectively)		74,018		66,372
Inventories		24,263		27,679
Other current assets		33,335		42,270
Total current assets		1,014,397		1,519,677
Investment in Huawei-3Com joint venture		135,766		142,891
Property and equipment, net		71,346		72,452
Property and equipment held for sale				42,147
Deposits and other assets		43,983		34,806
Deferred income taxes		3,053		2,937
Intangible assets, net		69,966		5,009
Goodwill		310,367		899
Total assets	$	1,648,878	$	1,820,818
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	77,725	$	80,408
Accrued liabilities and other		232,992		226,161
Total current liabilities		310,717		306,569
Deferred revenue and long-term obligations		9,149		15,135
Stockholders equity:				
Preferred stock, $.01 par value, 10,000 shares authorized; none outstanding				
Common stock, $.01 par value, 990,000 shares authorized; shares issued: 383,286 and 392,738, respectively		2,302,372		2,262,223
Treasury stock, at cost, 10,127 and 0 shares, respectively		(49,577)		
Unamortized stock-based compensation		(13,279)		(2,577)
Retained deficit		(905,702)		(755,244)
Accumulated other comprehensive loss		(4,802)		(5,288)
Total stockholders equity		1,329,012		1,499,114
Total liabilities and stockholders equity	$	1,648,878	$	1,820,818

See notes to condensed consolidated financial statements.

4

3Com Corporation

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	**Nine Months Ended February 25, 2005**	**February 27, 2004**
Cash flows from operating activities:		
Loss from continuing operations	$ (137,361)	$ (328,006)
Adjustments to reconcile loss from continuing operations to cash (used in) operating activities:		
Loss from discontinued operations		(2,541)
Depreciation and amortization	36,797	96,789
Write down of intangibles	1,242	1,905
(Gain) loss on property and equipment	(5,445)	41,111
(Gain) loss on investments, net	(1,769)	11,314
Equity interest in loss of unconsolidated joint venture	7,125	16,789
Deferred income taxes	(118)	(207)
Purchased in-process research and development	6,775	
Stock-based compensation expense	1,778	2,206
Changes in assets and liabilities:		
Accounts receivable	(7,646)	3,319
Inventories	(4,581)	(2,090)
Other assets	(5,884)	(8,611)
Accounts payable	(2,682)	(8,746)
Accrued liabilities and other	2,074	27,831
Net cash (used in) operating activities	(109,695)	(148,937)
Cash flows from investing activities:		
Investment in Huawei-3Com joint venture		(160,000)
Purchases of investments	(466,330)	(662,734)
Proceeds from maturities and sales of investments	706,071	782,310
Purchases of property and equipment	(13,704)	(12,552)
Businesses acquired in purchase transactions, net of cash acquired	(355,686)	
Proceeds from sale of property and equipment	50,946	100,240
Net cash provided by (used in) investing activities	(78,703)	47,264
Cash flows from financing activities:		
Issuances of common stock	11,779	106,521
Repurchases of common stock	(73,365)	
Collection of note receivable issued for warrants		8,421
Repayments of borrowings	(1,308)	(346)
Net cash provided by (used in) financing activities	(62,894)	114,596
Effect of exchange rate changes on cash and equivalents	1,997	1,222
Increase (decrease) in cash and equivalents during period	(249,295)	14,145
Cash and equivalents, beginning of period	476,274	415,798

Cash and equivalents, end of period	$	226,979	$	429,943

See notes to condensed consolidated financial statements.

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 25, 2005 and May 28, 2004, and our results of operations and cash flows for the three and nine months ended February 25, 2005 and February 27, 2004.

Certain amounts from prior periods have been reclassified to conform to the current period presentation. In connection with the preparation of this report, we concluded that it was appropriate to classify auction rate securities, which are securities with longer stated maturities, but have interest rates that reset similar to short-term securities, as short-term investments. Previously, such investments had been classified as cash and equivalents. We made corresponding adjustments to our Condensed Consolidated Statement of Cash Flows and to our Condensed Consolidated Balance Sheet. These reclassifications had no impact on working capital, our results of operations or our cash flows from operating activities.

We use a 52 or 53-week fiscal year ending on the Friday nearest to May 31. The results of operations for the three and nine months ended February 25, 2005 may not be indicative of the results to be expected for the fiscal year ending June 3, 2005. 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 fiscal year ended May 28, 2004.

Recent Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (EITF) of the FASB issued EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF 03-1 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB issued Staff Position EITF 03-1-1, which delays the effective date until additional guidance is issued for the application of the recognition and measurement provisions of EITF 03-1 to investments in securities that are impaired. We do not believe that adoption of EITF 03-1 will have a material impact on our financial position or results of operations.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R is effective for all interim periods beginning after June 15, 2005 and, thus, will be effective for us beginning with the second quarter of fiscal 2006. Retroactive application of the provisions of SFAS 123R to the beginning of the fiscal year that includes the effective date is permitted, but not required. We are currently evaluating the impact of SFAS 123R on our financial position and results of operations. See Note 3 for information related to the pro forma effects on our reported net loss and net loss per share of applying the fair value recognition provisions of the previous Statement of Financial Accounting Standards (SFAS) 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

Note 2. **Discontinued Operations**

On March 4, 2003, we entered into an agreement (Asset Purchase Agreement) to sell selected assets and liabilities of our CommWorks division to UTStarcom, Inc. in exchange for $100 million in cash, subject to certain closing adjustments. On May 23, 2003, we completed the sale pursuant to the terms of the Asset Purchase Agreement. As a result, we reported the CommWorks division as a discontinued operation beginning in the fourth quarter of fiscal 2003 and restated all prior periods presented on a comparative basis. The loss from discontinued operations for the three months and nine months ended February 27, 2004 resulted from adjustments to previous estimates of liabilities related to the sale of the CommWorks division.

Note 3. Stock-Based Compensation

We have stock option plans under which employees and directors may be granted options to purchase common stock. Options generally are granted with exercise prices at not less than the fair market value at the date of the grant, vest annually over two to four years, and expire seven to ten years after the grant date.

Restricted stock represents shares of common stock that are issued at no cost to key employees and that generally vest over a one to four-year period. Such shares are subject to our right to reacquire those shares upon such person s termination of employment to the extent that such right has not lapsed. We also grant time accelerated restricted stock awards whereby shares with a specified time-based vesting period may be accelerated if specific performance milestones are achieved.

Additionally, 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 end of the six-month offering period.

As permitted under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, we follow Accounting Principles Board (APB) Opinion 25 and related Interpretations in accounting for stock-based awards to employees. Under APB Opinion 25, compensation expense associated with employee stock awards is measured as the difference, if any, between the price to be paid by an employee and the fair value of the underlying common stock on the grant date, which usually is the measurement date for accounting purposes. Generally, we recognize no compensation expense with respect to stock-based option awards and stock issued under the ESPP. However, to the extent that we modify an employee s stock options subsequent to the grant date (for example, by extending the period of time permitted for exercising a stock option following an employee s involuntary termination), we record compensation expense attributable to the modifications. Also, we record compensation expense related to restricted stock over the applicable vesting period; such compensation expense is measured as the fair market value of the restricted stock at the date of the grant.

SFAS 123 requires disclosure of the pro forma effects on our reported net loss and net loss per share of applying the fair value recognition provisions of SFAS 123 to stock-based employee compensation. The following table illustrates such pro forma effects:

(in thousands, except per share amounts)	**Three Months Ended**		**Nine Months Ended**	
	February 25, 2005	**February 27, 2004**	**February 25, 2005**	**February 27, 2004**
Net loss as reported	$ (53,005)	$ (85,572)	$ (137,361)	$ (330,547)
Add: Stock-based compensation included in reported net loss	913	955	1,778	2,206
Deduct: Total stock-based compensation determined under the fair value-based	(5,163)	(4,229)	(12,898)	(14,918)

method, net of related tax effects				
Pro forma net loss	$ (57,255)	$ (88,846)	$ (148,481)	$ (343,259)
Net loss per share-basic and diluted:				
As reported	$ (0.14)	$ (0.22)	$ (0.36)	$ (0.88)
Pro forma	(0.15)	(0.23)	(0.39)	(0.91)

For purposes of this pro forma disclosure, the estimated fair values of employee stock options (ESOs) are assumed to be amortized over the applicable vesting periods, and the estimated fair values of ESPP shares are assumed to be amortized over the applicable subscription periods.

As of February 25, 2005, and February 27, 2004, the expected average life of ESOs was estimated at approximately one and a half years after the vesting date. Although there were no purchase rights granted under the ESPP for the three months ended February 25, 2005 and February 27, 2004, the expected average life of purchase rights granted under the ESPP in prior periods was estimated at six months from the subscription date. The fair values of ESOs and ESPP shares granted during the third quarter of fiscal 2005 and fiscal 2004 and the first nine months of fiscal 2005 and 2004 have been estimated as of the date of grant using the Black-Scholes option pricing model. The assumptions used in preparing the estimates and the resulting fair values are shown below:

	Three Months Ended		Nine Months Ended	
	February 25, 2005	February 27, 2004	February 25, 2005	February 27, 2004
Volatility-ESO	51.0%	64.0%	55.2%	67.0%
Volatility-ESPP			40.0%	45.0%
Risk-free interest rate-ESO	3.6%	2.7%	3.4%	2.6%
Risk-free interest rate-ESPP			2.2%	1.0%
Dividend yield-ESO and ESPP	0.0%	0.0%	0.0%	0.0%
Per-share fair value of options granted under ESO	$ 1.59	$ 4.08	$ 2.06	$ 2.86
Per-share fair value of purchase rights granted under ESPP			$ 1.13	$ 1.79

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. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility.

On January 31, 2005, we completed our acquisition of TippingPoint Technologies, Inc. (TippingPoint). Pursuant to the merger agreement, at the effective time of the merger, outstanding options to purchase shares of TippingPoint common stock were converted into options to purchase approximately 13.9 million shares of our common stock. The fair value of each option grant was estimated on the date of acquisition using the Black-Scholes option pricing model with input assumptions similar to those used for our stock options granted during the three months ended February 25, 2005. Deferred compensation of $9.4 million related to the intrinsic value of unvested stock options was recorded as part of the acquisition and will be amortized to expense over the remaining service period.

Note 4. Acquisition

On January 31, 2005, we completed our acquisition of TippingPoint for consideration of $430.0 million, subject to adjustment. This amount excludes the cost of integration, as well as other costs related to the transaction. TippingPoint is a provider of networked-based intrusion prevention systems (IPS). The acquisition enabled us to expand our portfolio of secure, converged voice and data networking solutions.

The TippingPoint acquisition was accounted for as a purchase, and accordingly, the assets purchased and liabilities assumed are included in the consolidated balance sheet as of February 25, 2005. The operating results of TippingPoint are included in the consolidated financial statements since the date of acquisition.

The preliminary purchase price is shown below (in millions):

Cash paid for common stock	$	389.5
Fair value of outstanding stock options assumed		36.1
Acquisition direct costs		4.4
Total purchase price	$	430.0

In accordance with SFAS No. 141, *Business Combinations*, we allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed, including in-process research and development, based on their estimated fair values, and deferred stock compensation. The excess purchase price over those fair values is recorded as goodwill. The fair values assigned to tangible and intangible assets acquired and liabilities assumed are based on estimates and assumptions provided by management, and other information compiled by management, including valuations that utilize established valuation techniques appropriate for the high technology industry. Goodwill recorded as a result of this acquisition is not expected to be deductible for tax purposes. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is not amortized but will be reviewed at least annually for impairment. Purchased intangibles with finite lives will be amortized on a straight-line basis over their respective estimated useful lives. The total preliminary purchase price has been allocated as follows (in millions):

Net tangible assets (liabilities) assumed	$	36.1
Amortizable intangible assets:		
Existing technology		39.1
Maintenance agreements		19.0
Other		11.8
Total amortizable intangible assets		69.9
In-process research and development		5.1
Deferred compensation on unvested stock options		9.4
Goodwill		309.5
Total purchase price allocation	$	430.0

The purchase price and related allocation are preliminary and may be revised as a result of adjustments made to the purchase price, additional information regarding liabilities assumed, including contingent liabilities, and revisions of preliminary estimates of fair values made at the date of purchase.

Intangible assets include amounts recognized for the fair value of existing technology, maintenance agreements, trade name and trademarks, and non-competition agreements. These intangible assets have a weighted average useful life of approximately five years.

The following pro forma financial information presents the combined results of operations of 3Com Corporation and TippingPoint as if the acquisition had occurred as of the beginning of the periods presented. Adjustments, which reflect the amortization of purchased intangible assets and deferred stock compensation, charges to cost of sales for inventory write-ups, and in-process research and development, have been made to the combined results of operations for the three and nine months ended February 25, 2005 and February 27, 2004, respectively. The unaudited pro forma financial information is not intended to represent or be indicative of our consolidated results of operations or financial condition that would have been reported had the acquisition been completed as of the dates presented, and should not be taken as representative of our future consolidated results of operations or financial condition.

	Three Months Ended	Nine Months Ended

(in millions, except per share amounts)	February 25, 2005	February 27, 2004	February 25, 2005	February 27, 2004
Net sales	$ 171.6	$ 173.7	$ 499.1	$ 518.3
Net loss	(67.8)	(104.5)	(169.9)	(369.5)
Basic and diluted loss per share	(0.18)	(0.27)	(0.44)	(0.98)

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 2001, we began a broad restructuring of our business to enhance the focus and cost effectiveness of our business units in serving their respective markets. These efforts continued through fiscal 2002. We took the following specific actions in fiscal 2001 and 2002 (the Fiscal 2001 and 2002 Actions): we organized around independent businesses that utilized shared central services; we exited product lines; we outsourced the manufacturing of certain high volume server, desktop and mobile connectivity products in a contract manufacturing arrangement; we implemented a reduction in workforce; and we consolidated our real estate facilities and made plans to sell excess facilities.

As a result of further sales declines and net losses, we took additional restructuring actions in fiscal 2003 (the Fiscal 2003 Actions). We announced the integration of the support infrastructure of two of our business units to leverage a common infrastructure in order to reduce costs. Additionally, we entered into agreements to outsource certain information technology (IT) functions, reduced our workforce, and continued to consolidate and dispose of excess facilities.

In response to continuing sales declines and net losses, we took additional measures to reduce costs during fiscal 2004 (the Fiscal 2004 Actions) and fiscal 2005 (the Fiscal 2005 Actions). These actions included reductions of our workforce, outsourcing of our remaining manufacturing operations, and continuing efforts to consolidate and dispose of excess facilities.

Restructuring charges related to these various initiatives in the third quarters of fiscal 2005 and fiscal 2004 were $9.1 million and $39.5 million, respectively. Such charges were net of reversals of prior charges of $0.2 million and $5.8 million, respectively, related primarily to revisions of previous estimates of employee separation expenses, lease obligation costs, and values of held for sale properties. Restructuring charges related to these various initiatives in the first three quarters of fiscal 2005 and fiscal 2004 were $16.4 million and $147.1 million, respectively. Such charges were net of reversals of prior charges of $6.1 million and $7.3 million, respectively, related primarily to revisions of previous estimates of employee separation expenses, lease obligation costs, and values of held for sale properties.

Accrued liabilities associated with restructuring charges are classified as current, since we intend to satisfy such liabilities in cash within the next twelve months, and are included in the caption Accrued liabilities and other in the accompanying condensed consolidated balance sheets.

Fiscal 2005 Actions

The following table provides a summary of the components of restructuring charges recorded in the first three quarters of fiscal 2005 with respect to the Fiscal 2005 Actions, together with changes in the accrued amounts and the ending balances as of February 25, 2005 (in thousands):

	Employee Separation Expenses	Facilities-related Charges	Other Restructuring Costs	Total

Balance at May 28, 2004	$		$		$		$	
Provision		5,439		59		333		5,831
Payments and non-cash charges		(2,192)		(59)		(333)		(2,584)
Balance at August 27, 2004		3,247						3,247
Provision		1,788		5		87		1,880
Payments and non-cash charges		(3,188)		(5)		(87)		(3,280)
Balance at November 26, 2004		1,847						1,847
Provision		8,572		4		438		9,014
Payments and non-cash charges		(4,727)		(4)		(438)		(5,169)
Balance at February 25, 2005	$	5,692	$		$		$	5,692

Employee separation expenses include severance pay, outplacement services, and medical and other related benefits. The reduction in workforce affected employees in the research and development, product management, customer service, supply chain, sales and marketing, and general and administrative functions. The total reduction in workforce associated with actions initiated during the first three quarters of fiscal 2005 includes approximately 350 employees. Separation payments associated with actions initiated during the first three quarters of fiscal 2005 totaled $9.7 million through February 25, 2005.

Facilities-related charges include costs associated with vacating leased offices in fiscal 2005. Other restructuring costs relate mainly to payments to suppliers for restructuring-related services.

Fiscal 2004 Actions

The following table provides a summary of the components of accrued restructuring charges related to the Fiscal 2004 Actions, together with changes in the accrued amounts during the first three quarters of fiscal 2005 and the ending balances of the associated accrued liabilities as of February 25, 2005 (in thousands):

	Employee Separation Expenses	Facilities-related Charges	Other Restructuring Costs	Total
Balance at May 28, 2004	$ 5,529	$ 530	$	$ 6,059
Provision (benefit)	(2,208)	(2,455)	192	(4,471)
Payments and non-cash changes	(2,596)	2,600	(192)	(188)
Balance at August 27, 2004	725	675		1,400
Provision		389	98	487
Payments and non-cash changes	(91)	78	(98)	(111)
Balance at November 26, 2004	634	$ 1,142		1,776
Provision		30		30
Payments and non-cash charges	(14)	(150)		(164)
Balance at February 25, 2005	$ 620	$ 1,022	$	$ 1,642

Employee separation expenses include severance pay, outplacement services, medical and other related benefits. The reduction in workforce mainly affected employees involved with the Dublin, Ireland manufacturing operations, and also affected employees in sales and marketing, research and development, and general and administrative functions.

Facilities-related charges in the first three quarters of fiscal 2005 relating to restructuring actions initiated in fiscal 2004 were the result of revisions in estimates of lease obligation costs.

Other restructuring costs primarily reflected payments to suppliers for restructuring-related services.

Fiscal 2003 Actions

The following table provides a summary of the components of accrued restructuring charges related to the Fiscal 2003 Actions, together with changes in the accrued amounts during the first three quarters of fiscal 2005 and the ending balances as of February 25, 2005 (in thousands):

		Facilities-related Charges
Balance at May 28, 2004	$	2,566
Provision		221
Payments and non-cash charges		(360)
Balance at August 27, 2004		2,427
Provision		1,442
Payments and non-cash charges		(360)
Balance at November 26, 2004		3,509
Provision		6
Payments and non-cash charges		(447)
Balance at February 25, 2005	$	3,068

Additional facilities-related charges were the result of revisions in estimates of lease obligation costs.

Fiscal 2001 and Fiscal 2002 Actions

The following table provides a summary of the components of accrued restructuring charges related to the Fiscal 2001 and Fiscal 2002 Actions, together with changes in the accrued amounts during the first three quarters of fiscal 2005 and the ending balances as of February 25, 2005 (in thousands):

	Facilities-related Charges	Other Restructuring Costs	Total
Balance at May 28, 2004	$ 6,723	$ 82	$ 6,805
Provision	1,203		1,203
Payments and non-cash charges	(1,320)	(31)	(1,351)
Balance at August 27, 2004	6,606	51	6,657
Provision	688		688
Payments and non-cash charges	(461)	(17)	(478)
Balance at November 26, 2004	6,833	34	6,867
Provision	43		43
Payments and non-cash charges	(518)	(15)	(533)
Balance at February 25, 2005	$ 6,358	$ 19	$ 6,377

Additional facilities-related charges were the result of changes in estimates associated with various lease obligations. Activity related to other restructuring costs primarily reflected payments to suppliers for restructuring-related services.

Note 6. Investment in Unconsolidated Joint Venture

On November 17, 2003, we formed the Huawei-3Com Joint Venture (H-3C) with a subsidiary of Huawei Technologies, Ltd. (Huawei). H-3C is domiciled in Hong Kong, and has its principal operating centers in Hangzhou and Beijing, China.

At the time of formation, we contributed cash, assets related to our operations in China and Japan, and licenses related to certain intellectual property in exchange for a 49 percent ownership interest. We recorded our initial investment in H-3C at $160.1 million, reflecting the carrying value of the assets contributed. Huawei contributed its enterprise networking business assets including Local Area Network (LAN) switches and routers; engineering, sales, and marketing resources and personnel; and licenses to its related intellectual property in exchange for a 51 percent ownership interest. Two years after formation of H-3C, we have the one-time option to purchase an additional two percent ownership interest from Huawei for an amount not to exceed $28 million. Three years after formation of H-3C, we and Huawei each have the right to purchase all of the other partner s ownership interest through a bid process.

We account for our investment in H-3C by the equity method. Under this method, we record our proportionate share of H-3C s net income or loss based on the most recently available financial statements. Since H-3C follows a calendar year basis of reporting, we report our equity in

H-3C s net income or loss based on H-3C s financial statements for the most recent calendar quarter, two months in arrears. In determining our share of H-3C s net income or loss, we make certain adjustments to H-3C s reported results. Such adjustments are made primarily to recognize the value and related amortization expense associated with Huawei s contributed assets, as well as to defer H-3C s sales and gross profit on sales of products sold to us that remained in our inventory at the end of the accounting period.

Summarized condensed unaudited financial information for H-3C, adjusted as described above, is as follows (in thousands):

Balance Sheet:

	December 31, 2004	March 31, 2004
Current assets	$ 264,489	$ 242,904
Non-current assets	147,906	208,471
Current liabilities	117,062	86,825
Non-current liabilities	8,866	8,866

Statements of Operations:

	Three Months-Ended December 31, 2004	Nine Months-Ended December 31, 2004
Sales	$ 87,116	$ 215,696
Gross margin	33,717	84,485
Loss from operations	5,536	16,663
Net loss	4,589	14,540

We and H-3C are parties to agreements providing for the sale of certain products between the two companies. During the third quarter of fiscal 2005, we made sales of products to H-3C of $3.2 million and made purchases of products from H-3C of $6.0 million. During the first nine months of fiscal 2005, we made sales of products to H-3C of $10.3 million and made purchases of products from H-3C of $12.9 million. As of February 25, 2005, our accounts receivable and accounts payable included $1.3 million and $2.8 million, respectively, related to transactions with H-3C. Also, as of February 25, 2005, we had deferred approximately $0.1 million related to sales of products to H-3C that had not yet been shipped to H-3C s end customers.

Note 7. Comprehensive Loss

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

	Three Months Ended		Nine Months Ended	
	February 25, 2005	February 27, 2004	February 25, 2005	February 27, 2004
Net loss	$ (53,005)	$ (85,572)	$ (137,361)	$ (330,547)
Other comprehensive income (loss):				
Net unrealized gain (loss) on investments	(196)	1,075	(1,583)	(258)
Net unrealized gain (loss) on cash flow hedges	817	(713)	(81)	(713)
Change in accumulated translation adjustments	(208)	556	2,150	1,214
Total comprehensive loss	$ (52,592)	$ (84,654)	$ (136,875)	$ (330,304)

Note 8. 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 February 25, 2005	Three Months Ended February 27, 2004	Nine Months Ended February 25, 2005	Nine Months Ended February 27, 2004
Loss from continuing operations	$ (53,005)	$ (84,887)	$ (137,361)	$ (328,006)
Loss from discontinued operations		(685)		(2,541)
Net loss	$ (53,005)	$ (85,572)	$ (137,361)	$ (330,547)
Weighted average shares-basic	379,946	385,019	382,075	376,077
Effect of dilutive securities:				
Employee stock options				
Restricted stock				
Weighted average shares-diluted	379,946	385,019	382,075	376,077
Net loss per share-basic and diluted:				
Continuing operations	$ (0.14)	$ (0.22)	$ (0.36)	$ (0.87)
Discontinued operations				(0.01)
Net loss	$ (0.14)	$ (0.22)	$ (0.36)	$ (0.88)

Employee stock options and restricted stock totaling 9.8 million shares and 11.0 million shares for the three months ended February 25, 2005 and February 27, 2004, respectively, and 4.9 million shares and 7.5 million shares for the nine months ended February 25, 2005 and February 27, 2004, respectively, were not included in the diluted weighted average shares calculation as the effects of these securities were anti-dilutive.

Note 9. Inventories

Inventories consist of the following (in thousands):

	February 25, 2005	May 28, 2004
Finished goods	$ 22,710	$ 25,869
Work-in-process	617	485
Raw materials	936	1,325
Total		