3COM CORP
Form 10-K
August 08, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended June 1, 2001 Commission File No. 0-12867

OR

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

For the transition period from ________________ to ________________

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

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.01 par value
Preferred Stock Purchase Rights

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 [X] No [_]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of the Registrant's Common Stock held by non-affiliates, based upon the closing price of the Common Stock on August 1, 2001, as reported by the Nasdaq National Market, was approximately $1,718,622,845. Shares of Common Stock held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Stock, based on Schedule 13G filings, have been excluded since such persons may be deemed affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of August 1, 2001, 345,640,449 shares of the Registrant's Common Stock were outstanding.

The Registrant's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on September 20, 2001 is incorporated by reference in Part III of this Form 10-K to the extent stated herein.

3Com Corporation
Form 10-K
For the Fiscal Year Ended June 1, 2001
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This annual report, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, particularly statements regarding our expectations on capital spending, our products and services gross margins expectations for fiscal year 2002, our expectations regarding the competitiveness of our product and service offerings, our expectations relating to our future investments and expenses relating to research and development, statements regarding our liquidity and capital resources, our expectation that we will incur more charges related to our restructuring efforts during fiscal 2002, our expectation that we will substantially complete our restructuring activities related to the global cost reduction to improve operational efficiencies, our expectation that gross margins will improve in future periods as a result of our restructuring efforts, our intention to reduce operating expenses in future periods, our plan to reduce fixed costs by completing our reduction in force plans, our expectation that emerging product lines will account for a higher percentage of our future sales over time, our expectation that our Total Control 2000 product will be available before the end of the calendar year, our plans to invest a significant portion of financial resources in developing products for emerging growth markets, our intention to consolidate our real estate portfolio and liquidate certain facilities associated with our manufacturing facilities in fiscal 2002, our intention to transition our Singapore facility into a regional distribution center and sales and support office, our intention to enter into a contract manufacturing relationship with Flextronics and outsource the manufacturing of our high volume server, desktop and mobile products, our plans to exit the consumer broadband cable and DSL modem business, our belief that we have sufficient flexibility in the monetization of surplus real estate and other financial resources to retire certain leases, our expectations that our acquisitions of businesses or product lines will decrease in comparison to historical levels, our expectation that international markets will continue to account for a significant percentage of our sales, our plans to make investments through 3Com Ventures and expectations related to payments that may be made over the next twelve months with respect to capital calls, our expectation that emerging product lines will grow at a significantly higher rate than the networking industry average, our expectation that emerging product lines will account for a higher percentage of our sales over time, our belief that our cash and equivalents, short term investments, and cash generated from operations will be sufficient to satisfy our anticipated cash requirements for at least the next 12 months, our expectation that adoption of SFAS 133 and SFAS 141 will not have a material effect on our results of operations or financial position, our intention to hold our fixed income investments until maturity, our expectations regarding the number of positions that will be affected by the reduction in force undertaken as part of our current restructuring initiatives, our expectation that employee separations related to our current restructuring activities will be substantially complete by May 2002, our expectations regarding future expenses associated with our current restructuring activities, our expectation that we will not reach minimum purchase commitments associated with a supply agreement as a result of our intended exit from consumer product lines, our belief that audits being conducted by certain domestic and foreign taxing jurisdictions of our income tax returns will not have a material adverse effect on our consolidated financial condition or results of operations and our expectations regarding the continuing volatility of our stock price. These statements are subject to certain risks and uncertainties that could cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties, see the "Business Environment and Industry Trends" section of this Form 10-K. 3Com undertakes no obligation to update forward-looking statements to reflect events or circumstances occurring after the date of this Form 10-K.

PRESENTATION OF DISCONTINUED OPERATIONS--PALM, INC.

The following information relates to the continuing operations of 3Com Corporation and our consolidated subsidiaries (3Com). Palm, Inc. (Palm) is accounted for as a discontinued operation, as a result of our decision to distribute the Palm common stock we owned to 3Com shareholders in the form of a stock dividend. Subsequent to the distribution to our shareholders on July 27, 2000, Palm's operations ceased to be part of our operations and reported results.

PART I

ITEM 1. Business

GENERAL

3Com Corporation was founded on June 4, 1979. A pioneer in the computer networking industry, our heritage is in providing robust networking solutions that are functionally rich, cost-effective and simple to use. Our competitive advantages include our industry-leading intellectual property portfolio, distributor and customer relationships, and brand identity. During fiscal year 2001, we won market share in emerging-growth product categories, established new levels of innovation, drove changes to benefit customers and delivered new products that validated our brand promise to our business customers - rich connectivity and radical simplicity.

We target sectors of the enterprise and service provider markets. Beginning in fiscal year 2002, we have structured our operations around three businesses that are leveraging our core strengths and focusing upon specific market opportunities that offer long-term, profitable growth. These businesses are:

o Business Networks Company (BNC), which provides network infrastructure solutions for the enterprise and small business markets;

o Business Connectivity Company (BCC), which provides products that enable computing devices to access computer networks; and

o CommWorks Corporation (CommWorks), which provides Internet Protocol (IP)-based access and infrastructure and services platforms for the telecommunications service provider market.

Each of these businesses has a unique business model tuned for the dynamics of its target market. This simplified structure allows greater focus, faster responsiveness, and increased accountability.

In fiscal 2001, we operated in two segments, 1) Commercial and Consumer Networks Business (CCB) and 2) Carrier Networks Business (CNB). CCB comprised the BNC and BCC businesses described above and the consumer product lines which were exited during fiscal 2001, as discussed further in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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INDUSTRY SEGMENTS

Business Networks Company

Our Business Networks Company develops technologies and products to build and manage networks supporting local area network (LAN) switching, web technologies, networked telephony and wireless LANs. BNC's solutions are feature rich so they can support the increasingly complex and demanding application environments in today's businesses but they are also easy to install, use and operate and are very affordable to own. BNC's network solutions help IT and business teams to run their businesses rather than spend time focusing on getting the technology to work.

Building upon our historical success in the networking infrastructure market, BNC continues to be a leader in key technologies that represent future growth opportunities. BNC achieves this leadership position through design innovation that makes feature-rich network technology simple to use. Recent innovations include modular, application-aware (Layer 3+) and Gigabit-over-copper networking switches; new application-specific integrated circuit (ASIC) designs that make our products more affordable; LAN telephony products that reliably handle voice traffic; and wireless LANs that offer robust security, ease of use and easy integration.

Markets and Customers

BNC provides network infrastructures to enterprises and small businesses, targeting in particular enterprises who value innovative, feature-rich networks that are easy to use and affordable to own. BNC distributes its solutions primarily through its worldwide channel of value-added resellers, system integrators and more recently, telecommunications service providers. BNC is fully committed to its Focus Partner Program and sees its resellers and channel partners as a vital extension of its sales force. It works extensively with its resellers and channel partners to ensure they are able to meet their business goals.

Competition

Principal competitors in the enterprise networking market include Avaya, Inc., Cisco Systems, Inc., Enterasys (Cabletron System, Inc.), Hewlett Packard Company, Lucent Technologies, Inc., and Nortel Networks, Corp.

Current Product Offerings

BNC delivers network infrastructure solutions for enterprises and small businesses worldwide. BNC develops three categories of products, 1) LAN infrastructure, composed of hubs, switches and web solutions, 2) networked telephony systems for voice over existing network connections and 3) wireless access points and adapters based on Wi-Fi technology.

LAN Infrastructure solutions:

- o Stackable SuperStack(R) 3 and Modular Switch 4000 Series family of Ethernet, Fast Ethernet and Gigabit Ethernet switches is a new generation of essential networking components that form the foundation of any business network.

- o The SuperStack 3 Web solutions, including firewall, Webcache and server load balancer, allow customers to access the Web faster, more securely and at a lower cost, as well as ensure network availability.

- o An affordable family of hubs and switches for cost-sensitive networking users that require reliable and powerful stackable LAN solutions.

- OfficeConnect (R) family of switches, hubs and firewalls are designed specially for small businesses to obtain all the benefits of rich networking and the Internet while enjoying all the ease of the plug-and-play products. Also available is 3Com's 800 Series of OfficeConnect digital subscriber line (DSL) routers for high-speed Internet access for businesses.

Networked Telephony solutions:

- SuperStack 3 NBX(R) and NBX 100 networked telephony solutions offer enterprise and small business customers significant telephony cost savings, flexibility and voice/data application integration over existing wiring.

- NBX 25 networked telephony solution gives small offices of up to 20 users a cost-effective voice product that can be deployed over existing LAN infrastructure.

Wireless LAN solutions:

- Reliable, easy-to-use wireless solutions are based on the industry standard Wi-Fi (802.11b). The range of these wireless LANs allow them to be used effectively in small businesses, large enterprises and even public access areas such as airports and hotels.

New Products in Fiscal Year 2001

On June 26, 2000, we announced new solutions that enable small business customers to reap the benefits of networked telephony with the NBX 25 business telephone system, and to advance network security to improve Internet access with our OfficeConnect access products. We also announced our Ethernet power source to create a single, continuous source of power for our networked telephony and wireless systems.

On July 17, 2000, we announced a new version of Network Supervisor, our network management solution that enables businesses to easily manage their 3Com LAN networks. This version offered new automation built into the software, removing the complexity for the user, yet offering sophisticated features, such as proactive alarm systems to avoid network downtime.

On August 1, 2000, we announced new easy-to-use 10/100 Megabits per second (Mbps) LAN switches at an aggressive price, leveraging product cost reductions.

On October 23, 2000, we announced new OfficeConnect products that help small business customers do business on the web while keeping secure their business-critical information.

On November 6, 2000, we announced a new series of products designed to address the new fundamental needs of modern business: how to make the network run faster, keep people constantly connected and do it all more securely and at the best possible price. This announcement was a significant commitment to the enterprise and small business market. This announcement addressed four key areas: Gigabit Ethernet with SuperStack 3, Web-enablement, wireless LANs and networked telephony.

On February 12, 2001, we announced the newest addition to our networked telephony product family, the SuperStack 3 NBX Networked Telephony Solution. The SuperStack 3 NBX was an expansion of our existing networked telephony product family (NBX 25, NBX 100, Ethernet Power Source) and became available in 45 countries worldwide in April 2001. Our IP private branch exchange (PBX) solution gives customers more capacity, increased reliability, enhanced functionality and

10/100-infrastructure support. The product enhancements and integration with the SuperStack product family positioned us to further advance our lead in this market by winning larger enterprise installations.

On March 6, 2001, we announced NBX Call Center, which is a software solution that gives businesses advanced call center capabilities, such as intelligent call routing, graphical alarms, drag and drop queuing, real-time monitoring and reporting.

On March 14, 2001, we announced new modules for the award-winning SuperStack 3 Switch 4900 family. We established ourselves as the only vendor able to offer both network interface cards (NICs) and switches in an end-to-end Gigabit Ethernet solution. According to Cahners In-Stat first quarter 2001 report, we increased our leadership position in the Gigabit Ethernet-over-Copper switch market by almost 8 percentage points and now hold a 35.7 percent market share.

On March 20, 2001, we announced the 3Com 11 Mbps Wireless LAN solution. This new Wi-Fi-certified offering comes with unique features that make set-up, use, and configuration simple without compromising the rich functionality, reliability and security that small business networks require.

On May 8, 2001, we announced new OfficeConnect Dual Speed Switches that eliminate cabling issues and offer network traffic prioritization for small business customers. This announcement reinforced our commitment to delivering best-in-breed Ethernet switches that are easier to own, install, and manage for small businesses.

On June 11, 2001 we announced the SuperStack(R) 3 Switch 4400, an application-aware, stackable, wirespeed 10/100 Fast Ethernet switch; the SuperStack 3 Switch 4300, a 48-port high-density 10/100 Ethernet switch and; the 3Com(R) Switch 4005, a 10/100/1000 Ethernet modular Layer 3 switch. Our latest version of network management software adds an extra level of management support for all new switches that enable intuitive setup and operation.

Business Connectivity Company

Our Business Connectivity Company is a leading provider of reliable, high-performance access products for the enterprise market. In today's networked world, it is important for people to stay connected while on the move. In order for people to realize the full potential of networked computing, secure and reliable network access must become simple.

BCC is advancing the concept of Universal Connectivity for the enterprise market. The ability to deliver Universal Connectivity hinges on three capabilities: Anytime, Anywhere Access, Reliable Performance and Secure Connections. BCC focuses on solutions delivering this promise of Universal Connectivity for users in networked environments - furthering our long-standing vision of pervasive networking.

Anytime, Anywhere Access

BCC delivers the breadth of technology forms and types for people to connect to information and each other anytime, anywhere. These forms include personal computer (PC) Card Type II and Type III, Mini-PCI, Modem Daughter Card (MDC), Compact Flash, Internal and External universal serial bus (USB), PCI and PCI-X NIC and LAN-on-Motherboard (LOM). Its wide range of connectivity technologies include Ethernet, Fast Ethernet, Gigabit Ethernet, Analog Modem, Wireless LAN and Bluetooth. Innovative software such as Mobile Connection Manager, Wireless

Connection Manager and GSM Connection manager deliver one-step mobile configurations and connectivity for multiple LAN and WAN locations.

Reliable Performance

BCC's products have a long-standing reputation for reliable performance. Technologies and features such as Gigabit, Link Aggregation, Self Healing Drivers, Traffic Prioritization, Failover, Exclusive Line Probing, Parallel Tasking(R) and Digital line guard insure a reliable, high-performance connection. Our reputation for reliability is evidenced by our partnerships with PC original equipment manufacturers (OEMs) and our large installed base in corporate enterprises.

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Secure Connections

Network technologies and mobile computing have made global partnerships and e-business initiatives achievable for many companies. With advances in network technologies increasing the ability for users to access networks anytime anywhere, the risks to network security have also increased. 3Com secure NICs and embedded firewall protect enterprise networks from attacks and provide tamper-resistant data protection. Furthermore, with IPSec encryption offloads, IT managers can secure the LAN without sacrificing performance.

Markets and Customers

BCC solutions are targeted for worldwide distribution to enterprise and small business customers via PC OEMs, such as Dell Computer Corp., Gateway Inc., Hewlett-Packard Company, and International Business Machines Corp., and resellers and systems integrators. Increasingly, BCC is selling directly to PC manufacturers, who integrate our connectivity products into their product offerings. BCC's branded products are sold primarily through our two-tier distribution channel, which leverages the capabilities of our resellers and channel partners.

Competition

BCC's principal competitor is Intel Corp. Recently, Taiwanese manufacturers have entered the low-end market, which is particularly price-competitive. These companies include Accton Technology Corp., D-Link Systems, Inc., and NetGear Inc.

Current Product Offerings

BCC offers a comprehensive product portfolio that allows users to connect to computer networks easily and reliably. BCC products include:

- 3Com 10, 10/100 and 100 Mbps Ethernet desktop NICs for businesses of all sizes
- 3Com 10/100, 10/100/1000 and 1000 Mbps Ethernet server NICs for businesses of all sizes
- 3Com 10, 10/100, and 10/100LAN+56K Modem PC cards for businesses of all sizes
- 3Com 10 Mbps LAN CompactFlash Cards for Windows CE environments
- 3Com Bluetooth PC Cards

- 3Com Management Software and Embedded Firewall

New Products in Fiscal Year 2001

On September 28, 2000, we announced our entry into the Gigabit Ethernet-over-copper NIC market with new network connections designed for the high-performance, reliability and manageability required in mission critical server applications. The new 3Com 10/100/1000 PCI-X Server NIC gives customers a feature-rich yet simple way to broaden their bandwidth and increase network performance - by as much as 100 times - over existing unshielded twisted pair (UTP) Category 5 copper wiring.

On November 28, 2000, we announced we would be teaming with Symantec Corporation of Cupertino, Calif., to develop a `best-in-breed' software solution for quick workstation deployment within a Wired for Management framework. Via integrated components from Symantec, our boot services with Symantec Ghost Enterprise software is the industry's premier tool for PC rollout, software and hardware migration, and disaster recovery.

On December 4, 2000, we announced Dual Port server NICs to deliver network availability in space-constrained servers. The new dual port card gives customers instant scalability from a single NIC upgrade using one PCI slot to support two network connections.

On December 11, 2000, we announced the formation of a strategic alliance with Broadcom Corporation relating to deployment of Gigabit Ethernet NIC and LOM solutions. Broadcom is a leading provider of integrated circuits enabling broadband communications.

On May 29, 2001, we announced our Wireless Bluetooth PC Card as one of the first network PC adapters based on the newly ratified 1.1 industry standard for Bluetooth. We are one of nine organizations actively participating in the Bluetooth Special Interest Group (SIG) which helps to drive the standardization and adoption of this important wireless technology designed for quick bursts of low-bandwidth information in a cable replacement application environment. Our Bluetooth PC Card with 3Com Connection Manager for Bluetooth software package and innovative XJACK (R) antenna design connects with Bluetooth-enabled personal devices including notebooks, desktop PCs, cell phones and hand-helds.

CommWorks

CommWorks Corporation, a wholly owned subsidiary of 3Com Corporation, designs, develops and deploys IP-based access infrastructures and service platforms for many of the largest telecommunications service providers in the world. CommWorks' products allow telecommunications service providers to offer new services with the same high availability as the traditional telecommunications network at a much lower cost. CommWorks combines expertise in network integration with experience in custom development to deliver highly specialized solutions that address the specific challenges telecommunications service providers face, such as:

- cutting operating costs,
- developing new revenue-generating services,
- attracting additional network traffic,

- differentiating product offerings, and

- improving communications for end-users.

CommWorks builds networks that deliver greater functionality, at significantly reduced cost and with the ability to offer multiple services over a single platform. A CommWorks IP network features the following characteristics:

- Scalability. Carriers need the ability to start small and grow the network as demand increases. CommWorks gives carriers the ability to take their existing network and add new applications without major additions of hardware;

- Reliability. The benchmark for network reliability is still the public switched telephone network (PSTN). CommWorks networks deployed today by some of the world's largest telecommunications service providers are delivering quality and reliability on a par with - and often better than - the traditional PSTN;

- Multiple services, common hardware. We offer carriers an IP platform based on common hardware that allows them to deliver multiple services. Regardless of the transport medium (wired, wireless, broadband) or the type of traffic (voice, data, fax, video) we allow the carrier to turn the traffic into revenue-generating services; and

- Open architecture. Our networks feature open, standards-based interfaces for multi-vendor connectivity. This encourages telecommunications service providers to deploy best-of-breed components and allows them to introduce new services in less time than for a traditional network infrastructure. Commitment to standards and open interfaces allows telecommunications service providers to customize solutions independently at each tier to address individual customer needs.

Markets and Customers

CommWorks' exclusive focus is on the telecommunications service provider market. Of the world's 20 largest telecommunications service providers - representing 71 percent of the world's public telecommunications service revenue - 16 are CommWorks customers.

CommWorks customers in the carrier market include:

- Incumbent local exchange carriers (ILECs);

- Interexchange carriers (IXCs);

- Post, telephone, and telegraph administrations (PTTs);

- Competitive Local Exchange Carriers (CLECs); and

- Internet Service Providers (ISPs).

Top accounts worldwide include:

- North America: AT&T, AT&T Canada, Bell Mobility, Quest, MCI/Worldcom, Motorola, SaskTel, Sprint, Sprint PCS, Telus Mobility, Verizon, SBC;

- Asia: Bharti, China Telecom, China Unicom, Clearcom, Communications Authority of Thailand, Commverge, CTI (Hong Kong), Gosun, Hitachi, Japan Telecom, KDDI, Korea Telecom, New C&C, NTT, Orange, Samsung, Satyam, Siemens (Taiwan), SingTel, SK Telecom, Telecom New Zealand, Telstra, VSNL;

- Europe: Airtel, Austria Telekom, Blixer, Carrier 1, Cegetel, KPN, Marconi Communications, MediaWays, Portugal Telecom, Prodigios / AOL, Telefonica, Telia;

- Latin America: Avantel / MCI, Embratel / MCI, Iusacell, Telefonica (Peru), Vesper, VTR (Chile); and

- Middle East: Bezeq, Internet Gold, Turk Telecom

Competition

Principal competitors in the telecommunications service provider market include Cisco Systems, Ericsson, Lucent Technologies, Nortel Networks, Siemens and Sonus.

Current Product Offerings

CommWorks is able to migrate telecommunications service providers to IP, with network solutions based on the CommWorks(R) architecture. Introduced more than two years ago, this three-tier, carrier-class solution architecture allows telecommunications service providers to scale their infrastructure and to rapidly deploy next-generation, enhanced services. The architecture includes:

- media processing;

- softswitch; and

- service creation layers.

The first layer, featuring the Total Control(R) 1000 and Total Control 2000 platforms, performs media gateway functions to integrate multiple traffic types and accommodate disparate networks. Layer Two, the control and network and service management layer, features the CommWorks Softswitch to bridge different signaling and call control protocols, enabling multimedia traffic to traverse disparate networks. Layer Three is the service creation layer, an environment that leverages open interfaces and strategic partners to enable rapid application and service deployment.

The softswitch is an integral component of the CommWorks architecture. It works with multi-service access platforms at layer one to provide end-to-end, carrier-grade IP-based communications. At layer two, it provides media control and management, session control functions and multi-protocol PSTN/IP signaling. At layer three, the softswitch is responsible for critical network services, including accounting, authentication and rating, billing support, directory mapping, and Web provisioning. The back-end services component of the softswitch includes modules that provide network-centric services. The CommWorks softswitch framework also includes feature servers to deliver IP Centrex, Interactive Voice Response, prepaid calling card, and presence management applications in addition to offerings in the area of unified messaging and fax-over-IP.

New Products in Fiscal Year 2001

In June 2000, we unveiled our next-generation Total Control(R) 2000 multiservice access platform. The Total Control 2000 platform is a carrier-class, high-density multiservice platform that will support both wireline and wireless solutions. The platform will address the requirements of telecommunications service providers for a high-density platform as they evolve from circuit-switched networks to more intelligent and efficient IP-based networks. Customer trials of the platform began in mid-2001, with product availability anticipated before the end of the calendar year.

Also in June 2000, we announced the availability of the CommWorks(R) 8210 unified messaging system, which bridges the circuit and packet networks to deliver a robust set of features. The CommWorks 8210 unified messaging system is a network-independent open service platform that gives end-users the freedom to communicate the way they choose with the communication device they prefer. Users can access all their e-mail, voice mail and fax messages from the PSTN, Internet, broadband or wireless network using an array of client devices, including telephones, personal and laptop computers, e-mail clients, Web browsers, wireless handsets, and personal digital assistants.

In November 2000, the new Total Control(R) 1000 Enhanced Data System was introduced. This system delivers higher port densities, enhanced performance and expanded service capabilities on CommWorks' Total Control 1000 multi-service access platform. Two new carrier-class solutions for delivering virtual private network (VPN) services were also unveiled. These VPN solutions are media access independent and can be delivered via cable, DSL, Code Division Multiple Access (CDMA) wireless or remote access networks.

Also in November 2000, we introduced an end-to-end solution that enables DSL providers to cost-effectively deliver secure VPNs over DSL. The carrier-class VPN over DSL solution integrates the advanced IP service intelligence of the Total Control(R) 500 192-port DSL concentrator with the VPN tunnel-switching capabilities of the Total Control 1000 multi-service access platform.

In December 2000, we announced the availability of an intelligent service provisioning solution for our carrier-class VPN services. The CommWorks(R) 5020 Intelligent Activation System is an end-to-end service activation solution that offers timely and accurate provisioning for numerous service opportunities and networking options; from inexpensive public Internet services to managed, secure, high-speed private network services. This integration eliminates the need for time-consuming, on-site, manual configuration of multiple network elements, enabling telecommunications service providers to drastically reduce the time between the customer's request for service and the actual service activation.

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In March 2001, we demonstrated an IP Centrex solution delivered via the Session Initiation Protocol (SIP). IP Centrex delivers the same basic services as traditional Centrex - such as call hold, call transfer, last number look-up and redial, call forward, and three-way calling - via a packet-based, or IP network. At the same time, IP Centrex enables a wide range of creative new IP-based services. IP Centrex brings the creativity of the Internet to the telephony system, allowing rapid service creation, customization and personalization.

On April 4, 2001, we announced we would be developing "universal port" technology that will allow telecommunications service providers to terminate voice, data and fax calls using a "universal" dial access port. Telecommunications service providers using the Total Control 1000 Enhanced Data System from CommWorks can upgrade their systems to universal port status through a software upgrade. The CommWorks Universal Port System will merge current remote access functionality with specific voice-over-IP (VoIP) offerings. Applications supported in the initial product release will include typical dial access; phone-to-phone voice support; real time and store-and-forward fax; support for SIP for call control; and various back-end servers for critical functions like directory mapping and billing. Early field trials of the CommWorks Universal Port System began in mid-year 2001, with general availability of the product expected before the end of the calendar year.

Also on April 4, 2001, we announced that our Total Control 1000 Enhanced Data System will support V.92, the latest industry standard for dial-up modem technology. CommWorks will support the V.92 standard in its next software upgrade for the Total Control 1000 Enhanced Data System, scheduled for the third quarter of calendar year 2001. For current customers, the V.92 features may be added through a simple software upgrade; no hardware changes are required. For end users, the V.92 modem specification offers a significantly improved Internet connection experience with the ability to switch between voice and data sessions. Telecommunications service providers who upgrade to V.92 can offer their subscribers more features for their dial-up connection, thus enhancing opportunities to retain and grow their customer base.

On April 9, 2001, we announced with TCSI Corporation, a leading provider of innovative network solutions for the telecommunications industry, the launch of a product that offers carrier-class network and service management solutions designed to reduce network operating costs for telecommunications service providers while allowing them to generate more revenue by offering new enhanced services. The CommWorks 5000 Network and Service Management System, a Web-enabled product, is a key component in the CommWorks' three-tiered architecture for IP-based service creation and delivery.

On April 30, 2001, we announced the CommWorks 5025 Unified Messaging System Provisioning Manager which combines the functionality of several software modules to provide a comprehensive solution for the activation and provisioning of new unified messaging services.

On May 21, 2001, we announced the availability of enhanced routing, accounting and reporting features on the Total Control 1000 transaction gateway. The Total Control 1000 transaction gateway is our solution for providing transaction processing services. The gateway is designed to handle hundreds of millions of quick, secure transactions involving the transfer of small amounts of data in a single dial access session. These transactions include credit card authorizations, debit card fund transfers, health benefit authorizations, electronic fund transfers, and other transactions. The Total Control 1000 transaction gateway is used by many of the largest transaction carriers in the United States, and many other telecommunications service providers, enterprises, health care networks, and financial institutions around the world.

On May 30, 2001, we announced we would be adding support for Internet Protocol Version 6 (IPv6) to our Total Control 100 enhanced gigabit routers. The Total Control 100 enhanced gigabit routers will support native IPv6 over a 2.4Gbit/s (OC-48c) line interface, the fastest interface available on any IPv6 router product.

PRODUCT DEVELOPMENT

Our research and development expenditures in fiscal years 2001, 2000, and 1999 were $535.7 million, $597.8 million, and $586.1 million, respectively. Our research and development expenditures span efforts to create new types of products and classes of service as well as to expand and improve our current product lines.

We are now focusing a higher percentage of our research and development investments in several high-growth or emerging areas. In fiscal 2002, we plan to invest a significant amount of our total research and development in Gigabit Ethernet-Over-Copper technology, Voice over IP and Wireless CDMA services, wireless networking products, Layer 3+ switching and IP telephony technologies to accelerate the introduction of new products to market.

Historically, we have incorporated proprietary ASICs into our products to provide key functions, cost efficiency, and the capacity for future upgrades. Customers can benefit from new technologies and enhanced capabilities through inexpensive, simple software upgrades rather than expensive, disruptive hardware replacements. In addition, ASICs facilitate higher density platforms--critical in certain applications, such as high-speed Layer 3 switching--and are less costly to manufacture. We incorporate ASIC technology into many of our products, including NICs, switches, hubs, and remote access equipment.

SIGNIFICANT CUSTOMERS

For the fiscal year ended June 1, 2001, Ingram Micro Inc. (Ingram Micro) accounted for 15 percent of our total sales. For the fiscal year ended June 2, 2000, Ingram Micro and Tech Data Corporation (Tech Data) accounted for 15 percent and 13 percent of our total sales, respectively. For the fiscal year ended May 28, 1999, Ingram Micro and Tech Data accounted for 16 percent and 12 percent of our total sales, respectively.

INTERNATIONAL OPERATIONS

We market our products globally, primarily through subsidiaries, sales offices, and relationships with OEMs and distributors with local presence in all significant global markets. Outside the U.S., we have significant research and development groups in the UK and Ireland. We have manufacturing facilities in Ireland and Singapore. We will continue manufacturing products in our Singapore facility until September 30, 2001, after which time the facility will be utilized as a distribution center. We maintain sales offices in 49 countries outside the U.S.

BACKLOG

In many cases we manufacture our products in advance of receiving firm product orders from our customers based upon our forecasts of worldwide customer demand. Generally, orders are placed by the customer on an as-needed basis and may be canceled or rescheduled by the customer without significant penalty. Accordingly, backlog as of any particular date is not indicative of our future sales. As of June 1, 2001, we do not have backlog orders that cannot be filled within the next fiscal year.

MANUFACTURING

We use a combination of in-house manufacturing and independent contract manufacturers to produce our products. We operate manufacturing facilities in Santa Clara, California; Mount Prospect, Illinois; Blanchardstown, Ireland; and Changi, Republic of Singapore. Purchasing, assembly, burn-in, testing, final assembly, and quality assurance functions are performed at all of these facilities. On June 19, 2001, we announced a contract manufacturing arrangement with Flextronics International (Flextronics) for our high volume server, desktop and mobile products, and our intention to liquidate certain facilities associated with manufacturing operations in fiscal 2002. Those facilities are located in Marlborough, Massachusetts; Mount Prospect, Illinois; and Santa Clara, California. In addition, the Singapore manufacturing facility will transition to become 3Com's Asia-Pacific regional distribution center and regional sales and support office.

INTELLECTUAL PROPERTY AND RELATED MATTERS

The quality of our innovation is reflected in a substantial portfolio of patents covering a wide variety of networking technologies. This ownership of core networking technologies creates opportunities to leverage our engineering investments and develop more integrated, powerful, and innovative networking solutions for customers.

We rely on U.S. and foreign patents, copyrights, trademarks, and trade secrets to establish and maintain proprietary rights in our technology and products. We have an active program to file applications for and obtain patents in the U.S. and in selected foreign countries where a potential market for our products exists. Our general policy has been to seek patent protection for those inventions and improvements likely to be incorporated in our products or that we otherwise expect to be valuable. As of June 1, 2001, we had 578 U.S. patents (including 557 utility patents and 21 design patents) and 103 foreign patents. During fiscal 2001, we filed 349 patent applications in the U.S. Numerous patent applications are currently pending in the U.S. and other countries that relate to our research and development. We also have patent cross license agreements with other companies.

We have registered 95 trademarks in the U.S. and have registered 101 trademarks in one or more of 72 foreign countries. Numerous applications for registration of domestic and foreign trademarks are currently pending.

EMPLOYEES

As of June 1, 2001, we had 8,165 full time employees, of whom 1,994 were employed in engineering, 2,648 in sales, marketing, and customer service, 1,698 in manufacturing, and 1,825 in finance and administration. Our employees are not represented by a labor organization, and we consider our employee relations to be satisfactory.

PALM SEPARATION

On September 13, 1999, we announced a plan to conduct an initial public offering (IPO) of our Palm subsidiary. On March 2, 2000, we sold 4.7% of Palm's stock to the public in an IPO and sold 1.0% of Palm's stock in private placements. On July 27, 2000, we completed the Palm spin-off by distributing to our shareholders all of the remaining Palm common stock that we owned. The distribution ratio was 1.4832 shares of Palm for each outstanding share of 3Com common stock.

RESTRUCTURING CHARGES

During fiscal 2001 and fiscal 2000, we undertook several initiatives aimed at both changing business strategy as well as improving operational efficiencies. Restructuring charges in fiscal 2001 were $163.7 million and related to the realignment of our business strategy and reduction in force and cost containment efforts. Restructuring charges in fiscal 2000 were $68.9 million, of which $9.9 million related to the separation of Palm from 3Com and $59.0 million related to implementing our change in strategic focus. These charges are discussed further in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

ITEM 2. Properties

We operate in a number of locations worldwide. In fiscal 2001, we had several significant real estate activities.

During the third quarter of fiscal 2001, we leased a new building totaling 78,000 square feet in West Valley City, Utah. The lease will expire in 2007. The facility will be used primarily for office space and research and development activities.

During the third quarter of fiscal 2001, we sold a vacated 296,000 square foot manufacturing and office facility in Morton Grove, Illinois.

We completed an expansion project at the existing Dublin, Ireland manufacturing facility. The construction was completed and fully operational in October 2000. This expansion added 177,000 square feet to the existing 307,000 square feet.

In the first quarter of fiscal 2001, we sold approximately 39 acres of undeveloped land in the San Francisco Bay Area.

We lease and sublease to third-party tenants approximately 317,000 square feet of office and research and development space on our Santa Clara, California headquarters site and approximately 15,000 square feet at our Winnersh site in the UK. The terms of these agreements expire in 2002 and 2003. We also sublease approximately 404,000 square feet of owned manufacturing and office space in the Chicago area, 137,000 square feet of leased office and research and development space in the Boston area, and approximately 132,000 square feet of leased office space in the San Francisco Bay area to third-party tenants. The terms of these agreements expire in 2003, 2002 and 2006, respectively. These locations, as well as other subleased locations, are included in the table below.

Our primary locations include the following:

Location	Sq. Ft.	Owned/Leased	Primary Use
United States - San Francisco Bay Area	1,374,000	Leased	Corporate headquarters, off research and development, m distribution, and computer
	120,000	Owned	Office, research and develo tenant
United States - Chicago Area	1,149,000	Owned	Office, research and develo and manufacturing
United States - Boston Area	566,000	Leased	Office, research and develo
United States - Salt Lake City Area	185,000	Owned	Property vacant; held for s
	78,000	Leased	Office, research and develo
Asia Pacific - Singapore	333,000	Owned	Office, manufacturing, and
Europe -	484,000	Owned	Office, research and develo

Ireland			
Europe - UK	283,000	Owned/Leased	Office, research and develo service

As part of our initiatives to maximize the efficiency of our facilities, we will be consolidating and liquidating excess real estate in several locations globally over the next 12 to 18 months. We intend to liquidate certain facilities associated with research and development and manufacturing operations located in Marlborough, Massachusetts; Mount Prospect, Illinois; and Santa Clara, California. In addition, the Singapore manufacturing facility will transition to become 3Com's Asia-Pacific regional distribution center and regional sales and support office.

ITEM 3. Legal Proceedings

We are a party to lawsuits in the normal course of our business. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. We believe that we have defenses in each of the cases set forth below and are vigorously contesting each of these matters. An unfavorable resolution of one or more of the following lawsuits could adversely affect our business, results of operations, or financial condition.

Securities Litigation

In December 1997, a securities class action lawsuit captioned Reiver v. 3Com Corporation, et al., Civil Action No. C-97-21083JW (Reiver), was filed in the United States District Court for the Northern District of California. Several similar actions have been consolidated into this action, including Florida State Board of Administration and Teachers Retirement System of Louisiana v. 3Com Corporation, et al., Civil Action No. C-98-1355. On August 17, 1998, the plaintiffs filed a consolidated amended complaint which alleged violations of the federal securities laws, specifically Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934, and which sought unspecified damages on behalf of a purported class of purchasers of 3Com common stock during the period from April 23, 1997 through November 5, 1997. In May 2000, 3Com answered the amended complaint. In October 2000, the parties agreed to settle this action and all other related actions, including Adler v. 3Com Corporation, which is discussed below. On February 23, 2001, the Court entered a final judgment approving the settlement.

In October 1998, a securities class action lawsuit, captioned Adler v. 3Com Corporation, et al., Civil Action No. CV777368 (Adler), was filed against 3Com and certain of its officers and directors in the California Superior Court, Santa Clara County, asserting the same class period and factual allegations as the Reiver action. The complaint alleged violations of Sections 25400 and 25500 of the California Corporations Code and sought unspecified damages. The parties agreed to stay this case to allow the Reiver case to proceed. Along with Reiver, this case was settled in October 2000. As part of the settlement, the plaintiffs have agreed to dismiss this action with prejudice. The settlement amount was $259.0 million, of which $9.0 million was recovered from insurance. Accordingly, 3Com recorded a litigation charge of $250.0 million in October 2000.

In November 2000, a shareholder derivative and class action lawsuit captioned Shaev v. Claflin, et al., No. CV794039, was filed in California Superior Court.

The complaint alleges that the Company's directors and officers made misrepresentations and/or omissions and breached their fiduciary duties to the Company in connection with the adjustment of employee and director stock options in connection with the separation of the Company and Palm, Inc. It is unclear whether the plaintiff is seeking recovery from 3Com or if the Company is named solely as a nominal defendant, against whom the plaintiff seeks no recovery. The Company and the individual defendants have removed this action to the United States District Court for the Northern District of California, where the action is captioned Shaev v. Claflin, et al., No. CV-01-0009-MJJ. The case was later remanded back to the California Superior Court. Defendants have not responded to the complaint. No trial date has been set.

Intellectual Property

On May 26, 2000, 3Com Corporation filed suit against Xircom, Inc. in the United States District Court for the District of Utah, Civil Action No. 2:00-CV-0436C alleging infringement of U.S. Patents Nos. 6,012,953, 5,532,898, 5,696,660, 5,777,836 and 6,146,209, accusing Xircom of infringement of one or more of the claims of the patents-in-suit by reason of the manufacture, sale, and use of the Real Port and Real Port 2 families of PC Cards, as well as a number of Xircom's Type II PC Modem Cards. Xircom has counter-claimed for a declaratory judgment that the asserted claims of the patents-in-suit are invalid and / or not infringed. This case is currently in the discovery phase. Currently pending before the Court is 3Com's motion for a preliminary injunction on the '209 patent. The Company intends to vigorously pursue this action.

On September 21, 2000, Xircom, Inc. filed an action against 3Com Corporation in the United States District Court for the Central District of California, Civil Action No. Case No.: 00-10198 MRP, accusing 3Com of infringement of U.S. Patents Nos. 5,773,332, 5,940,275, 6,115,257 and 6,095,851, accusing 3Com of infringement by reason of the manufacture, sale, and use of the 3COM 10/100 LAN+Modem CardBus Type III PC Card, the 3COM 10/100 LAN CardBus Type III PC Card, the 3COM Megahertz(R) 10/100 LAN CardBus PC Card, the 3COM Megahertz 10/100 LAN+56K Global Modem CardBus PC Card and the 3COM Megahertz 56K Global GSM and Cellular Modem PC Card. 3Com has counter-claimed for declaratory judgment that the asserted claims of the patents-in-suit are not infringed and/or invalid and that the claims of the 5,940,275 patent are unenforceable. This case is in the discovery phase. Xircom filed a motion for preliminary injunction seeking to enjoin 3Com from the continued manufacture and sale of its Type III PC card products. The motion was heard on March 26, 2001 and was denied by the Court. Currently pending before the Court is 3Com's Motion for Summary Judgment of Non-infringement of the '332 patent. The Company intends to vigorously pursue this action.

On July 6, 2001, Xircom, Inc. filed an action against the Company in the United States District Court for the Central District of California, Civil Action No. 01-5902 GAF (JTLX). Xircom's complaint accuses 3Com of infringement of U.S. Patent No. 6,241,550 by reason of the manufacture, sale, and use of the 3COM 10/100 LAN+Modem CardBus Type III PC Card and the 3COM 10/100 LAN CardBus Type III PC Card. 3Com has not yet answered the Complaint, but an answer and counterclaim will be filed and served in the near future. This action has only recently been filed, but Xircom has threatened to file a motion for preliminary injunction on the '550 patent. That motion has not yet been filed. The Company intends to vigorously pursue this action.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

Executive Officers of 3Com Corporation

The following table lists the names, ages and positions held by all executive officers of 3Com. There are no family relationships between any director or executive officer and any other director or executive officer of 3Com. Executive officers serve at the discretion of the Board of Directors.

Name	Age	Position
Bruce L. Claflin	49	Chief Executive Officer
Irfan Ali	37	President, CommWorks Corporation
Dennis Connors	47	President, 3Com Business Connectivity Company
John McClelland	56	President, 3Com Business Networks Company
Gwen McDonald	46	Interim Senior Vice President, Corporate Services
Mark D. Michael	50	Senior Vice President, Legal and Government Relations, and Secretary
Michael Rescoe	48	Senior Vice President, Finance and Planning, and Chief Financial Officer
Janet L. Soderstrom	54	Senior Vice President, Worldwide Marketing and Brand Management

BRUCE L. CLAFLIN has been 3Com's Chief Executive Officer since January 2001 and President and Chief Operating Officer since August 1998. Prior to joining 3Com, Mr. Claflin worked for Digital Equipment Corporation (DEC) from October 1995 to June 1998. From July 1997 to June 1998, he was Senior Vice President and General Manager, Sales and Marketing at DEC and prior to that he served as Vice President and General Manager of DEC's Personal Computer Business Unit from October 1995 to June 1997. From April 1973 to October 1995, Mr. Claflin held a number of senior management and executive positions at International Business Machines Corporation (IBM). Mr. Claflin serves as a director of Time Warner Telecom.

IRFAN ALI has been President of CommWorks Corporation since December 2000 and, prior to that, he was the Senior Vice President and General Manager of 3Com's Carrier Systems Business Unit, the predecessor to CommWorks Corporation, since March 1999. From October 1997 to March 1999 he was Vice President, Worldwide Marketing of 3Com's Carrier Systems. Prior to joining 3Com, Mr. Ali worked for Newbridge Networks, Inc., where he was Vice President, Marketing from July 1995 to October 1997 and Assistant Vice President, Fast Packet Networks from July 1993 to June 1995. Prior to working at Newbridge Networks, Inc., Mr. Ali was Senior Manager, Market Development for Strategic Technology at Northern Telecom, Inc. from July 1991 to July 1993.

DENNIS CONNORS has been President of 3Com Business Connectivity Company since June 2001. Prior to that, he was 3Com's Senior Vice President of e-Commerce Group from June 2000 to June 2001 and Senior Vice President of Global Customer Service from November 1999 to June 2001. Prior to joining 3Com, Mr. Connors was the Executive Vice President and General Manager of Business Operations and Services for Ericsson, Inc. He also served as Ericsson's Vice President and Global Business Manager for WorldCom in 1997. During his tenure in Private Radio Systems in the Ericsson/General Electric joint venture, Mr. Connors was the Vice President of Global Product Development and Operations from 1995 through 1997, and between 1993 and 1995 Mr. Connors was the Vice President of Marketing and Research and Development.

JOHN MCCLELLAND has been the President of 3Com Business Networks Company since June 2001. Prior to that, he was 3Com's Senior Vice President, Operations from December 2000 to June 2001 and Senior Vice President, Supply Chain Operations from April 1999 to December 2000. Prior to joining 3Com, Mr. McClelland was Chief Industrial Officer for the Philips Consumer Electronics division of Philips International, B.V. from November 1998 to March 1999. Mr. McClelland was Vice President of Manufacturing and Distribution at Digital Equipment Corporation from February 1995 to October 1998. From October 1968 to January 1995, Mr. McClelland held various management positions at IBM. Most recently at IBM, he held the position of Vice President Manufacturing and Distribution, IBM PC Co. from April 1994 to January 1995.

GWEN MCDONALD has been 3Com's Interim Senior Vice President of Corporate Services since May 2001. Prior to that, Ms. McDonald served in various capacities in Human Resources within 3Com for the past 12 years, including vice president of worldwide Human Resources for Staffing and Operations and vice president of worldwide Supply Operations. Prior to joining 3Com, Ms. McDonald was the HR manager for LSI Logic's Santa Clara operations in 1988 and served Fairchild Semiconductor for the 12 years prior to that, holding numerous key HR positions within Fairchild.

MARK D. MICHAEL has been 3Com's Senior Vice President, Legal and Government Relations, and Secretary since May 1999. Mr. Michael served as Senior Vice President, Legal, General Counsel and Secretary since September 1997. Mr. Michael joined 3Com in 1984 as Counsel, was named Assistant Secretary in 1985, and General Counsel in 1986. Prior to joining 3Com, Mr. Michael was engaged in the private practice of law with law firms in Honolulu, Hawaii from 1977 to 1981 and in San Francisco from 1981 to 1984.

MICHAEL RESCOE has been 3Com's Senior Vice President, Finance and Planning, and Chief Financial Officer since May 2000. Prior to joining 3Com, Mr. Rescoe was the Chief Financial Officer for Intelisys Electronic Commerce in New York in 1999. He also served as the Chief Financial Officer for PG&E Corporation in San Francisco from 1997 through 1999. Before holding that position, Mr. Rescoe was the Chief Financial Officer of Enserch Corporation in Dallas between 1995 and 1997. Previous to his Enserch position, he was the Senior Managing Director (Partner) at Bear Sterns in New York beginning in 1992 through 1995. Prior to 1992, Mr. Rescoe was the Senior Vice President of Corporate Finance at Kidder, Peabody, also in New York.

JANET L. SODERSTROM has been 3Com's Senior Vice President, Worldwide Marketing and Brand Management since October 1999. Prior to joining 3Com, Ms. Soderstrom joined Visa USA in 1985 as Director of Advertising and Marketing. She served as Visa USA's Senior Vice President of Advertising and Marketing, before being appointed as the Executive Vice President of Marketing for Visa International from 1996 through 1999. In the past, Ms. Soderstrom has served on the boards of Winkler Advertising, Decker Communications, the Ad Council and the Association of National Advertisers where she served as Chairman from 1994 through 1996.

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PART II

ITEM 5. Market for 3Com Corporation's Common Stock and Related Stockholder Matters

Fiscal 2001	High	Low	Fiscal 2000	High
First Quarter	$ 17.94	$ 9.65	First Quarter	$ 6.53
Second Quarter	20.69	12.25	Second Quarter	9.13
Third Quarter	13.38	7.13	Third Quarter	17.19
Fourth Quarter	7.16	4.55	Fourth Quarter	21.57

Our common stock has been traded in the Nasdaq stock market under the symbol COMS since our initial public offering on March 21, 1984. The preceding table sets forth the high and low closing sales prices as reported on the Nasdaq stock market during the last two years. As of June 1, 2001 we had approximately 5,488 stockholders of record. We have not paid and do not anticipate that we will pay cash dividends on our common stock.

On July 27, 2000, we distributed to our shareholders in the form of a stock dividend 1.4832 shares of Palm for each outstanding share of 3Com common stock. The stock prices presented above are restated stock prices and reflect the distribution of our ownership in Palm to our shareholders.

ITEM 6. Selected Financial Data

The following selected financial information has been derived from the audited consolidated financial statements. The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included elsewhere in this Form 10-K.

	Years ended		
(In thousands, except per share and employee data)	June 1, 2001	June 2, 2000	May 28, 1999
Sales	$2,820,881	$4,333,942	$5,202,253
Net income (loss)	(965,376)	674,303	403,874
Income (loss) from continuing operations	(969,913)	615,563	364,945
Income (loss) per share, continuing operations:			
Basic	($2.81)	$1.77	$1.01
Diluted	(2.81)	1.72	0.99
Total assets	$3,452,802	$6,603,077	$4,239,159
Assets, net of discontinued			

operations	3,452,802	5,544,840	4,158,879
Working capital, net of discontinued operations	1,397,977	3,181,420	2,111,909
Long-term obligations	10,536	141,285	94,268
Retained earnings	771,639	1,982,079	1,403,709
Stockholders' equity	2,505,421	4,043,064	3,196,455
Number of employees	8,165	10,597	12,543

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.

Our consolidated financial statements for all periods account for Palm as a discontinued operation, as a result of our decision to distribute the Palm common stock we owned to 3Com shareholders in the form of a stock dividend. Unless otherwise indicated, the following discussion relates to our continuing operations. Subsequent to the distribution to shareholders on July 27, 2000, Palm's operations ceased to be part of our operations and reported results.

RESTRUCTURING ACTIVITIES

During fiscal 2001 and fiscal 2000, we undertook several initiatives aimed at both changing business strategy as well as improving operational efficiencies. We recorded restructuring charges of $163.7 million and $68.9 million in the fiscal years ended June 1, 2001 and June 2, 2000, respectively.

Exit of Analog-Only Modem and High-End LAN/WAN Chassis Product Lines and Separation of Palm

We realigned our strategy in the fourth quarter of fiscal 2000 to focus on high-growth markets, technologies, and products. Operations were restructured around two distinct business models: 1) Commercial and Consumer Networks Business and 2) CommWorks. In support of this new strategy, we exited our analog-only modem and high-end LAN and WAN chassis product lines and completed the separation of Palm. For the fiscal year ended June 1, 2001, we recorded restructuring charges of $13.2 million relating to these activities. For the fiscal year ended June 2, 2000, we recorded net restructuring charges of $59.0 million, consisting of restructuring charges of approximately $125.4 million, partially offset by a gain recognized upon receipt of a warrant to purchase common stock in Extreme Networks, Inc., valued at $66.4 million. We also recorded a credit of $0.2 million and charges of $9.9 million for the fiscal years ended June 1, 2001 and June 2, 2000, respectively, related to the separation of Palm. We completed our restructuring activities associated with the exit of the analog-only modem and high-end LAN and WAN chassis product lines during fiscal 2001.

Global Cost Reduction to Improve Operational Efficiencies

On December 21, 2000, we announced further restructuring activities. The Commercial and Consumer Networks Business and CommWorks operations were restructured to enhance the focus and cost effectiveness in serving their respective markets. Effective for fiscal 2002, three independent businesses - Business Connectivity Company, Business Networks Company and CommWorks Corporation - were formed through this restructuring effort, with each business utilizing central shared corporate services. Additionally, we implemented reduction in force and cost containment actions and exited our consumer Internet Appliance product line to lower the cost structure of the Company and return it to profitability. For the fiscal year ended June 1, 2001, we recorded charges of approximately $150.7 million related to these restructuring initiatives. Subsequent to June 1, 2001, we announced further cost reduction and cash flow generating initiatives. We plan to exit the consumer broadband cable and DSL modem product lines and outsource the manufacturing of high volume server, desktop and mobile connectivity products to Flextronics under a contract manufacturing arrangement. Concurrent with such outsourcing, we intend to consolidate our real estate portfolio including the disposition of excess facilities. We expect to incur more charges related to these restructuring efforts during fiscal 2002. We expect to substantially complete our restructuring activities related to the global cost reduction to improve operational efficiencies by May 2002.

BUSINESS COMBINATIONS AND JOINT VENTURES

We completed the following transactions during the fiscal year ended June 1, 2001:

- During the third quarter of fiscal 2001, we acquired the Gigabit Ethernet NIC business of Alteon WebSystems (Alteon), a wholly-owned subsidiary of Nortel Networks Corporation (Nortel) for an aggregate purchase price of $123.0 million, consisting of cash paid to Nortel of $122.0 million, and $1.0 million of costs directly attributable to the completion of the acquisition. We purchased the Alteon NIC business and are licensing certain Gigabit Ethernet-related technology and intellectual property from Alteon.

  Approximately $22.5 million of the aggregate purchase price represented purchased in-process technology that had not yet reached technological feasibility and had no alternative future use, and accordingly, was charged to operations in the third quarter of fiscal 2001. A risk adjusted after-tax discount rate of 25 percent was applied to the in-process project's cash flows. This purchase resulted in $86.0 million of goodwill and other intangible assets that are being amortized over an estimated useful life of four years.

- During the second quarter of fiscal 2001, we acquired Nomadic Technologies, Inc. (Nomadic), a developer of wireless networking products that we will incorporate into solutions for both small business and enterprise customers for an aggregate purchase price of $31.8 million, consisting of cash paid to Nomadic of $23.5 million, issuance of restricted stock with a fair value of $3.8 million, stock options assumed with a fair value of $4.3 million, and $0.2 million of costs directly attributable to the completion of the acquisition.

  For financial reporting purposes, the aggregate purchase price was reduced by the intrinsic value of unvested stock options and restricted stock totaling $6.9 million which was recorded as deferred stock-based compensation and is being amortized over the respective vesting periods. Approximately $8.3 million of the aggregate purchase price represented purchased in-process technology that had not yet reached technological feasibility and had no alternative future use, and accordingly, was charged to operations in the second quarter of fiscal 2001. A risk adjusted after-tax discount rate of 30 percent was applied to the in-process projects' cash flows. This purchase resulted in $18.6 million of goodwill and other intangible assets that are being amortized over estimated useful lives of three to five years.

o During the first quarter of fiscal 2001, we acquired Kerbango, Inc. (Kerbango), developer of the Kerbango(TM) Internet radio, radio tuning system, and radio web site, for an aggregate purchase price of $73.5 million, consisting of cash paid to Kerbango of $52.2 million, issuance of restricted stock with a fair value of $17.2 million, stock options assumed with a fair value of $3.8 million, and $0.3 million of costs directly attributable to the completion of the acquisition. In addition, deferred cash payments to founders and certain former employees totaling $7.7 million were contingent upon certain events through July 2002.

For financial reporting purposes, the aggregate purchase price, excluding deferred cash payments, was reduced by the intrinsic value of unvested stock options and restricted stock totaling $20.2 million which was recorded as deferred stock-based compensation and was being amortized over the respective vesting periods. Approximately $29.4 million of the aggregate purchase price represented purchased in-process technology that had not yet reached technological feasibility and had no alternative future use, and accordingly, was charged to operations in the first quarter of fiscal 2001. A risk adjusted after-tax discount rate of 35 percent was applied to the in-process project's cash flows. This purchase resulted in $33.7 million of goodwill and other intangible assets that were being amortized over estimated useful lives of three to five years.

As part of our efforts to improve profitability, we announced that we would exit the Internet Appliance product line during fiscal year 2001. As a result, we determined that the net unamortized assets had no remaining future value and consequently wrote off the net remaining amounts of deferred stock-based compensation, goodwill, and intangible assets. This included $15.5 million of accelerated amortization of deferred stock-based compensation for qualified terminated Kerbango employees and $21.1 million of net goodwill and intangible assets related to the Kerbango acquisition. These charges were included as part of restructuring charges in fiscal 2001.

o During the first quarter of fiscal 2001, we completed the transfer of our analog-only modem product lines to U.S. Robotics Corporation (New USR), the new joint venture formed with Accton Technology and NatSteel Electronics. We contributed $3.1 million of assets to New USR, for an 18.7 percent investment in the joint venture. U.S. Robotics Corporation has assumed the analog-only modem product line, including U.S. Robotics and U.S. Robotics Courier branded modems.

During fiscal 2001, we wrote off our $3.1 million investment in New USR as the value of this investment was determined to be other-than-temporarily impaired. The amount was charged to gains (losses) on investments, net.

We completed the following transactions during the fiscal year ended June 2, 2000:

o On April 3, 2000, we acquired Call Technologies, Inc. (Call Technologies), a leading developer of Unified Messaging (UM) and carrier-class Operational Systems and Support (OSS) software solutions for telecommunications service providers, for an aggregate purchase price of $86.0 million, consisting of cash of approximately $73.4 million, assumption of stock options with a fair value of approximately $8.6 million, the assumption of $1.4 million in debt and $2.6 million of costs directly attributable to the completion of the acquisition. Approximately $10.6 million of the total purchase price represented purchased in-process technology that had not yet reached technological feasibility, had no alternative future use, and was charged to operations in the fourth quarter of fiscal 2000. This purchase resulted in approximately $86.7 million of goodwill and other intangible assets that are being amortized over estimated useful lives of three to seven years.

During fiscal year 2001, we determined that the downturn in the telecommunications industry resulted in an impairment of the developed OSS technology and related goodwill that arose from the Call Technologies acquisition. These assets were written down $18.2 million to fair value, which was estimated using discounted future cash flows. The impairment charge was included in amortization and write down of intangibles, and is a component of contribution margin for CommWorks as reported in Note 19 of the consolidated financial statements. Remaining net goodwill and intangible assets continue to be amortized over their original useful lives.

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- On December 22, 1999, we acquired LANSource Technologies, Inc. (LANSource), a leading developer of Internet and LAN fax software and modem sharing software, for an aggregate purchase price of $15.8 million in cash including $0.2 million of costs directly attributable to the completion of the acquisition. Approximately $2.9 million of the total purchase price represented purchased in-process technology that had not yet reached technological feasibility, had no alternative future use, and was charged to operations in the third quarter of fiscal 2000. This purchase resulted in approximately $13.3 million of goodwill and other intangible assets that are being amortized over estimated useful lives of two to five years.

  As part of our efforts to improve profitability, we decided that we would exit certain LANSource product lines and license the technology to a former competitor in that market. As a result of this decision, we determined that an impairment of developed technology and related goodwill that arose from the LANSource acquisition had occurred. These assets were written down $1.1 million to their estimated realizable fair value. This amount was included in restructuring charges in fiscal 2001. In addition, we determined that a customer's product line discontinuation resulted in an impairment of a license agreement and related goodwill that arose from the LANSource acquisition. Those assets were determined to have no future value, and accordingly $1.0 million was written off. The impairment charge was recorded in amortization and write down of intangibles, and is a component of contribution margin for CommWorks as reported in Note 19 of the consolidated financial statements. Remaining net intangible assets continue to be amortized over their original useful lives.

- On December 2, 1999, we acquired Interactive Web Concepts, Inc. (IWC), an Internet business consulting, creative design, and software engineering firm, for an aggregate purchase price of $3.5 million in cash including $0.1 million of costs directly attributable to the completion of the acquisition. This purchase resulted in approximately $4.1 million of goodwill and other intangible assets that were being amortized over an estimated useful life of three years.

  As part of our efforts to improve profitability, we decided that we would discontinue providing IWC services during fiscal year 2001. As a result, we determined that the net unamortized assets had no remaining future value and consequently wrote off $2.1 million, which was the net remaining amount of goodwill and intangible assets. This amount was included in restructuring charges in fiscal 2001.

We completed the following transactions during the fiscal year ended May 28, 1999:

o On March 5, 1999, we acquired NBX Corporation (NBX), a developer of IP-based telephony systems that integrate voice and data communications over small business LANs and WANs. The aggregate purchase price of $87.8 million consisted of cash of approximately $75.4 million, assumption of stock options with a fair value of approximately $11.9 million, and $0.5 million of costs directly attributable to the completion of the acquisition. Approximately $5.6 million of the total purchase price represented purchased in-process technology that had not yet reached technological feasibility, had no alternative future use, and was charged to operations in the fourth quarter of fiscal 1999. This purchase resulted in approximately $94.4 million of goodwill and other intangible assets that are being amortized over estimated useful lives of two to seven years.

o On February 18, 1999, we acquired certain assets of ICS Networking, Inc. (ICS), a wholly-owned subsidiary of Integrated Circuit Systems, Inc. and manufacturer of integrated circuit products focused on the design and marketing of mixed signal integrated circuits for frequency timing, multimedia, and data communications applications, for an aggregate purchase price of $16.1 million in cash including $0.1 million of costs directly attributable to the completion of the acquisition. Approximately $5.0 million of the total purchase price represented purchased in-process technology that had not yet reached technological feasibility, had no alternative future use, and was charged to operations in the third quarter of fiscal 1999. This purchase resulted in approximately $6.9 million of goodwill and other intangible assets that are being amortized over estimated useful lives of three to seven years.

o On January 25, 1999, we entered into a joint venture named ADMTek, Inc. (ADMtek). We contributed approximately $5.3 million in cash for a 44 percent interest in the joint venture and began consolidating the joint venture with our results, due to our ability to exercise control over the operating and financial policies of the joint venture. In September 1999, we sold a portion of our existing interest in ADMTek to our joint venture partner. As a result of this sale, our ownership interest was reduced and we no longer exercised control over the joint venture. Therefore, during the second fiscal quarter of fiscal 2000, we began accounting for this investment using the cost method.

o On November 6, 1998, we acquired EuPhonics, Inc. (EuPhonics), a developer of digital signal processor (DSP)-based audio software that drives integrated circuits, sound cards, consumer electronics, and other hardware. The aggregate purchase price of $8.3 million consisted of cash of approximately $6.6 million, assumption of stock options with a fair value of approximately $1.5 million, and $0.2 million of costs directly attributable to the completion of the acquisition. The charge for purchased in-process technology associated with the acquisition was not material, and was included in research and development expenses in the second quarter of fiscal 1999. This purchase resulted in approximately $10.8 million of goodwill and other intangible assets that were being amortized over estimated useful lives of four years.

As part of our efforts to change strategic focus in fiscal 2001, we decided that we would exit the products and technology that arose from the EuPhonics acquisition. As a result, we determined that the net unamortized assets had no remaining future value and consequently wrote off $5.8 million, which was the net remaining amount of goodwill and intangible assets. This amount was included in restructuring charges in fiscal 2001.

RESULTS OF OPERATIONS

The following table sets forth, for the fiscal years indicated, the percentage of total sales represented by the line items reflected in our consolidated statements of operations:

	Fiscal Years Ended		
	June 1, 2001	June 2, 2000	May 2 1999
Sales	100.0%	100.0%	100.
Cost of sales	81.1	57.1	55.
Gross margin	18.9	42.9	44.
Operating expenses:			
Sales and marketing	28.4	22.0	19.
Research and development	19.0	13.8	11.
General and administrative	6.5	4.9	4.
Amortization and write-down of intangibles	2.5	0.6	0.
Purchased in-process technology	2.1	0.3	0.
Merger-related credits, net	--	(0.1)	(0.
Restructuring charges	5.8	1.6	-
Total operating expenses	64.3	43.1	35.
Operating income (loss)	(45.4)	(0.2)	8.
Net gains on land and facilities	6.3	0.6	0.
Gains (losses) on investments, net	(0.7)	19.4	(0.
Litigation settlement	(8.8)	--	-
Interest and other income, net	5.1	2.4	1.
Income (loss) from continuing operations before income taxes and equity interests	(43.5)	22.2	10.
Income tax provision (benefit)	(9.1)	7.9	3.
Other interests in loss of consolidated joint venture	--	--	-
Equity interest in loss of unconsolidated investee	--	0.1	-
Income (loss) from continuing operations	(34.4)	14.2	7.
Income from discontinued operations	0.2	1.4	0.
Net income (loss)	(34.2)%	15.6%	7.

Comparison of fiscal years ended June 1, 2001 and June 2, 2000

Sales

Fiscal 2001 sales totaled $2.82 billion, a decrease of 35 percent from fiscal 2000 sales of $4.33 billion. During fiscal 2001, our principal operating segments were: 1) Commercial and Consumer Networks and 2) CommWorks.

Commercial and Consumer Networks. Sales of commercial and consumer network products (e.g., switches, desktop NICs, PC cards, LAN telephony, broadband cable and DSL modems, hubs, wireless LANs, and customer service and support) in fiscal 2001 were $2.27 billion, a decrease of 19 percent from fiscal 2000 sales of $2.80 billion. The decrease in sales of commercial and consumer network products when compared to fiscal 2000 was due to significant competitive pressures in our LAN infrastructure, NIC and PC Card product lines, resulting in lower pricing and loss of market share. The market growth for these mature technologies also slowed with the economic downturn in fiscal 2001. The exiting of our large, complex chassis products at the end of fiscal 2000 and cost reduction efforts in fiscal 2001 also resulted in disruptions in sales of our ongoing products. The decrease in sales was partially offset by growth in new product and market segments such as Layer 3+ switching, LAN telephony, wireless LANs and Gigabit-over-copper NICs. We also experienced revenue growth in our consumer cable and DSL modem products, although we announced on June 7, 2001 that we have discontinued these products due to an inability to sustain a profitable business model. Sales of commercial and consumer network products represented 81 percent of total sales in fiscal 2001 compared to 65 percent of total sales in fiscal 2000.

CommWorks. Sales of CommWorks products (e.g., access infrastructures and IP services platforms for network service providers, enhanced data, IP telephony, wireless, cable, and DSL access systems, remote access concentrators) in fiscal 2001 were $0.40 billion, a decrease of 31 percent from fiscal 2000 sales of $0.58 billion. The decrease in sales of CommWorks products when compared to fiscal 2000 was due primarily to the slowdown in the U.S. telecommunications industry, which resulted in a significant decline in revenues from our enhanced data products, partially offset by growth of our wireless CDMA access infrastructure products. Sales of CommWorks products represented 14 percent of total sales in fiscal 2001 compared to 13 percent of total sales in fiscal 2000.

Exited Product Lines. Sales of exited product lines (analog-only modems and high-end LAN and WAN chassis products) in fiscal 2001 were $0.15 billion, a decrease of 84 percent from fiscal 2000 sales of $0.95 billion. The decrease in sales of exited product lines when compared to fiscal 2000 was due primarily to the impact of our business restructuring and change in strategic focus. Sales of exited products represented 5 percent of total sales in fiscal 2001 compared to 22 percent of total sales in fiscal 2000.

Geographic. U.S. sales represented 45 percent of total sales in fiscal 2001 compared to 49 percent in fiscal 2000 and decreased 40 percent when compared to fiscal 2000. International sales in fiscal 2001 decreased 30 percent when compared to fiscal 2000. The overall decline in both U.S. and international sales is largely attributable to the worldwide deteriorating economic conditions, especially the U.S. telecommunications market.

New Operating Segments. Beginning in fiscal 2002, we have implemented a new organizational structure to refine our strategic focus. As a result, the principal operating segments for fiscal 2002 will be: 1) Business Connectivity Company, 2) Business Networks Company and 3) CommWorks. Revenues related to product lines we have exited in fiscal 2001 or have announced discontinuation in fiscal 2002, such as our consumer cable and DSL modems, will be aggregated with other exited products and will be presented separately from our three operating segments beginning in the first quarter of fiscal 2002.

Gross Margin

Gross margin as a percentage of sales was 18.9 percent in fiscal 2001, compared to 42.9 percent in fiscal 2000. Gross margin declined ten percentage points in fiscal 2001 due to reductions in standard margin. The decline in standard margin was primarily caused by a mix shift to lower-margin commercial access and consumer broadband modem products and eroding prices on LAN infrastructure, NIC and PC Card products. Gross margin declined eight percentage points in fiscal 2001 resulting from higher provisions for excess and obsolete inventory due to reduced demand and the discontinuation of our consumer product lines. Gross margin declined six percentage points in fiscal 2001 due to underutilized capacity in our manufacturing plants and commitment shortfalls with subcontract manufacturers. We also recorded a liability related to future contractual commitments with a subcontract manufacturer as a result of our intention to exit our consumer product lines and the reduction in sales demand. We are taking actions to address manufacturing capacity and other supply chain utilization issues through our restructuring efforts. As these efforts are successfully completed, we expect gross margins to improve over fiscal 2001 levels.

Operating Expenses

Operating expenses in fiscal 2001 were $1.81 billion, or 64.3 percent of sales, compared to $1.86 billion, or 43.1 percent of sales in fiscal 2000. Excluding amortization and write down of intangibles charges of $69.7 million, purchased in-process technology charges of $60.2 million, net merger-related credits of $0.7 million, and restructuring charges of $163.7 million, operating expenses would have been $1.52 billion, or 53.9 percent of sales for fiscal 2001. Excluding amortization and write down of intangibles charges of $24.5 million, purchased in-process technology charges of $13.5 million, net merger-related credits of $2.3 million, and restructuring charges of $68.9 million, operating expenses would have been $1.76 billion, or 40.6 percent of sales for fiscal 2000. We are taking actions that are intended to reduce operating expenses in future periods.

Sales and Marketing. Sales and marketing expenses in fiscal 2001 decreased $145.2 million or 15.3 percent from fiscal 2000. Sales and marketing expenses as a percentage of sales increased to 28.4 percent of sales in fiscal 2001 compared to 22.0 percent of sales in fiscal 2000. The year-over-year decrease in sales and marketing expenses in absolute dollars was attributable to lower selling expenses resulting from the decease in sales, the exit of product lines associated with our restructuring activities, reduced headcount, and other cost-containment efforts. These decreases were partially offset by increased spending on corporate advertising and brand recognition programs. The year-over-year increase as a percentage of sales was affected by the decline in sales greater than the decrease in sales force and related expenses as described above.

Research and Development. Research and development expenses in fiscal 2001 decreased $62.1 million, or 10.4 percent, compared to fiscal 2000. Research and development expenses as a percentage of sales increased to 19.0 percent of sales in fiscal 2001 compared to 13.8 percent of sales in fiscal 2000. The year-over-year decrease in research and development expenses in absolute dollars was primarily due to headcount reductions and cost containment efforts, especially in our discontinued and mature product lines. These cost savings were partially offset by additional investments in emerging growth technologies, such as LAN telephony, wireless LANs and next generation wireless access infrastructure carrier products. The year-over-year increase as a percentage of sales was affected by the decline in sales in fiscal 2001, as described above.

General and Administrative. General and administrative expenses in fiscal 2001 decreased $31.0 million or 14.5 percent from fiscal 2000. As a percentage of sales, general and administrative expenses increased to 6.5 percent of sales in fiscal 2001 compared to 4.9 percent of sales in fiscal 2000. The year-over-year decrease in general and administrative expenses in absolute dollars was primarily due to decreased headcount, cost containment efforts, and lower consulting costs associated with our restructuring activities. In addition, provisions for bad debts were significantly lower than fiscal 2000 due to the drop in sales volume. The year-over-year increase as a percentage of sales was affected by the decline in sales in fiscal 2001, as described above, partially offset by the decrease in expenses.

Purchased In-Process Technology. During fiscal 2001, we recorded a charge for purchased in-process technology of approximately $60.2 million associated with the acquisitions of certain assets of Alteon WebSystems (Alteon), Nomadic Technologies (Nomadic) and Kerbango. We continued to develop technologies that were in process at Alteon, Nomadic and Kerbango, as of the dates of the acquisitions. The fair values of the existing products and technology currently under development were determined using the income approach, which discounts expected future cash flows to present value. The discount rates used in the present value calculations were typically derived from a weighted-average cost of capital analysis, adjusted upward to reflect additional risks inherent in the development life cycle. The costs to be incurred for the projects in process are primarily labor costs for design, prototype development, and testing. As of the acquisition dates, purchased in-process technology was approximately 70 percent complete for Alteon projects and 75 percent complete for both Kerbango and Nomadic projects. We continued development of nine projects, and spent approximately $0.5 million, $4.8 million and $0.6 million on Alteon, Kerbango and Nomadic projects, respectively, as of June 1, 2001. At the end of fiscal 2001, all purchased in-process technology projects were completed or terminated.

Merger-Related Credits, Net. During fiscal 2001, we recorded net pre-tax merger-related credits of approximately $0.7 million. This net amount reflects adjustments to previously recorded merger and restructuring charges.

Restructuring Charges. During fiscal 2001 and fiscal 2000, we undertook several initiatives aimed at both changing business strategy as well as improving operational efficiencies. Restructuring charges in fiscal 2001 were $163.7 million and related to the realignment of our business strategy and reduction in force and cost containment efforts. Restructuring charges in fiscal 2000 were $68.9 million, of which $9.9 million related to the separation of Palm from 3Com and $59.0 million related to implementing our change in strategic focus.

Net Gains on Land and Facilities.

During fiscal 2001, 3Com finalized the sale of a 39-acre parcel of undeveloped land in San Jose, California to a financial institution, as directed by Palm, for total net proceeds of approximately $215.6 million. 3Com recorded a net gain of $174.4 million related to this sale. In February 2001, 3Com sold a vacated office and manufacturing building in Morton Grove, Illinois for total net proceeds of $12.4 million, resulting in a gain of approximately $4.4 million. During fiscal 2000, we sold our manufacturing facility and related assets in Salt Lake City, Utah and recognized an impairment charge for our remaining Salt Lake City facility held for sale, which together resulted in a net gain of $25.5 million.

Gains (Losses) on Investments, Net

Net losses on investments of $18.6 million were recorded during fiscal 2001, comprised of $117.1 million of net gains realized on sales of publicly traded equity securities and $135.7 million of net losses recognized due to fair value adjustments of investments in limited partnership venture capital funds and write downs for other-than-temporary declines in value of both publicly traded securities and investments in private companies. During fiscal 2000, gains on investments were $838.8 million, comprised of $792.7 million of net gains realized on sales of publicly traded equity securities and $46.1 million of net gains recognized due to fair value adjustments of investments in limited partnership venture capital funds and in private companies acquired by public companies.

Litigation Settlement

We recorded a charge of $250.0 million during fiscal 2001 for the settlement of the Reiver and Adler cases, as discussed in Note 21 to the consolidated financial statements.

Interest and Other Income, Net

Interest and other income, net was $144.6 million in fiscal 2001, compared to $104.3 million in fiscal 2000. The increase of $40.3 million compared to fiscal 2000 was primarily due to higher interest income, attributable to higher average cash and short-term investment balances, as well as higher interest rates.

Income Tax Provision

Our effective income tax benefit rate was 21.0 percent in fiscal 2001 compared to an effective income tax expense rate of 35.5 percent in fiscal 2000. The fiscal 2001 benefit rate was comprised of a tax benefit on the United States federal tax loss, offset by tax provisions in certain foreign countries, a valuation allowance on deferred taxes, and non-deductible expenses related to acquisitions. The valuation allowance reduces deferred tax assets to estimated realizable value. The valuation allowance relates to a portion of the credit and net operating loss carryforwards and other temporary differences for which we believe that realization is uncertain due to various limitations on their use and our operating loss in the current year.

Equity Interest in Loss of Unconsolidated Investee

In fiscal 2000, we invested $7.0 million in OmniSky Corporation (OmniSky). This investment was accounted for using the equity method, resulting in losses of $1.4 million and $5.6 million in fiscal 2001 and 2000, respectively.

Income from Discontinued Operations

Income from discontinued operations includes the results of operations of Palm. Income from discontinued operations for the fiscal year ended June 1, 2001 was $4.5 million, or $0.01 per share, compared to $58.7 million, or $0.16 per share for fiscal 2000.

Comparison of fiscal years ended June 2, 2000 and May 28, 1999

Sales

Fiscal 2000 sales totaled $4.33 billion, a decrease of 16.7 percent from fiscal 1999 sales of $5.20 billion.

Commercial and Consumer Networks. Sales of commercial and consumer network products in fiscal 2000 were $2.80 billion, a decrease of 9 percent from fiscal 1999 sales of $3.09 billion. The decrease in sales of commercial and consumer network products when compared to fiscal 1999 was due to price declines in NICs, price competition and loss of market share in LAN workgroup hubs and switches, and disruption to the sales of on-going products that resulted from our March 20, 2000 announcement to exit certain product lines. Sales of commercial and consumer networks products represented 65 percent of total sales in fiscal 2000 compared to 59 percent of total sales in fiscal 1999.

CommWorks. Sales of CommWorks products in fiscal 2000 were $0.58 billion, an increase of 27 percent from fiscal 1999 sales of $0.46 billion. The increase in sales of CommWorks products when compared to fiscal 1999 was due to strong demand for our CMDA wireless products. Sales of CommWorks products represented 13 percent of total sales in fiscal 2000 compared to 9 percent of total sales in fiscal 1999.

Exited Product Lines. Sales of exited product lines (analog-only modems and high-end LAN and WAN chassis products) in fiscal 2000 were $0.95 billion, a decrease of 42 percent from fiscal 1999 sales of $1.66 billion. The decrease in sales of exited product lines when compared to fiscal 1999 was due to increased price competition and the loss of market share in these markets. In addition, as a result of our March 20, 2000 announcement that we would be exiting these product lines, we experienced a significant decrease in sales related to these products in the fourth quarter of fiscal 2000. Sales of exited products represented 22 percent of total sales in fiscal 2000 compared to 32 percent of total sales in fiscal 1999.

Geographic. U.S. sales represented 49 percent of total sales in fiscal 2000 compared to 51 percent in fiscal 1999 and decreased 21 percent when compared to fiscal 1999. International sales in fiscal 2000 decreased 12 percent when compared to fiscal 1999. The overall decline in both U.S and international sales was largely attributable to our decision to exit our high-end LAN and WAN chassis and analog-only modem product lines as part of our restructuring initiative. International sales reflected strong growth in the Asia Pacific region, offset by lower sales in Europe.

Gross Margin

Gross margin as a percentage of sales was 42.9 percent in fiscal 2000, compared to 44.3 percent in fiscal 1999. The decline in gross margins in fiscal 2000 was due to the impact of our business realignment on our fourth quarter results, partially offset by higher gross margin performance during our first three fiscal quarters. For the first three quarters of fiscal 2000, the gross margin percentage was 46.5 percent. The higher gross margin performance during the first three quarters of fiscal 2000 was primarily due to improvements in our inventory management, which resulted in reduced manufacturing period costs, partially offset by higher costs for certain product components. During the fourth quarter of fiscal 2000, gross margins were lower due to reduced sales volumes associated with our restructuring activities. In addition, we incurred one-time charges of $55.5 million within cost of sales primarily related to excess and obsolete inventory, warranty reserves, and return and rebate programs in connection with the exiting of certain product lines. The gross margin percentage in the fourth quarter of fiscal 2000 was 25.8 percent. For fiscal 2000 in total, the decline in the gross margin percentage was relatively small because the fourth quarter impact was moderated by higher gross margins during our first three fiscal quarters.

Operating Expenses

Operating expenses in fiscal 2000 were $1.86 billion, or 43.1 percent of sales, compared to $1.84 billion, or 35.4 percent of sales in fiscal 1999. Excluding amortization and write down of intangibles of $24.5 million, purchased in-process technology charges of $13.5 million, net merger-related credits of $2.3 million and restructuring charges of $68.9 million, operating expenses would have been $1.76 billion, or 40.6 percent of sales for fiscal 2000. Excluding amortization and write-down of intangibles of $19.6 million, a purchased in-process technology charge of $10.6 million, and net merger-related credits of $17.6 million, operating expenses would have been $1.83 billion, or 35.2 percent of sales for fiscal 1999.

Sales and Marketing. Sales and marketing expenses in fiscal 2000 decreased $66.5 million, or 6.6 percent from fiscal 1999. Sales and marketing expenses as a percentage of sales increased to 22.0 percent of sales in fiscal 2000 compared to 19.5 percent of sales in fiscal 1999. The year-over-year decrease in sales and marketing expenses in absolute dollars was attributable to lower sales force expenses and reduced spending on marketing programs related to non-strategic product lines. The year-over-year increase as a percentage of sales was affected by the sharp decline in sales in the fourth quarter of fiscal 2000, as described above, partially offset by the lower sales force expenses and reduced spending on marketing programs related to non-strategic product lines.

Research and Development. Research and development expenses in fiscal 2000 increased $11.7 million or 2.0 percent compared to fiscal 1999. Research and development expenses as a percentage of sales increased to 13.8 percent of sales in fiscal 2000 compared to 11.3 percent of sales in fiscal 1999. The year-over-year increase in research and development expenses in absolute dollars was primarily due to increased investments in our then-targeted high-growth, emerging product lines: multi-services access to carrier networks, LAN telephony, broadband access (primarily cable and DSL), wireless access, home networking, and internet appliances, partially offset by decreased spending related to mature product lines such as analog modems. The year-over-year increase as a percentage of sales was affected by the sharp decline in sales in the fourth quarter of fiscal 2000, as described above, as well as the increased investments in our then-targeted emerging growth product lines.

General and Administrative. General and administrative expenses in fiscal 2000 decreased $14.5 million or 6.4 percent from fiscal 1999. As a percentage of sales, general and administrative expenses increased to 4.9 percent of sales in fiscal 2000 compared to 4.3 percent of sales in fiscal 1999. The year-over-year decrease in general and administrative expenses in absolute dollars was primarily due to lower bad debt expenses, which resulted from an increased rate of collection of past-due accounts, partially offset by higher spending on employee incentive programs and higher consulting costs. The year-over-year increase as a percentage of sales was affected by the sharp decline in sales in the fourth quarter of fiscal 2000, as described above, as well as the increase in spending on employee incentive programs and consulting, partially offset by decreased bad debt expenses.

Purchased In-Process Technology. During fiscal 2000, we recorded a charge for purchased in-process technology of approximately $13.5 million associated with the acquisitions of certain assets of Call Technologies and LANSource. We continued to develop technologies that were in process at Call Technologies and LANSource, as of the dates of the acquisitions.

Merger-Related Credits, Net. During fiscal 2000, we recorded net pre-tax merger-related credits of approximately $2.3 million. This net amount reflects adjustments to estimates for previously recorded merger and restructuring charges.

Restructuring Charges. During fiscal 2000, we took steps to refocus our business strategy, change our growth profile, and streamline our operations. This included the separation and IPO of Palm and the realignment of our strategy to focus on high-growth markets, technologies, and products. Restructuring charges in fiscal 2000 were $68.9 million, of which $9.9 million related to the separation of Palm from 3Com and $59.0 million related to implementing our change in strategic focus.

Net Gains on Land and Facilities

During fiscal 2000, we sold our manufacturing facility and related assets in Salt Lake City, Utah and recognized an impairment charge for our remaining Salt Lake City facility held for sale, which together resulted in a net gain of $25.5 million. During fiscal 1999, we recorded a $4.2 million net gain on the sale of land in California.

Gains (Losses) on Investments, Net

Net gains on investments of $838.8 million were recorded during fiscal 2000, comprised of $792.7 million of net gains realized on sales of publicly traded equity securities and $46.1 million of net gains recognized due to fair value adjustments of investments in limited partnership venture capital funds and in private companies acquired by public companies. During fiscal 1999, losses on investments were $2.6 million.

Interest and Other Income, Net

Interest and other income, net was $104.3 million in fiscal 2000, compared to $56.9 million in fiscal 1999. The increase of $47.4 million compared to fiscal 1999 was primarily due to higher interest income, attributable to higher cash and short-term investment balances, as well as higher interest rates.

Income Tax Provision

Our effective income tax rate was 35.5 percent in fiscal 2000 compared to 30.1 percent in fiscal 1999. The increase in tax rate from 1999 to 2000 was primarily attributable to our gains on investments during fiscal 2000. The effective tax rate on all other income for fiscal 2000 was 29.1 percent.

Other Interests in Loss of Consolidated Joint Venture

In January 1999, we entered into a joint venture named ADMTek and began consolidating the joint venture with our results, due to our ability to exercise control over its operating and financial policies. In September 1999, we sold a portion of our existing interest in ADMTek to our joint venture partner. As a result of this sale, our ownership interest was reduced and we no longer exercised control over the joint venture. Therefore, during our second fiscal quarter, we began accounting for this investment using the cost method. The pro-rata share of the joint venture's loss allocated to the other investors for the period during which we had the ability to exercise control over the joint venture was $1.0 million in fiscal 2000 and $1.1 million in fiscal 1999.

Equity Interest in Loss of Unconsolidated Investee

In accordance with equity method accounting for our investment in OmniSky, we recorded a $5.6 million charge for equity interest in loss of unconsolidated investee in fiscal 2000.

Income from Discontinued Operations

Income from discontinued operations includes the results of operations of Palm. Income from discontinued operations for the fiscal year ended June 2, 2000 was $58.7 million, or $0.16 per share, compared to $38.9 million, or $0.10 per share, for fiscal 1999.

BUSINESS ENVIRONMENT AND INDUSTRY TRENDS

Industry trends and specific risks may affect our future business and results in our business. Some of the factors that could cause future results to materially differ from past results or those described in forward-looking statements include the matters discussed below.

Our business has been adversely impacted by the worldwide economic slowdown and related uncertainties

Weaker economic conditions worldwide, particularly in the U.S. and Europe, have contributed to the current technology industry slowdown and impacted our business resulting in:

- reduced demand for most of our products;
- increased risk of excess and obsolete inventories;
- increased price competition for our products;
- excess manufacturing capacity under current market conditions; and
- higher overhead costs, as a percentage of revenues.

Additionally, these economic conditions are making it very difficult for 3Com, our customers and our vendors to forecast and plan future business activities. This level of uncertainty severely challenges our ability to operate profitably or to grow our business. In particular, it is difficult to develop and implement strategy, sustainable business models and efficient operations, and effectively manage contract manufacturing and supply chain relationships. If the economic or market conditions continue or further deteriorate, this will have a material adverse impact on our financial position, results of operations and cash flow.

We are restructuring to operate as three independent businesses

We have recently restructured our commercial and carrier systems operations to form three independent businesses -- 3Com Business Connectivity Company (BCC), 3Com Business Networks Company (BNC) and CommWorks Corporation (CommWorks) -- with each business using certain central shared corporate services. Each business has a dedicated management team focusing on developing and executing its own business strategies, assessing and meeting the needs of its customers and implementing sustainable efficient operations.

We cannot be certain that we will be able to effectively implement and manage the restructuring of the company into three independent businesses or that we can properly manage these businesses or that each of the businesses can successfully run its own independent operations. We previously operated as a single integrated company and, therefore, may lack experience or operational history in managing independently run businesses. Also, the management teams of each of the businesses may lack the requisite expertise or experience to successfully manage and operate independent businesses. There could be additional changes in the management teams as the teams begin to operate independently, thereby causing further disruption in both the specific business and our combined operations. In addition, this restructuring may likely cause significant diversion of management time and resources from other business activities.

Failure to effectively implement and manage this restructuring or to properly manage three independent business operations or failure of the three businesses to sustain efficient operations or to successfully implement their business strategies will likely cause further deterioration in revenues, significantly compromise our on-going business prospects and materially impair our overall financial performance.

Cost and expense reductions are critical to achieving positive cash flow and profitability

We are continuing efforts to reduce our expense structure. In fiscal 2002, we plan to reduce fixed costs by completing our previously announced reduction-in-force plans, substantially increasing outsourcing of our manufacturing, disposing of excess facilities and completing our exit from the broadband cable and DSL consumer modem and Internet Appliance businesses. We believe strict cost containment and expense reductions are essential to achieving positive cash flow and profitability for the company, especially since we have experienced a decline in revenues sequentially for the last three quarters and the outlook on future quarters is unclear given the general economic conditions. A number of factors could preclude us from successfully bringing costs and expenses in line with our revenues, including unplanned-for use of cash (see Business Environment and Industry Trends - "Future cash requirements or restrictions on cash could have a negative impact on our financial position"), inability to accurately forecast business activities and further deterioration of our revenues. If we are not able to effectively reduce our costs and achieve an expense structure commensurate with our business activities and revenues, we may have inadequate levels of cash for operations or for capital requirements, which could significantly harm the company's ability to operate its business.

We have recently changed our manufacturing strategy to increase contract manufacturing

We have recently changed our manufacturing strategy so that more of our products will be sourced from contract manufacturers. On September 30, 2000 we sold our Mt. Prospect, Illinois manufacturing and distribution operation to Manufacturers' Services Ltd. (MSL) and entered into a supply agreement with MSL to manufacture CommWorks products, broadband modems and certain mobile products for us. On June 19, 2001 we announced a contract manufacturing arrangement with Flextronics for our high volume server, desktop and mobile products, and the intended sale of the facilities associated with those manufacturing operations. The cost, quality, performance and availability of third-party manufacturing operations are and will be essential to the successful production and sale of many of our products. The inability of any contract manufacturer to meet our cost, quality, performance and availability standards could adversely impact our financial condition or results of operations. We may not be able to provide

contract manufacturers with product volumes that are high enough to a