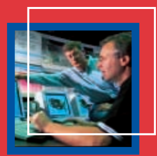
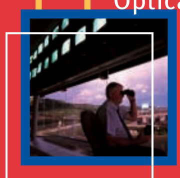
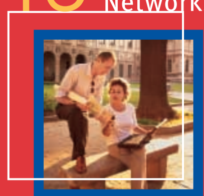
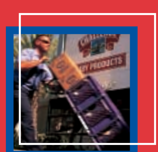
Communications Networks for the **Next Generation**

1999 ANNUAL REPORT









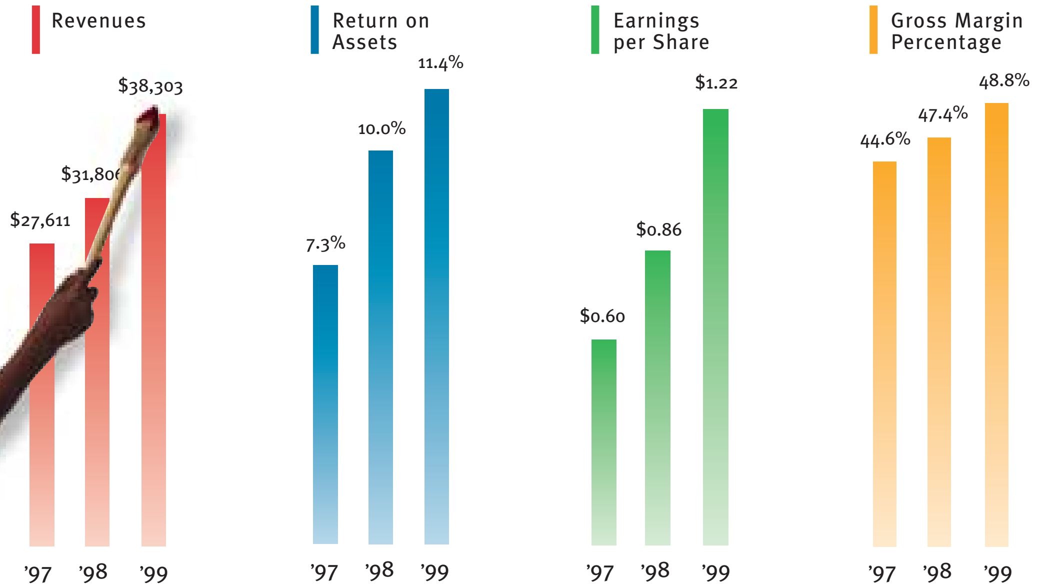
Lucent is Building **Next-Generation** Communications Networks **Now**

The next generation will live in a networked world that will simplify and enrich their lives. Information and entertainment will be delivered instantly. Education will be revolutionized as textbooks connected to networks come alive. The workplace will be wherever the worker needs it to be. Choices for buying, selling, working and playing will be unlimited — only a click or a voice command away.

Next-generation networks will make access to knowledge affordable and reliable — in any form, at speeds thousands of times faster than today. All of today's public and private networks will converge into a network of networks that's "always on."

For Lucent Technologies, **this bright digital future offers unprecedented growth**, as we take on the challenge of connecting millions of people around the world to information and to each other.

In the following pages, you'll learn that Lucent has a clear vision of next-generation networks, and unmatched strengths in every key technological building block, from systems and software to silicon and services. **At Lucent, the next generation begins today.**



Revenues have increased 39 percent since 1997.

Return on assets has risen 4.1 percentage points since 1997. (see notes a, b and c)

Earnings per share have increased 103 percent since 1997. (see notes a, b, c and d)

Gross margin has risen 4.2 percentage points since 1997. (see notes a and c)

1999 FINANCIAL HIGHLIGHTS

(Dollars in millions, except per share amounts; unaudited)

	Year ended September 30 1999	Year ended September 30 1998	CHANGE
OPERATIONS			
Revenues	$38,303	$31,806	20.4%
Gross margin	$18,687 (a)	$15,091	23.8%
Selling, general and administrative	$ 8,166 (a)	$ 6,867	18.9%
Research and development	$ 4,496 (a)	$ 3,903 (b)	15.2%
Operating income	$ 6,025 (a)	$ 4,321 (b)	39.4%
Net income *(excluding certain one-time events)*	$ 3,833 (a)	$ 2,619 (b)	46.4%
Earnings per share-diluted[d] *(excluding one-time events)*	$ 1.22 (a)	$ 0.86 (b)	41.9%
FINANCIAL POSITION			
Total assets	$38,775	$29,363	32.1%
Working capital	$10,153	$ 4,899	107.2%
Shareowners' equity	$13,584	$ 7,709	76.2%
OTHER INFORMATION			
Capital expenditures	$ 2,215	$ 1,791	23.7%
Return on assets	11.4% (a)	10.0% (b)	1.4 points
Debt to total capital	34.1%	37.6%	(3.5) points
Stock price	$64 7/8	$34 5/8	87.4%

(a) *Excludes impact of $274 ($167 after-tax) gain associated with the sale of an investment in Juniper Networks, $337 ($270 after-tax) of merger, asset impairment and integration costs associated with Ascend and Nexabit and $282 ($272 after-tax) of costs associated with the acquisitions of Stratus Computer, Inc.; Quadritek Systems, Inc.; WaveAccess; Sybarus; and the Ethernet LAN business of Enable Semiconductor, as well as $1,308 (after-tax) gain from the cumulative effect of an accounting change related to pension and postretirement benefits. Including the impact of these charges and gain, Lucent reported net income of $4,766 and per share amount of $1.52.*

(b) *Excludes impact of $1,683 ($1,679 after-tax) of one-time charges associated with the acquisitions of Livingston Enterprises Inc.; Prominet Corporation; Yurie Systems, Inc.; Optimay GmbH; LANNET; SDX Business Systems plc; JNA Telecommunications Limited; MassMedia Communications Inc.; and Stratus Computer, Inc., as well as $149 ($95 after-tax) gain on the sale of Lucent's Advanced Technology Systems unit. Including the impact of these charges and gain, Lucent reported net income of $1,035 and per share amount of $0.34.*

(c) *1997 numbers exclude impact of $1,360 ($1,301 after tax) of one-time charges associated with the acquisitions of Octel Communications, Sahara Networks Inc. and InterCon Systems Corporation and the merger-related costs associated with the Whitetree, Inc. and Cascade Communications Corp. mergers. Including the impact of these charges, Lucent reported net income of $449 and per share amount of $0.15.*

(d) *All per share data reflect the two-for-one stock splits that became effective April 1, 1998, and April 1, 1999.*

Highlights For Fiscal Year 1999

1998

October 22 Winstar Communications and Lucent enter into a long-term strategic relationship worth $2 billion to build Winstar's fixed wireless broadband telecommunications network.

November 11 Lucent wins multimillion-dollar data networking contract to supply Asynchronous Transfer Mode equipment to the State Postal Bureau of the People's Republic of China.

December 8 Ken Thompson and Dennis Ritchie of Bell Labs are presented the U.S. National Medal of Technology by President Bill Clinton.

9 Lucent signs contract worth more than $90 million for optical networking and network management systems with four service providers in Europe and Asia.

1999

February 17 Lucent announces two-for-one stock split, the second such split in 12 months.

March 29 Lucent wins an expected $1 billion agreement to supply equipment and services for the next phase of AT&T's Digital PCS network.

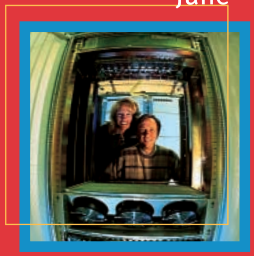
31 Lucent's Microelectronics Group ranked world's fastest-growing top-20 semiconductor business by leading industry analyst Dataquest.

April 21 Sprint awards Lucent a $780 million, three-year contract for equipment and services for Sprint PCS' nationwide wireless network.

27 Bell Labs researchers announce production of a device with features as small as 80 nanometers; it's the smallest working electronic device ever made with optical lithography, the technology now used to make silicon chips.

28 Lucent unveils portfolio of products, called R/Evolutionary Networking, that will allow network operators worldwide to deliver over packet networks virtually every service and feature available on today's public network.

May 10 Lucent announces world's first single-chip Internet telephony solution, which allows us to design a solution that reduces the electronics costs of current Internet telephones.



June 2 Lucent's flagship 5ESS® switch sets new record, becoming the only switch in history to achieve 99.9999 percent up-time and continues to lead the industry in reliability, according to an analysis of a Federal Communications Commission report.

23 Level 3 Communications announces a minimum four-year, $250 million strategic agreement with Lucent to purchase software switches for IP networks. The agreement could grow to $1 billion over five years.

29 Telefonica selects Lucent as strategic supplier for the design and installation of an IP-based multiservice network for customers in 15 countries.

July 21 Lucent announces world's smallest optical amplifier module for high-speed optical transmission systems.

September 2 Lucent wins nine Synchronous Digital Hierarchy tenders, valued at more than $40 million, from Chunghwa Telecom for network equipment in Taiwan.

20 Bell Labs researchers George Smith and Willard Boyle receive the C&C Prize, one of the world's top honors for pioneers in computing and communications, for their invention of the charge-coupled device.

We're Building **New Networks** for a New Millennium

Richard A. McGinn
Chairman and Chief Executive Officer

To Our Shareowners:

Lucent Technologies had another record year of growth in revenues and net income. It was also a strong year for creating new customer relationships and for delivering innovative products to market.

I am pleased to report that this year Lucent was recognized as the global leader in the communications networking market and in more than a dozen high-growth market areas (see list on page 6). We achieved that leadership by growing faster than the market and by taking market share. Now, to continue this momentum, we've reinvented our company once again to help us sustain high-performance growth and build on our leadership in the increasingly global marketplace.

The industry in which we operate has never been more dynamic. At a growth rate of more than 14 percent a year, the market will approach $815 billion by 2003. That growth is being propelled by customer demand for next-generation networks: converged networks that deliver new services in any form — voice, data or video. This is creating a wealth of opportunity for Lucent.

Not only is the communications industry fast-growing, it's rapidly changing as well. A number of service providers have merged so they can address customer needs for a broader array of services. Thousands of new service providers have emerged to offer telephone and Internet services. Cable TV service providers are

Recent **Acquisitions**

International Network Services
Network consulting, design and integration; based in Sunnyvale, Calif.

SpecTran
Designer and manufacturer of multi-mode and specialty optical fibers; Sturbridge, Mass.

CCOM
Developer of directory solutions and Computer Telephone Integration software; Edison, N.J.

Nexabit Networks
Developer of high-performance Internet protocol (IP) wide area network (WAN) equipment; Marlborough, Mass.

Batik Equipamentos
Manufacturer of compact digital switching systems; Belo Horizonte, Brazil.

Zetax Tecnologia
Digital central office switching equipment and special technology; Valinhos, Brazil.

Mosaix
Provider of software that links firms' front and back offices and helps them deliver more efficient customer service; Redmond, Wash.

Enable Semiconductor (Ethernet LAN business)
Privately held developer of fast Ethernet and Gigabit Ethernet transceivers; Milpitas, Calif.

Sybarus Technologies
Privately held semiconductor design company; Ottawa, Canada.

Ascend Communications
Leading provider of WAN core switching and access data networking equipment; Alameda, Calif.

Kenan Systems
Leading provider of billing and customer care communications software; Cambridge, Mass.

WaveAccess
Developer of high-speed, wireless data communications technology; Ra'anana, Israel, and Wellesley, Mass.

Pario Software
Privately held start-up developer of next-generation network security software for IP-based networks; Redwood City, Calif.

"Lucent leads in our ability to design, build and service networks for the next generation."

looking for ways to adapt their networks for the delivery of new communications services. Enterprise customers around the world are responding to new competitive challenges as commerce on the Internet continues its explosive growth. E-business has become the Internet's latest growth phenomenon, and enterprises are looking for networking solutions to give them new operating efficiencies while helping them improve their relationships with customers. Every major customer is striving to build converged, reliable, high-speed voice and data networks.

Demand for our communications semiconductors and optoelectronic devices also continues to grow as communications becomes the new driver for the industry. Today, Lucent is the worldwide leader in chips and devices specifically built for communications products such as cell phones, modems and personal computers. In addition, we are a leader in the hottest semiconductor trend since the microprocessor — systems-on-a-chip solutions. This new technology, which places the electronics for an entire system like a cell phone on a single fingernail-sized slice of silicon, offers our customers benefits such as lower cost, reduced power consumption and easier integration into their products.

As a result of these industry dynamics, demand has exploded for networking products and services — optical, packet, broadband, software, semiconductors, wireless and network consulting — all areas of major strength for Lucent.

The Strongest Year in Lucent's History

For the fiscal year ended September 30, 1999, net income rose 46 percent to $3.8 billion, while earnings per share increased nearly 42 percent to $1.22 a share, excluding one-time events (see notes a and b, page 1). Revenues increased 20 percent to $38 billion.

Each of our three major products and services groups contributed to these gains. Sales of Systems for Network Operators, our largest group, rose 24 percent to $25 billion, driven by sales of optical networking systems, wireless systems, data networking systems for service providers, broadband networks, communications software and services.

Our Business Communications Systems group posted a 5 percent increase in revenues to $8.6 billion, led by sales of DEFINITY® Enterprise Communications Servers — including those with call center applications — and messaging systems and NetCare® services.

Our Microelectronics business posted revenue growth of 18 percent to $3.6 billion, driven by increased sales of optoelectronic components and power systems, customized chips for high-speed communications, data networking and wireless systems.

During the year, Lucent again grew faster than the market. We announced 125 contracts worth more than $11.4 billion, nearly half with customers outside the United States. We also won contracts with 96 major new customers around the world.

> "A key to Lucent's success has been our willingness and our ability to constantly reinvent our company to succeed in an industry that is constantly reinventing itself."

Our business outside the United States is growing stronger every year. Revenues from outside the United States increased 47 percent in the fiscal year, accounting for 32 percent of total revenues — up from about 23 percent when Lucent was created four years ago. One-third of our current business, and two-thirds of our total opportunity, lie outside the United States. To address this opportunity we are focusing on countries that will yield the most profitable returns, including key customers in the Asia/Pacific region, Latin America and Europe. In Latin America we experienced phenomenal growth. We signed more than 20 major contracts, valued at more than $2 billion, and grew 100 percent over 1998. In Europe, the Middle East and Asia, where we signed contracts with over 100 new service providers, we're growing twice as fast as the market. Throughout these regions we have forged strategic relationships with service providers like Telefonica in Spain and Portugal Telecom.

Every day, we capture sales in areas that were out of our reach only a year ago, until the right technology emerged. We won more than 60 major contracts for products that didn't exist a year ago. For example, we signed contracts with Level 3 Communications in the United States, Telefonica Data of Spain and Telstra of Australia for large networks that will be based on a Bell Labs breakthrough technology called the Softswitch, which brings the reliability of voice networks to data networks.

Constantly Reinventing Lucent for Growth and Profitability

A key to Lucent's success has been our willingness and our ability to constantly reinvent our company to succeed in an industry that is constantly reinventing itself.

In the past few years, we have steadily added new technologies and capabilities — generated by Bell Labs innovations and by acquiring technology and talent — to help us deliver next-generation networks to our customers.

Also, we continued to deliver Bell Labs innovations to the market at a faster pace. Last year Lucent introduced a record 128 products that originated at Bell Labs. Bell Labs researchers also earned 1,020 patents during the year — more than ever before.

In addition, we acquired industry-leading companies to help us address the industry's highest-growth areas (see list at left). The integration of Ascend Communications, with our other data networking resources, gives us leadership in data networking systems for service providers.

With the acquisition of Ascend, Lucent is now a leader in both the voice and data worlds for service providers. Today, 70 percent of the world's Internet traffic travels over Ascend equipment. The Lucent 5ESS switch serves nearly 300 service providers in more than 50 countries.

The addition of Kenan Systems gives us global leadership in a market that's growing even faster than communications software overall — at 30 percent annually. If Lucent were strictly a software company, we would be the fifth largest in the world.

With International Network Services, we now have a professional services force of more than 5,500 experienced consultants, technicians and engineers, the largest in the world of communications networking. It will address a market that's growing at 17 percent annually.

Nexabit Networks brings us leading next-generation Internet protocol switches that can speed data through networks at more than 1 trillion bits a second — four times faster than today's counterparts. Nexabit's blazing speeds will bring high-quality Internet services such as live television or movies-on-demand downloaded by computer. Nexabit switches will also link directly to our optical networking systems to add even more speed to our high-capacity networks.

With Excel, we are a leader in programmable switches, a market that's growing at 20 percent a year. Programmable switches enable telephone companies to keep pace with technological changes without replacing their existing systems. A software upgrade lets carriers add new applications — like prepaid calling cards, "follow me, find me" services and unified messaging features.

We're **No.1**

Lucent is No. 1 worldwide in the following high-growth segments:

- **Communications networking** overall
- **Switching** for global service providers
- **Optical networking** using Dense Wavelength Division Multiplexing
- **Voice over Internet protocol**
- **Wireless networks** using Code Division Multiple Access
- **Networking Services and Support**
- **Remote access**
- **Superfast (ATM) switching** for core networks
- **Frame relay** a high-speed switching technology
- **Call centers**
- **Messaging**
- **Semiconductors** for communications
- **Optoelectronic components** for communications
- **Application fiber**
- **Power equipment**

"We continue to win the competitive war for talent in four key areas — systems, software, silicon and services."

Realigning the Business to Deliver What Customers Want

To help us integrate these acquisitions and focus clearly on customers worldwide, we realigned our business and our leadership to offer our customers what they want: converged networks. The realignment will help us respond faster to customer needs with our full capabilities.

It's intended to sharpen our focus on high-growth areas — such as data networking, optical networking, wireless, semiconductors, e-business and professional services — while also speeding our growth in international markets and increasing productivity across the company.

Each of our core businesses is capable of responding rapidly to customer needs, and of providing converged voice and data network solutions. And they are operating under one brand, with one standard of quality, supported by Bell Labs.

Service Provider Networks consists of our Optical Networking, Switching and Access Solutions, Wireless Networks and Communications Software products and services groups; our business focused on serving cable TV operators; those parts of InterNetworking Systems focused on service providers; and the global service provider sales and service organizations.

Enterprise Networks consists of our current Business Communications Systems and Government Solutions, plus those parts of InterNetworking Systems focused on enterprise customers and the channel that supports SYSTIMAX® cabling systems. It is responsible for both voice and data solutions for enterprises, including the U.S. government.

NetCare Professional Services consists of our current professional services business, which recently merged with the newly acquired International Network Services company to create the most comprehensive services portfolio in communications networking.

Microelectronics and Communications Technologies consists of our current Microelectronics business, Network Products, New Ventures and the Intellectual Property Division.

Our realignment is all about growing our business and managing our operations in ways that produce ever greater efficiency and productivity.

A Clear Vision

Our strategy is to build long-term alliances with major industry players. When Telefonica Data needed to build a network based on Internet protocol technology, they were looking for more than just routers and hubs. They turned to Lucent, because we understand their future network vision and we can support that vision with the latest technologies and advanced services.

We offer our customers the end-to-end network solutions they need. We have leadership in every key network building block — in voice, data, optical and wireless networking. We have the clearest vision of communications net-

"We have leadership in every key network building block — in voice, data, optical and wireless networking."

works for the next generation: We know how voice and data networks work together today and how they will converge into the network of networks tomorrow.

We offer the best migration path to next-generation networks, as well as the best solutions for so-called "greenfield," or start-up, companies, whether they're building wireline or wireless networks. Add to these strengths our unparalleled network integration capabilities, and it becomes clear why we lead the industry in communications networking.

Positioned for Growth

We are proud of our achievements for 1999 and the people who stand behind our past success and our future prospects in the marketplace.

I believe our people are the best in the industry. And we continue to be successful in the competitive war for talent in four key areas — systems, software, silicon and services. Our culture continues to change as well, becoming quicker, more open and more entrepreneurial.

We are proud of the reputation we have forged with customers, investors and the public. In a *Wall Street Journal* survey of 6,000 subscribers, Lucent ranked fourth among 773 companies for "quality of management," fifth for "reputation of a company" and second for "investment potential." Among communications technology companies, Lucent ranked first in all three categories in the survey.

We are proud, too, of the diversity of our work force, which also has received public attention. In 1999, we captured eighth place in *Fortune* magazine's ranking of the 50 best companies for minorities. *Fortune* found that "Lucent has more people of color among its 25 highest-paid executives (nine) than any other company in our rankings."

We believe we're well positioned to continue our extraordinary growth and to increase value for our shareholders. Demand for our systems, technologies and services remains strong. The market remains robust. And no one comes close to Lucent in our ability to build, design and service networks for the next generation.

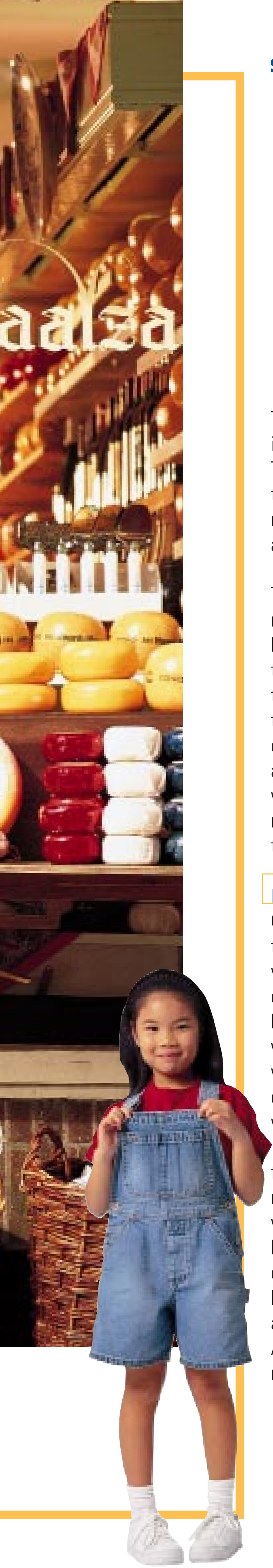
Rich McGinn

Richard A. McGinn
Chairman and Chief Executive Officer

November 15, 1999

E-commerce is coming to the world's first high-capacity fiber-optic global network, linking 100 cities throughout Europe. The network, being built by Global Crossing using Lucent's WaveStar™ OLS 400G system and WaveStar BandWidth Manager, will help cheese-maker Henri Willig of Edam, Netherlands, reach customers around the world through his Web site.

Lucent's 7R/E™ Packet Solutions portfolio allows service provider customers worldwide to deliver over packet networks virtually every service and feature available on today's public network. Left, Lucent engineers Hector Iurcovich (foreground), Ana Torres and Cyrus Pourooshasb test the 7R/E equipment in the lab.



Unleashing the **Power of Networks**

The key network building blocks are optical and packet technology and software. Lucent is leading the way in integrating these technologies to deliver next-generation networks.

Today's internet brings people a wealth of information, commerce and entertainment. The Internet of tomorrow will offer all this, and more. It will be all-pervasive, as much a part of our lives as the telephone and television.

But getting to that point won't be easy. The challenge is to bring together the many networks of today — wired, wireless, local, long distance and international. As the leader in broadband networking, Lucent today has the technology and talent to transform today's Internet into something even better: a new kind of network that is available anywhere, that carries voice as well as DVD-quality video and audio, that is reliable and secure, and that is affordable to many millions worldwide.

Packet, Optical, Software

One key is packet switching — a technology that shunts bits of digitized voice, data or video across a network. Now, the true power of broadband networking is emerging as Lucent integrates it with optical technology, which will deliver almost unlimited bandwidth. It will open the door to the applications of tomorrow, and let people communicate without limit.

Software is another key. Software confers network intelligence to support communications services over the different networks that will be part of tomorrow's broadband communications. Software will unify optical networks, packet networks like the Internet, and networks using a super-fast switching technology called Asynchronous Transfer Mode, into a single network of networks.

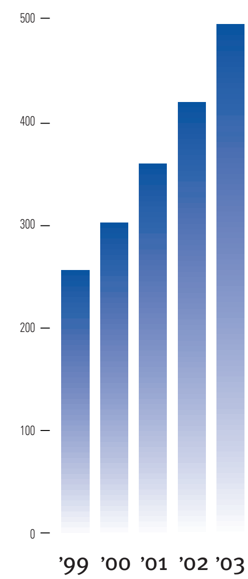
No company is better able than Lucent to integrate these technologies. During 1999, we solidified our leadership in broadband networking. We acquired new businesses. We added 7,000 people from those acquisitions to our broadband thrust. We rolled out dozens of broadband products, including PacketStar™ and Stinger™ DSL Access Concentrators.

Our merger with Ascend has given us the broadest and deepest solutions to help service providers offer broadband services and provide applications. Contracts we signed in 1999 demonstrate the potential of Lucent and Ascend worldwide. These include contracts with major companies like Telstra of Australia, Telefonica of Spain and Bell Atlantic. In fact, 27 of the world's 30 largest global service providers use Lucent and Ascend switching equipment in their data networks. Clearly, Lucent leads in next-generation networking for the service provider market. A synergy of the Ascend merger is the marriage of switching and optical technology in the core of networks to move voice, data and video around the world.

A case in point is Telefonica Data, a division of Telefonica Group, a carrier with some 50 million customers throughout Spain, Chile, Argentina, Peru and Brazil. Telefonica Data awarded us a $200 million contract to build a global network of packet-based technology called Internet protocol (IP). The agreement includes Ascend products, notably the MAX™ TNT™ wide area networking access switch. Also included is our Softswitch, a next-generation centerpiece that gives standard computer hardware the

Service Provider Networking Market

(dollars in billions)



The global service provider networking market is growing 18 percent annually (based on industry sources).

"My best friend moved to Brazil. Now we trade videos of each other and cool music, too." Megan Ng, 9

Lucent Tunes in Cable TV

Lucent entered a new market in 1999 — the cable TV market — with a product portfolio that includes our breakthrough PathStar™ Access Server. Comcast, a leading cable company that views services based on Internet protocol technology as a key to its broadband future, is trialing the PathStar system.

Part of Lucent's CableConnect™ Solutions portfolio, PathStar helps transform a cable operator from a video supplier to a full-service supplier of video, high-speed data and telephony.

Working with Lucent, Comcast can deliver high-speed Internet connections and telephone calls over its existing network, including conventional voice communications that people expect, such as three-way calls, call waiting and caller ID.

A big market for Lucent, cable TV operators in the United States are expected to spend $18 billion over the next five years to upgrade their networks for broadband services —according to market research firm Paul Kagan & Associates.

E-business is a growing channel for Lucent products. Illinois-based Anixter Inc. relies on the iBuy Lucent Web site for speedy product information and ordering.

power to connect any service — and to rapidly program new services.

Other carriers staking plans for revolutionary next-generation networks know that customers demand innovative broadband services. They also know that the first service most people want is to talk. The PathStar access server enables these customers to carry not only data and video services but also feature-rich voice.

Revolutionary Networking Is Evolutionary for Some

For established network providers, a transition to next-generation broadband networks means complementing the value of a voice-technology base like the Lucent 5ESS digital central office. Lucent's 7R/E Packet Solutions portfolio does this. It puts voice on packets, yet captures everything voice networks do best, including delivery of any of 3,000 networking and calling features. Our 7R/E Packet Driver helps 5ESS switch customers evolve to packet networks while reusing up to 80 percent of existing hardware.

And for making sure that ordinary phone wires can deliver packets at high speed to the home, Lucent's new Stinger product is the industry's first flexible, assured high-quality digital subscriber line (DSL) system. Stinger is in widespread trials, already serving St. Louis-based Primary Network in the United States and proving an entrant in the growing DSL market worldwide.

But whether revolutionary or evolutionary, a pivotal capability of the next-generation network is its programmability. This means the potential to define new services that combine voice, video and data in ways that make networks more valuable to users. Customers in the programmable switching market, growing at 20 percent a year, turn to Lucent's programmable Softswitch, our Excel switch and our 7R/E portfolio.

With our breakthrough advances in broadband technology, Lucent is fueling the growth of networks of all types by making possible new, reliable, secure services for people who want to communicate without limits — exactly what you'd expect from a leader in next-generation networks.

Lucent's merger with Ascend has made us a leader in wide area network switching technology. Ascend customer PSINet, an Internet super carrier, uses Ascend's MAX remote access servers to give customers speedier access to the Internet. Above, a technician at a PSINet global hosting center helps keep customer networks humming.

Telefonica is bringing voice and Internet access to 15 countries in the Americas and Europe. Lucent, as the carrier's strategic supplier, is helping build the new network. The network will help members of SOS Orquideas, a group that preserves orchids in the wild, exchange information worldwide. Here, a member of the group conducts pollination studies on the flowers near Sao Paulo, Brazil.

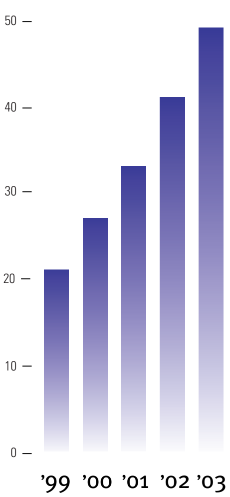
"When I'm not skateboarding, I'm surfing the Internet to talk to other skateboarders. There sure are a lot of us out there." Jamal Aldubayan, 10

Savvy Software
Seamless Services

Software will integrate today's optical, packet and voice networks into tomorrow's next-generation networks.

Communications Software Market

(dollars in billions)



The communications software market is growing 23 percent annually (based on industry sources).

Software is the network intelligence required to deliver the wealth of services people will need as they seek out new ways to communicate. Software is one of the hottest markets in communications — growing at 23 percent a year. Our software business continues to outpace the market, growing at 30 percent a year.

As the worlds of voice and data converge, software will help bind them together to work as one. For example, our open, programmable Softswitch will offer network providers a full range of seamless communications services on Internet protocol (IP) networks, packet based networks, and voice networks.

More than 40 customers and independent software vendors are currently working with Softswitch to quickly develop and deploy new, advanced services. One example is our software-powered TelePortal™ service that enables users to surf and "hear" Web page content from any telephone. And Lucent's software-smart Intelligent Assistant makes your voice a "command center" of sorts, enabling you to use natural speech to manage inbound and outbound calls and even voice mail.

Our software also lets users work on the Internet without missing an important call over the same line. With our Online Communications Center (OCC), users receive a "call waiting" message right on the computer screen with no disruption to the connection. They then can choose to receive the call via Voice over Internet protocol or let the call forward automatically to normal call coverage. Cavalier Telephone in Virginia is using Lucent's OCC to be the first to bring Internet caller-ID service to Richmond.

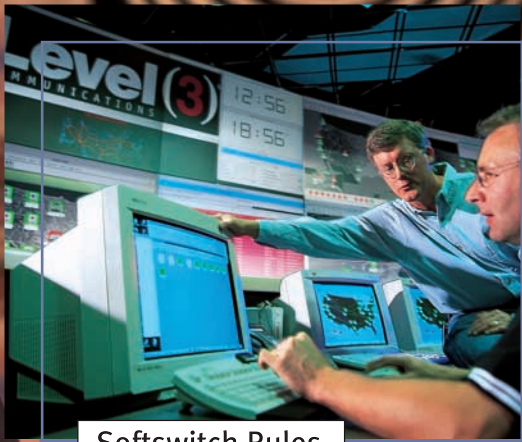
With services multiplying and networks converging, easy-to-use billing software is critical. The acquisition of Kenan Systems makes Lucent the world leader in billing and customer care software. Our billing systems are used by more than 150 customers in 30 countries on six continents. Kenan Systems software can quickly establish new services, then deliver a single bill for any combination of telephone, wireless, cable and Internet access usage.

Lucent's network management software also is hard at work "minding the network store." Take the NetMinder™ System for example. Among the world's best real-time decision support systems, the NetMinder System optimizes traffic flow during periods of network stress. The system handles every aspect of traffic data collection, monitoring and control across diverse networks and technologies, maximizing performance to prevent overload and failure.

Lucent and Bell Labs continue to commit strategic R&D to achieve software breakthroughs, create innovative technologies, then rapidly bring them to market. In fact, two-thirds of Bell Labs' 24,000 people develop software. As busy as the next-generation network crossroads may be, Lucent software will be there, evolving along with the hardware that shares the Lucent name.

Lucent's merger with Kenan Systems has made us a world leader in third-party billing and customer care software, a market segment growing at 30 percent annually. FirstWorld Communications signed agreements totaling $70 million for Lucent products, including Kenan billing software. Here, Kenan project manager Eric Wheatley (right) reviews new billing software installation with FirstWorld's Cyndi Lauda, enterprise billing manager, and Marion Jenkins, chief information officer.

Lucent is helping Sprint expand its all-PCS network, one of the largest in the United States. Our intelligent networking software lets customers, like this craft shop owner on the Tohono O'odham Nation Reservation in Arizona, activate service from their cell phones.



Softswitch Rules

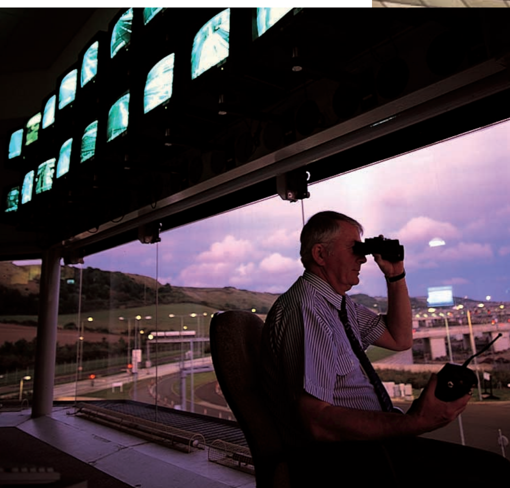
Through the power of communications software, the voice network is now carrying data, too. Add the explosive growth of the Internet and new packet-based networks, and the picture is clear — the telecommunications industry is experiencing a convergence of technologies.

In the communications industry evolution, software holds much of the promise of reliability, competitive price and, most important, innovation.

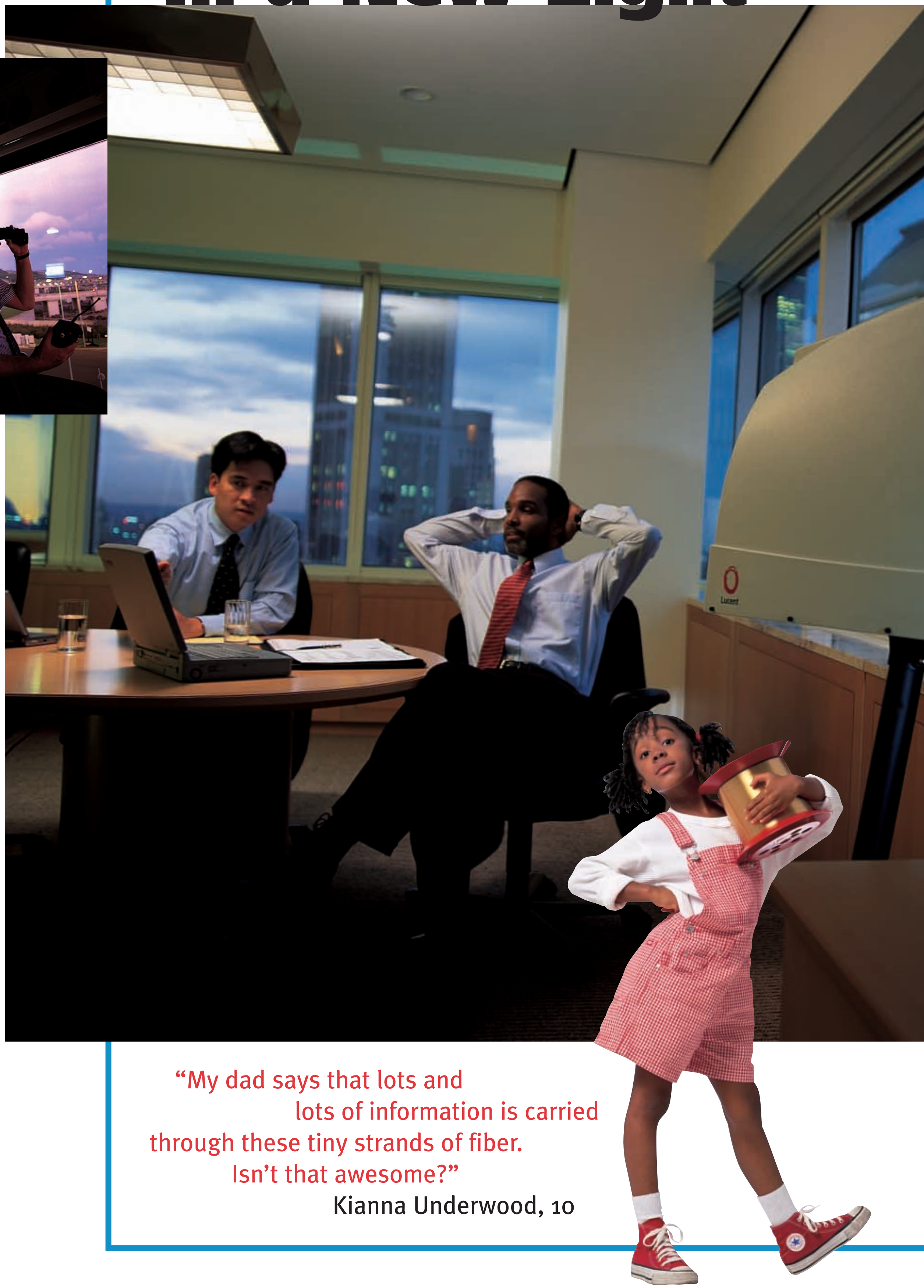
After his company signed a strategic agreement worth up to $1 billion for Lucent systems and the breakthrough Softswitch, Level 3 Communications president and chief executive officer James Q. Crowe said, "The Lucent Softswitch, together with Level 3's Internet protocol network, will bring customers the best of both the traditional telephone network and the Internet — ubiquity and reliability combined with rapid cost reductions and innovative new services."

"I go everywhere with my dog, Daphne, except school. When I get home, I call my best friend and we take her to the park to play."
Michael Cliggett, 6

Next-Generation Networking
In a New Light

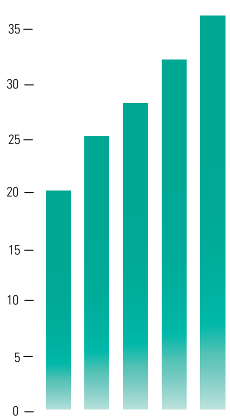


Lucent is a leader in optical networking, having delivered some 4,000 systems to customers worldwide. Our high-speed products will help EuroTunnel expand its communications network between Paris and London. Above, a EuroTunnel manager in a control tower on the British side keeps an eye on autos being loaded on trains for the trip to France.



Optical Networking Market

(dollars in billions)



The global optical networking market is growing 16 percent annually (based on industry sources).

"My dad says that lots and lots of information is carried through these tiny strands of fiber. Isn't that awesome?"

Kianna Underwood, 10

We believe optical networking will be as important to the 21st century as electricity has been to the 20th century.

Lucent's first-of-its-kind OpticAir™ system transmits information across beams of light to provide high-speed data networking directly through the air. Small enough to be placed on rooftops or in office windows, the system dramatically boosts the capacity of local networks where cost, geography or other constraints make fiber connections impractical. Here, two executives receive data through the system on a laptop computer.

As the torrent of Web pages, phone calls, e-mails, faxes and video clips inundates networks worldwide, service providers are turning to optical technology to meet this demand. In the new millennium, the world's most powerful broadband networks will be all-optical, delivering vast amounts of data to more people at the speed of light.

Optical networking, which boosts network bandwidth, or the capacity for carrying information, pumps information as pulses of laser light through hair-thin glass strands. Our WaveStar OLS 400G system uses a technique called Dense Wavelength Division Multiplexing (DWDM) to beam as many as 80 different colors of data-laden light down a single fiber strand, dramatically raising the fiber's capacity.

With more than 4,000 systems serving customers around the globe, Lucent is well ahead of its competitors in the deployment of DWDM technology. In fact, we've captured the largest share — 29 percent — of the $2.2 billion global DWDM market, according to industry analyst KMI Corporation.

And it's not hard to see why. We've shipped our WaveStar OLS 400G system to some 35 telephone companies, Internet Service Providers and other network providers worldwide. The system will play a major role in Global Crossing's new network, where it will team with our WaveStar BandWidth Manager — which routes data traffic as efficiently as voice traffic. The pair of products will help Global Crossing cover Europe with a glass highway of light, connecting people in 100 cities in the world's first high-capacity fiber-optic global network.

Lucent's Local Hero

Lucent's WaveStar systems are linking people all over the world, hurling trillions of bits of information a second across 50 countries on six continents as well as under the oceans. But our new high-capacity WaveStar AllMetro™ series is moving optical networking closer to home.

It's bringing bandwidth-boosting DWDM technology to local service providers, helping eliminate bottlenecks on their networks and helping give Web surfers lightning-fast access to cyberspace.

Air Lucent

Most optical signals speed over today's networks through fiber buried beneath the earth or on the ocean floor. Now, Lucent has launched a revolutionary new kind of optical networking system that uses photons to propel huge volumes of information through the air — up to 10 billion bits a second. That's 65 times faster than today's swiftest wireless systems. The system's compact transmitter can be placed on a rooftop or in an office window to beam information to a nearby building.

It's the first system to use DWDM technology without cables, and it will raise the capacity of local data networks, speeding up tasks like Internet access for people who use the network.

Fabulous Fiber

The rise of optical networking as an enabler of the communications revolution has increased Lucent's fiber and cable business by a wide margin. And it's growing even faster with the emergence of new players in telecommunications and the deregulation of global service providers. In 1999, we signed contracts with 18 new customers totaling more than $3 billion.

Our TrueWave® and AllWave™ fiber hold more than a 65 percent share of the new, high-growth application fiber market.

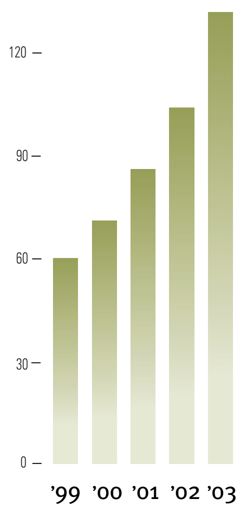
In 1999, we unveiled two undersea fibers, TrueWave Submarine RS and TrueWave XL, that enable network providers to greatly increase the capacity and transmission speed of their transoceanic networks. And our newest fiber offering, the LazrSPEED™ solution, is the industry's first fiber-optic cabling solution for enterprise networks that performs at speeds up to 10 times faster than other products on the market.

Next-Generation Networking **Takes to the Air**

Every minute, 26 people sign up for wireless service in the United States.

Wireless Infrastructure Market

(dollars in billions)



The global wireless infrastructure market is growing 22 percent annually (based on industry sources).

China alone adds 1.5 million new wireless users a month — 34 people a minute. There's a wireless revolution going on — and it's more powerful, more pervasive, more inclusive than ever. As the world speeds into a new millennium running on next-generation networks, Lucent is poised to lead that wireless revolution — with an expertise that isn't limited to a single technology, a single solution or a single continent.

Today, wireless networks carry an increasing volume of voice traffic. In less than a decade, the number of wireless users worldwide will equal wireline subscribers. People everywhere are on the move and talking. Wireless networks are rapidly evolving to support data and personal services and Lucent is leading the way.

Next-Generation Leader

We're prepared to take our customers to the next step in wireless — to 3G, the third-generation wireless services.

3G will offer high-speed on-ramps to the Internet at speeds approaching those that wires deliver at home or in the office. Subscribers will be able to surf the Internet, send mail or shop online.

Lucent is the only wireless solution provider involved in trials of multiple 3G technologies on four continents. We're participating with AT&T Wireless Services, Bell Atlantic Mobile and Sprint PCS in the United States, as well as with carriers in Japan, Australia and the United Kingdom. Our customers are already starting to leverage their existing networks to create revenue opportunities with location-based services and accommodate ever-growing amounts of voice and data traffic.

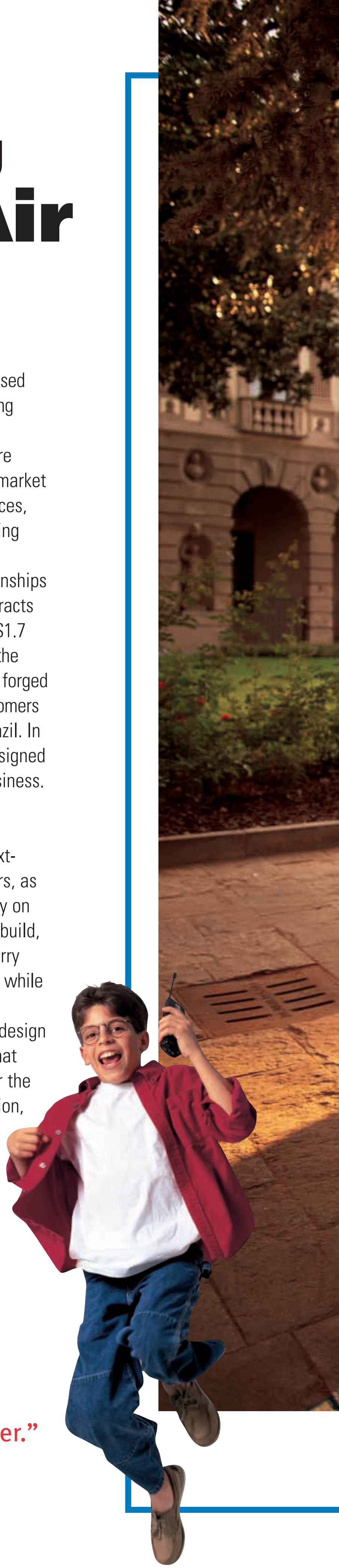
Many of the newest operators are counting on Lucent to gain a time-to-market advantage with next-generation services, thanks to our proven record in deploying networks quickly.

In 1999, we strengthened relationships with AT&T and Sprint by signing contracts that are expected to total more than $1.7 billion for equipment and services for the next phase of their PCS networks. We forged stronger relationships with other customers as well, including Telesp Celular in Brazil. In the Asia/Pacific region alone, Lucent signed more than a billion dollars in new business.

Investment Protection

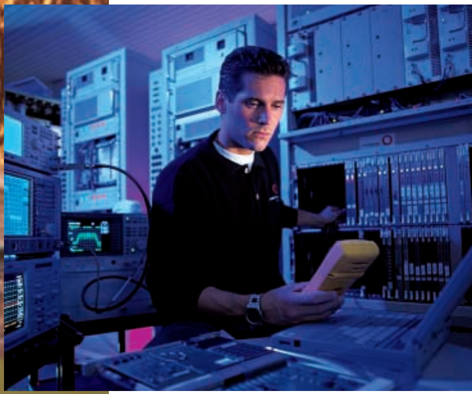
Lucent is committed to supporting next-generation networks for new operators, as well as for current customers who rely on Lucent's and Bell Labs' experience to build, blend and evolve their networks to carry any mix of voice, data and multimedia, while protecting investments already made.

Lucent is uniquely positioned to design and deliver the end-to-end systems that wireless networks demand. Wherever the world is going in the wireless revolution, Lucent is intent on getting it there.



"My mom gave me my own cell phone for my birthday. Now I'm never late for dinner."
Peter Louis Cuttone, 11

Lucent is a step ahead of the industry in being able to demonstrate that packet networks designed for high-speed wireless data can be enhanced to transmit voice traffic. A common network based on our PacketGSM™ technology will efficiently handle both data and voice, as shown in tests performed by Lucent Lab Manager Don DeLorenzo at our lab in Swindon, England.



Lucent strengthened its relationship with AT&T in 1999, signing a four-year, $1 billion contract for equipment and services for the next phase of AT&T's nationwide Digital PCS wireless network. In addition, AT&T plans to add Lucent equipment in the metropolitan New York City area. Here, Lucent employees Andrea Lynn Stone, Bob Louis (center) and Tony Simonetti, on a New York City rooftop, review installation plans for part of the AT&T network.

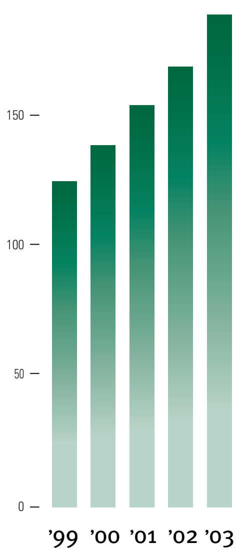
Next-generation networks will enable mobile service providers like Italy's Omnitel to offer customers many capabilities, including high-speed wireless data. Lucent's 7R/E Packet Driver, coupled with our 5ESS switches, will help Omnitel evolve to the new network. Above, Lucent employees are helping Omnitel design part of its network near Milan.

Students at the University of Maryland's McKeldin Graduate Library at the College Park campus can stay connected to the college network no matter how deep they get buried in the stacks when they use a laptop equipped with a card connecting them to Lucent's WaveLAN® wireless network.

The Seattle Mariners' new home, SAFECO Field, uses Lucent voice and data networks to power its operations, from Internet ticket sales to concessions. Lucent's Cajun™ switches, a DEFINITY server, customer care solutions and SYSTIMAX cabling are part of the network that brings fans cutting-edge conveniences. Here, a Mariners' employee updates play-by-play statistics on the team's Web site.

Enterprise Networking Market

(dollars in billions)



The global enterprise networking market is growing 11 percent annually (based on industry sources).

Lucent's new IP Exchange Systems help Challenge Dairy, based in Dublin, Calif., control costs and create next-generation networks to help grow its business.

Business Connections That Count

Enterprises, from neighborhood shops to global powerhouses, look to Lucent for communications solutions and e-business applications to help them grow.

We're helping businesses move to an era when networks of all kinds will converge and operate as one, an era when businesses will operate as virtual enterprises with customers, employees, suppliers and partners connected through reliable, secure, flexible and efficient networks.

We know — inside and out — the real-world applications that make enterprises work. We're taking our leadership in messaging and call centers and transforming it into intelligent communications solutions that enable businesses to compete in an e-business world. These customers range from small boutique gift bakeries like Atlanta's Blooming Cookies to financial services giant Prudential.

We know that a voice mailbox can be much more than a place to catch messages when you're away from home. New products like www.messenger,™ which lets people access and manage their mailbox over the Web, and INTUITY™ Interchange,™ which ties together all an enterprise's mail systems, help weave the next generation of communications networks into a pattern for business success.

Real-World Communications

Both large and small enterprises, including nearly 90 percent of Fortune 500 companies, depend on our world-leading DEFINITY server for their communications and we've made those investments even more valuable.

With the DEFINITY IP Solutions portfolio, for example, enterprise customers need only add a card and software to turn the DEFINITY server into an ultrareliable "triple-network" server. And they can do so without changing their existing voice and data networks or disrupting service.

The new solution gives users access to a voice network, a network that uses Internet protocol (IP) technology, plus a network that employs a high-speed switching and transmission technology called Asynchronous Transfer Mode (ATM). The three seamlessly mesh to let users make phone calls and exchange faxes, as well as share key business-building applications like call centers and messaging.

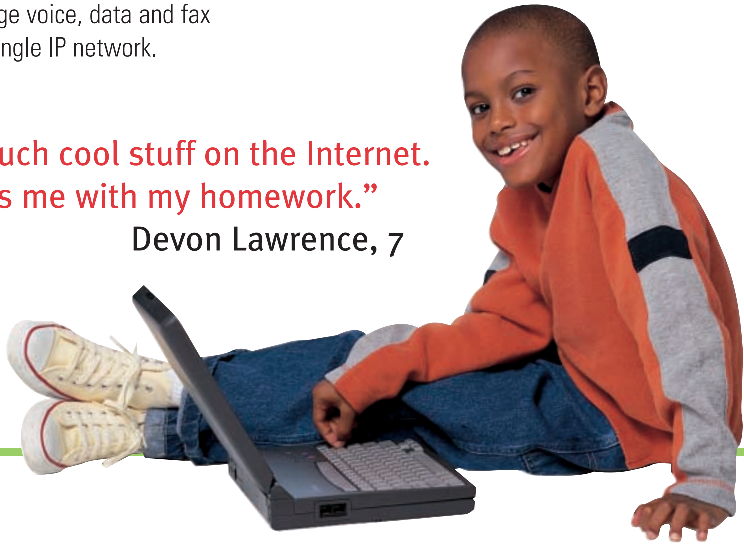
Lucent's new family of IP Exchange Systems gives enterprises another option: It lets them build a software-based network that offers voice features over standard computer hardware, such as a Windows NT® server. It's the first of a new class of solutions that cost-effectively converge voice, data and fax transmissions over a single IP network.

Lucent is uniquely able to provide end-to-end solutions that combine the best of voice networking with the best of data. We're technology pacesetters in every key area of enterprise communications. Examples include our industry-leading DEFINITY communications servers, Voice over Internet protocol solutions, award-winning Cajun Campus data networking switches, a broad portfolio of wide area networking products, network security devices, network management software, enterprise wireless offerings for LANs and in-building telephony, and messaging and customer relationship management solutions. These systems all work — together and with the products of other vendors — to meet the changing needs of enterprises.

At a Pennsylvania school district, for example, education is moving into the next century with the help of an enterprise data and voice network installed and run by Lucent. Cajun ATM switches and Cajun Ethernet data switches are part of a complete data solution that works seamlessly with Lucent's leading-edge DEFINITY server, INTUITY Unified Messaging System and interactive voice response system. Together, these systems give 8,700 students and 600 teachers and administrators high-speed data links to the Internet, a homework hotline, and voice and e-mail services.

Uniglobe.com uses Lucent's CentreVu® Internet Solutions in the first fully integrated global customer contact center for online travel shoppers.

"I can find such cool stuff on the Internet. It really helps me with my homework."
Devon Lawrence, 7

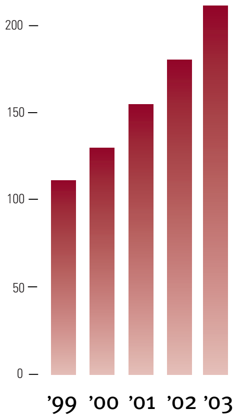


Windows NT is a registered mark of Microsoft Corporation.

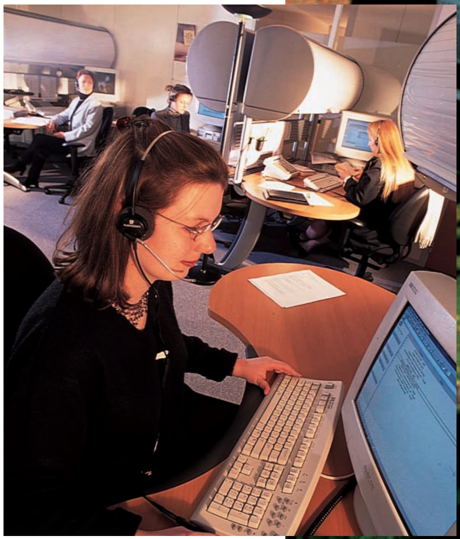
The Knowledge Behind the Network

Network Support Services Market

(dollars in billions)



The global market for network support services is growing 17 percent annually (based on industry sources).



Lucent NetCare centers worldwide provide a central point of contact for all our NetCare products and services on an around-the-clock basis. Lucent's Nathalie Möschberger (foreground) and her colleagues at our center in Sophia Antipolis, France, keep customers in the region updated on the resolution of network problems.

With our acquisition of network services powerhouse INS, Lucent now helps more than 10,000 clients in 93 countries design, build and manage their networks. When Babson College near Boston needed to expand its networks, INS evaluated the existing network operating system and provided a plan for migration to a new system. Students, faculty and staff use the new network for e-mail, Internet access and other applications.

When BellSouth International (BSI) needed help in planning, designing and implementing Internet Service Provider services for BSI's affiliates in South America, Europe and the Middle East, they turned to Lucent's NetCare Professional Services (NPS) for help. NPS built a fully functional prototype and test system, which will also be used for training employees of BSI affiliates prior to full-service rollout of the services in their respective countries.

Like no other company, Lucent is positioned to help customers build and run high-performance networks.

To capture the promise of the network of networks requires much more than electronic boxes and cables. It demands network knowledge — from experts who can quickly plan, design, implement and operate multivendor networks that deliver information, reliably and profitably, around the clock and across the globe.

Our team of 5,500 consultants, technicians and engineers in 93 countries supports more than 10,000 clients worldwide. Among them are more than half the companies in the Fortune 100, and one-third of those in the Fortune 1000, including such blue-chip names as AT&T and Sprint.

When we ask our customers what is most important to them, the answer we often hear is how to smoothly integrate new networks into existing networks — and do it at Internet speed.

Consulting the Experts

As networks grow more complex and ever more central to business success, many customers are assigning their network planning, implementation and support to outside experts. This trend has created a global market for network professional services that is growing at 17 percent annually.

In 1999, Lucent moved to seize this opportunity by acquiring the world's premier multivendor network consulting company, International Network Services — a company that grew its revenue in the past year by 82 percent.

This acquisition, together with technology and talent acquired from Ascend Communications and Lucent's own strength in network installation, maintenance and operations — including state-of-the-art network operations and support centers — gives Lucent powerful offerings for each phase of the network life cycle.

With INS and Ascend, Lucent added consulting and service capabilities in today's hottest digital networking technologies, such as Asynchronous Transfer Mode, frame relay and Internet protocol. INS added 2,200 networking experts to the 3,300 already at work in Lucent's NetCare Professional Services (NPS) organization.

Lucent also added software, Web and knowledge systems for network service. Lucent VitalSuite™ is a family of network monitoring and management software from INS. The award-winning eSight interactive Web site from Ascend enables NetCare customers to manage and maintain their networks through assisted self-help around the clock. The Knowledge Network from INS is the world's largest database of network solutions.

NPS is a unique piece of Lucent's business — a people-intensive consulting operation that addresses the needs of customers, using a multivendor approach to ensure an independent view of network design for our customers.

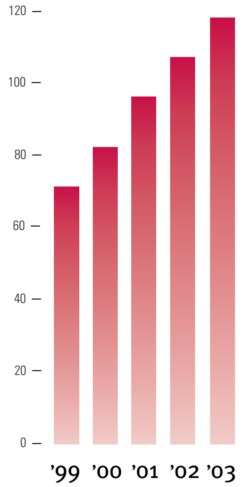
Building from a base of strong leadership, effective operations, talented people and close client relationships, Lucent's NetCare Professional Services is prepared to outperform and outgrow its competition.

"I can find great things on the computer at school. When I get home, I can play great games on it, too."
Chaz Slemmons, 6

Small Packages Big Payoffs

The Market for Lucent's Semiconductor Products

(dollars in billions)



The global market for the types of semiconductors sold by Lucent is growing 14 percent annually (based on industry sources).

The global Web population is expected to jump to 502 million in 2003, up from 196 million today. Lucent's computer modem chips speed up Internet access for many of those users, like the family shown here. The child taps into the Internet for homework help, while her mother uses a laptop to catch up on e-mail — both over a single phone line.

Unseen, unsung, they're true heroes of the communications revolution.

They're hard at work in virtually every product that keeps the Information Age humming — from personal computers and cell phones to modems and disk drives, telecommunications and data networking gear. And they'll be every bit as important to next-generation networks.

They're semiconductor chips. They hold the integrated circuits whose job is to electronically process, store and move information. Today, Lucent is the worldwide leader in chips specially built for communications, according to leading industry analyst Dataquest. The reason: Our chips are in more communications systems than anyone else's.

And we intend to keep that lead. In our eyes, the big business challenge for the next century will be to address the needs of the communications industry as we create chips for next-generation networks.

Our strategy is to focus on customers who lead their segments of the communications marketplace. Their successful products translate into healthy sales for us. We're also placing our bets on solutions that put the electronics for an entire system like a cell phone on a single fingernail-sized slice of silicon.

Because of the complexity of such "systems-on-a-chip," they're less likely to become low-profit commodities. Just as important, they offer our customers big benefits such as lower cost, reduced power consumption and easier integration into their products.

Lucent is the leader in delivering solutions like these to our customers. In fact, we derive more than 50 percent of our microelectronics revenues from systems-on-a-chip. In 1999, we introduced the world's first true, universal single-chip solution for moving voice and data traffic from networks that use copper cables to those using fiber-optic connections. The solution slashes system costs for our customers as much as 80 percent, and cuts time-to-market by up to six months.

Speedier Internet Access

Other major system-on-a-chip offerings are companion pieces of a sort. Our new second-generation WildWire™ chip set is for the service provider's central office. With technology pioneered by Bell Labs, it economically enables subscribers to access the Internet and other networks over ordinary phone lines — at speeds more than 100 times faster than today's fastest modems.

The other half of the team is our WildCard™ solution. It also speeds up network access and downloading, but it's installed in personal computers.

To win in the world of next-generation networks, chip companies must offer comprehensive solutions that wed silicon and optics technologies. Today, Lucent is the only industry player that supplies both the chips and the optoelectronic components like lasers needed to move voice, data and video over converging networks.

In fact, in 1999 we announced the industry's first optical networking module that marries advanced optoelectronic components with system-on-a-chip integrated circuits. The new module cuts design time for high-speed transmission systems by six months to a year. It also reduces space needs for the circuitry, slashing power consumption some 50 percent.

Powering the Industry

Lucent is the power behind the communications industry, whether it's powering traditional telecommunications systems or Internet applications. Our business was ranked No. 1 in worldwide sales of power equipment in a $20 billion industry by market research firm Micro-Tech Consultants. We added more than 125 power customers in 1999 to our growing list of service providers and other customers around the globe.

We've redefined how tomorrow's semiconductors will be powered. For tight spacing in equipment and for superior performance, the revolutionary Titania™ Power Modules are the industry's smallest and fastest, and have outpaced the competition with unmatched reliability for next-generation microprocessors. Titania has won more than $100 million in contracts since April 1999 .

"My science teacher said that a silicon wafer the size of a CD can contain more than 700 chips, all going into neat communications gear."

Tristan Patrick, 9

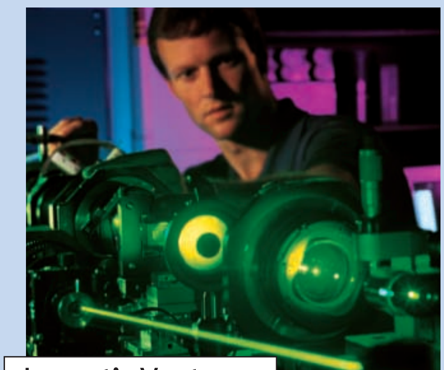
A Look Ahead

For the future, we've launched the final piece of the supply, sales and production system that runs our business. It allows us to deliver chips to some customers in as little as 48 hours. The system controls the manufacturing schedule at all our plants worldwide and lets customers see where their orders are in the supply chain. What's more, it lets them influence factory production schedules daily, not weekly or monthly.

In an era where speed to market determines the winners and losers, we're betting on this new system to give us a leg up on competitors in product delivery. It's another strategic move aimed at keeping Lucent solidly ahead in today's red-hot marketplace.

Speed to market is a key determiner of success in today's competitive marketplace, and Lucent's new logistics system gets chip orders into customers' hands faster than ever. Part of that system includes an alliance with DHL Worldwide Express, which enables us to deliver chips to most customers in 48 hours or less.

Lucent has developed next-generation chip-making technology that will allow tiny wireless phones in wristwatches or earrings. Here, Lucent engineer Eddie Santos tests a wafer produced by our Orlando, Fla., facility.



Lucent's Ventures

Bell Labs is a gold mine of new ideas, and our New Ventures Group is helping us to pinpoint some of the choicest "nuggets" for development into hot new businesses. Above, Bell Labs researcher Kevin Curtis conducts tests on a new photosensitive material planned for use by Lucent in a high-capacity holographic memory that would store 125 billion bytes of data on a five-inch disk.

A dozen ventures have been launched since 1996, including the following, which were created in 1999:

- *Optical Disk Memory is a venture that will develop a new kind of optical disk technology capable of storing 10 times more data than today's magnetic disk drives.*
- *WatchMark offers software products that let wireless carriers optimize their networks for more efficient operation. This will reduce costs and boost quality for cellular calls.*
- *Persystant Technologies offers the BitRoom Collaboration system, which will enable businesses to conduct multimedia conferencing over the Internet.*

Serving Our Communities

As part of Lucent's fourth annual Global Days of Caring, 90 employees and family members from Lucent Technologies and Tata Lucent Technologies, Ltd. entertained the residents of St. Mary's Home for the Aged in New Delhi, India. Nivedita Bajpai, wife of Prakash Bajpai, sales and marketing vice president at Tata Lucent, shared a smile and a warm moment with one of the home's residents. Almost 16,000 Lucent employees and family members volunteered at 450 projects around the world.

Lucent Technologies Foundation

The Lucent Technologies Foundation, with a budget of $50 million for 2000, helps young people around the world realize their highest potential. In 1999, major initiatives of the Foundation included:

- Project GRAD (Graduation Really Achieves Dreams), the cornerstone of our $6 million commitment to the city of Newark, N.J. GRAD aims to raise student achievement in reading, writing and math, and increase the number of high school graduates and college enrollees.
- The Lucent Universal Preschool Initiative, which provides young children with access to quality early childhood education, connecting teachers, parents and caregivers with the resources they need to deliver developmentally appropriate care.
- Outreach programs at 13 science museums in the United States, China, France and Canada aimed at sparking students' interest in and enhancing their learning of science.
- A global grants program in partnership with the International Youth Foundation to support youth development in 10 countries.
- Lucent Links, a global initiative to help young people better understand themselves and others who are different from them.
- Our matching gifts program, which provides a dollar-for-dollar match for gifts employees make to education and disaster relief around the world, and to arts and culture organizations in the United States.

In July 1999, Lucent hosted the first worldwide summit of the Lucent Global Scholars Program, a talent competition focused on supporting students around the world who are interested in information technology. The meeting, which included 80 of the world's brightest students from nine countries, inaugurated a 10-year-program that is the largest science scholars program in the world in terms of the number of participants and Lucent's $10 million funding commitment.

Diversity

Lucent creates and actively supports an environment where different ideas and diverse opinions are valued. This fosters innovation and taps into the creative energy of our global work force. We provide maximum opportunity to qualified minority- and women-owned businesses to participate as suppliers, contractors and subcontractors of goods and services through our Minority and Women's Business Enterprises (MWBE) initiative. To view Lucent's latest MWBE report, simply go to www.lucent.com/mwbe.

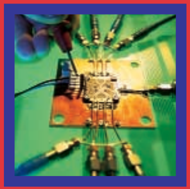
Environment, Health and Safety Goals

Lucent is dedicated to meeting the following goals by 2000:

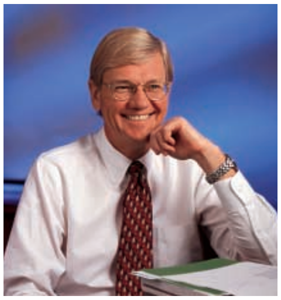
- Have in place environment, health and safety management systems, based on recognized standards, for at least 95% of our products, services, operations and facilities.
- Reduce our lost workday accident rate by 30%.
- Develop and apply Design for Environment criteria to produce competitive, environmentally preferable products and services.
- Prevent the emission of at least 135,000 metric tons of greenhouse gases.
- Recycle at least 70% of our waste paper.
- Continue to reduce manufacturing waste disposal and reportable air emissions as we expand our business globally.

For more information, please go to www.lucent.com/environment.

Lucent **At a Glance**

	KEY PRODUCTS	MARKET POSITIONS	KEY CUSTOMERS	2000 FOCUS
Service Provider Networks 	Switching and transmission systems for voice and data; data networking routing switches and servers; wireless network infrastructure; optical networking systems; communications software; support services.	No. 1 in optical networking No. 1 in ATM switching No. 1 in frame relay technology No. 1 in remote access technology No. 1 in VoIP gateways No. 1 in U.S. in central office switching systems No. 1 in U.S. in wireless infrastructure	Global service providers; competitive local exchange companies; wireless service providers; independent telephone companies; Internet service providers; private, public and government-owned telephone companies worldwide; U.S. government agencies.	Providing customers with solutions that enable the convergence of data and voice networks; the transition from circuit to packet networks; next-generation wireless networks; and the expansion of optical networks beyond the network core.
Enterprise Networks 	Communications servers for voice and data; e-business solutions; customer relationship management applications; messaging systems and applications; wireless and conferencing systems; IP-based and LAN/WAN products; network cabling for buildings; network management software; support services.	No. 1 in call centers No. 1 in messaging No. 1 in unified messaging No. 1 in cabling systems for buildings No. 1 in U.S. in voice communications servers No. 1 in U.S. in in-building wireless systems	More than 1.5 million customer locations worldwide, including small and mid-sized businesses, multinational Fortune 500 companies, government agencies, schools.	e-business solutions; systems and software that let enterprises converge their voice and data traffic over circuit-switched, IP and ATM networks; unified messaging applications and customer relationship management solutions; and network design, integration and management services.
NetCare Professional Services 	Services for the life cycle of a network, including planning, design, implementation, operations, maintenance, education and software; VitalSuite network monitoring and management software, and eSight interactive customer care Web site.	No. 1 in network professional services No. 1 in multivendor capabilities No. 1 in U.S. in network services	More than 10,000 customers worldwide, including incumbent service providers, emerging service providers and major multinational businesses, including more than half of the Fortune 100 and more than a third of the Fortune 1000.	Be the global leader in providing multivendor voice/data/video convergence solutions. Deliver the broadest and deepest portfolio of network design and consulting services to service providers and enterprises.
Microelectronics and Communications Technologies 	Integrated circuits for wireless and wired communications, computer modems and networks; optoelectronic components for communications systems; power systems; optical fiber; cable; connectivity solutions.	No. 1 in communications integrated circuits (ICs) No. 1 in application-specific ICs No. 1 in read-channel ICs No. 1 in communications optoelectronics No. 1 in SONET/SDH ICs No. 1 in power equipment	Makers of wireless, data networking and other communications products and equipment; computer manufacturers; and service providers.	Providing systems chips that carry voice and data over LANs and WANs, over copper and fiber, and over wired and wireless networks. Our capabilities to integrate IC, optoelectronic and power solutions position us well to move networks to the next generation.
Bell Labs 	Supports other Lucent units by providing basic research and product and service development. Recent innovations include Internet switching and transmission products, wireless systems and record-setting optical networking systems.	In 1999, Bell Labs produced the first high-capacity, all-optical communications router, the first software switch for IP networks, the fastest transmission of information over optical fiber using a single wavelength, and the most sensitive geolocation technology for pinpointing wireless 911 calls.	Lucent's direct customers, such as enterprises and service providers; end users of communications networking products and services.	Create, obtain and deliver more rapidly to customers innovative technologies to establish, maintain and expand Lucent's global market leadership in communications systems, components and networking software. Continue to globalize R&D efforts.

Lucent **Leadership**

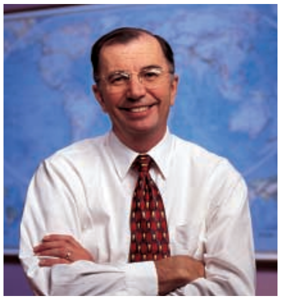
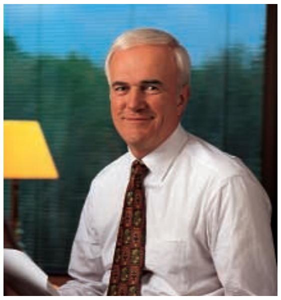



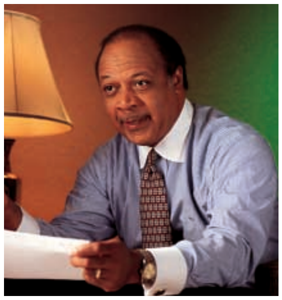




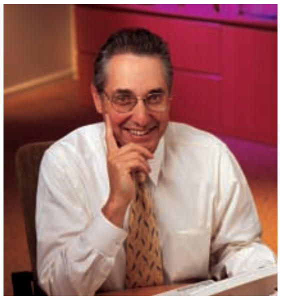










Patricia F. Russo
Executive Vice President
and Chief Executive Officer,
Service Provider Networks

William T. O'Shea
Executive Vice President
and Chief Executive Officer,
Enterprise Networks

John T. Dickson
Executive Vice President and Chief
Executive Officer, Microelectronics
and Communications Technologies

John L. Drew
Executive Vice President
and Chief Executive Officer,
NetCare Professional Services

Arun N. Netravali
President,
Bell Labs

Curtis N. Sanford
Group President,
InterNetworking Systems

Daniel C. Stanzione
Special Advisor
to the Chairman

Richard A. McGinn
Chairman and
Chief Executive Officer

Ben J. M. Verwaayen
Vice Chairman

Gerald J. Butters
Group President,
Optical Networking

Lance B. Boxer
Group President,
Communications Software

James K. Brewington
Group President,
Wireless Networks

Robert C. Holder
Executive Vice President,
Strategy, Business Development
and Corporate Operations

Donald K. Peterson
Executive Vice President
and Chief Financial Officer

Curtis R. Artis
Senior Vice President,
Human Resources

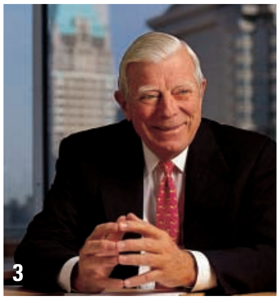
William R. Spivey
Group President,
Network Products

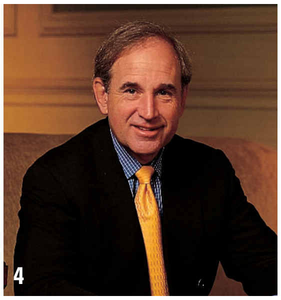
Richard J. Rawson
Senior Vice President,
General Counsel

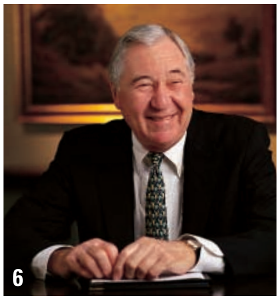
Kathleen M. Fitzgerald
Senior Vice President, Public
Relations, Investor Relations
and Advertising

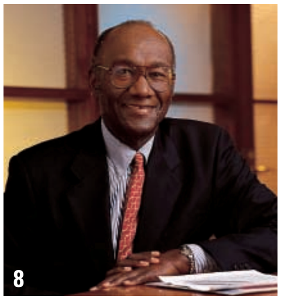
Thomas M. Uhlman
President,
New Ventures

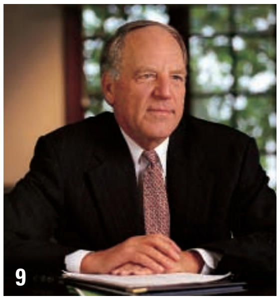
Board of **Directors**











1. **Paul A. Allaire**
61, chairman of Xerox Corp. (document processing services and products) since 1991. Director, Sara Lee Corp.; SmithKline Beecham p.l.c.; J.P. Morgan & Co.; priceline.com Incorporated. Lucent director since 1996.

2. **Carla A. Hills**
65, chairman and chief executive officer of Hills & Company (international consultants) since 1993. Director, American International Group, Inc.; Chevron Corp.; Time Warner Inc. Lucent director since 1996.

3. **Drew Lewis**
68, retired chairman and chief executive officer (1987-1996) of Union Pacific Corp. (rail transportation and trucking). Director, Aegis Communications Group, Inc.; American Express Company; FPL Group, Inc.; Gannett Co., Inc.; Millennium Bank; Union Pacific Resources Group Inc. Lucent director since 1996.

4. **Richard A. McGinn**
53, chairman and chief executive officer of Lucent since February 1998; chief executive officer and president of Lucent 1997-1998; president and chief operating officer of Lucent 1996-1997; executive vice president of AT&T and chief executive officer of AT&T Network Systems Group 1994-1996. Director, Oracle Corp.; American Express Company. Lucent director since 1996.

5. **Paul H. O'Neill**
64, chairman and chief executive officer of Alcoa Inc. (aluminum production) since 1987; chairman, Rand Corporation. Director, Eastman Kodak Company; the National Association of Securities Dealers, Inc.; Gerald R. Ford Foundation; Manpower Demonstration Research Corporation. Lucent director since 1996.

6. **Donald S. Perkins**
72, retired chairman and chief executive officer (1970-1980) of Jewel Companies, Inc. (diversified retailer); nonexecutive chairman (1995) of Kmart Corp. Director, Aon Corp.; LaSalle Hotel Properties; Nanophase Technologies Corp. Lucent director since 1996.

7. **Henry B. Schacht**
65, director and senior advisor, E.M. Warburg, Pincus & Co., LLC (global venture banking firm) since March 1999; chairman of Lucent 1996-1998; chief executive officer of Lucent 1996-1997; chairman (1977-1995) and chief executive officer (1973-1994) of Cummins Engine Company, Inc. Director, Chase Manhattan Corporation and The Chase Manhattan Bank, N.A.; Alcoa Inc.; Cummins Engine Company, Inc.; Johnson & Johnson; Knoll, Inc.; The New York Times Co. Lucent director since 1996.

8. **Franklin A. Thomas**
65, consultant to the TFF Study Group (nonprofit initiative assisting development in southern Africa) since April 1996; retired president (1979-1996) of The Ford Foundation. Director, Alcoa Inc.; Citigroup N.A.; Cummins Engine Company, Inc.; PepsiCo, Inc. Lucent director since 1996.

9. **John A. Young**
67, vice chairman of Novell, Inc. (network software and directory-enabled network solutions) since 1997; vice chairman of SmithKline Beecham p.l.c. since January 1999; retired president and chief executive officer (1978-1992) of Hewlett-Packard Co. Director, Wells Fargo Bank; Wells Fargo & Co.; Chevron Corp.; SmithKline Beecham p.l.c.; Affymetrix, Inc.; Novell, Inc. Lucent director since 1996.

Management's Discussion and Analysis
of Results of Operations and Financial Condition

Highlights

Lucent Technologies Inc. (the "Company") reported net income of $4,766 million, or $1.52 per share (diluted), for the year ended September 30, 1999, compared with year-ago net income of $1,035 million, or $0.34 per share (diluted). In 1999, Lucent changed its method for determining annual net pension and postretirement benefit costs. As a result, included in 1999 net income is a $1,308 million, or $0.42 per share (diluted), cumulative effect of accounting change. See Note 10 to the Consolidated Financial Statements for further detail of the accounting change. Lucent's income before the cumulative effect of the accounting change was $3,458 million for the year ended September 30, 1999.

In 1999, Lucent recorded a $141 million ($93 million after-tax) reversal of business restructuring charges, a $101 million non-tax deductible charge to operating expenses for merger-related costs and a $236 million charge ($169 million after-tax) primarily associated with asset impairments and integration-related charges associated with the Ascend Communications, Inc. and Nexabit Networks, Inc. mergers, a $274 million gain ($167 million after-tax) on the sale of an equity investment in Juniper Networks, and $282 million ($272 million after-tax) purchased in-process research and development expenses related to the acquisitions of Stratus Computer, Inc., Quadritek Systems, Inc., Sybarus Technologies, WaveAccess Ltd. and the Ethernet local area network ("LAN") component business of Enable Semiconductor ("Enable").

In 1998, Lucent recorded a $118 million ($76 million after-tax) reversal of business restructuring charges (including an $18 million pre-tax reversal of merger-related costs by Ascend), a $149 million ($95 million after-tax) gain on the sale of Lucent's Advanced Technology Systems ("ATS") business, and $1,683 million ($1,679 million after-tax) purchased in-process research and development expenses related to the acquisitions of Stratus, JNA Telecommunications Limited, LANNET, MassMedia Communications Inc., SDX Business Systems plc, Yurie Systems, Inc., Optimay GmBH, Prominet Corporation and Livingston Enterprises, Inc.

All per share amounts have been adjusted to reflect the two-for-one stock splits of Lucent common stock that became effective April 1, 1999 and April 1, 1998.

All financial information has been restated to reflect the Ascend and Kenan Systems Corporation mergers.

Convergence

The communications industry is experiencing rapid changes in the technologies used to service customers' needs. Traditional circuit-based switching and data packet transmission are converging. This convergence of technologies is driven by the growing demands for the transmission of information using data, voice, video and fax, or any combination of these. The demand is driven by the expansion of Internet traffic over existing networks – both wireline and wireless – as well as the buildout of new and improved networks.

Lucent's strategy is to meet its customers' needs by offering an end-to-end solutions platform. This strategy brings together the core products of switching, transmission, software, messaging and optoelectronics (including microelectronic componentry) with the new portfolio offerings obtained through strategic acquisitions as well as the research and development of Bell Laboratories. These new offerings are in the areas of data packet switching, access products, software and services. With these new offerings, Lucent will enhance its spectrum of communications products and services – data, voice, optical, wireless, software, services and support – and is able to offer a full-service package for the next generation of networks.

In June 1999, Lucent merged with Ascend. The Ascend merger enhances Lucent's data switching and remote access products. The February 1999 merger with Kenan refines Lucent's expertise in the field of billing software and customer care. Subsequent to the close of fiscal 1999, Lucent continued to broaden its portfolio by merging with International Network Services ("INS"), a global provider of network consulting and software solutions, and Excel Switching Corporation, a provider of open switching solutions for telecom carriers.

Lucent will continue to review its portfolio of offerings and may use acquisitions to enhance those offerings where it makes good business sense. These acquisitions may occur through the use of cash, the issuance of debt or common stock, or any combination of the three.

Acquisitions and Dispositions

As part of Lucent's continued efforts to provide its customers with end-to-end communications solutions, the Company completed the following acquisitions and dispositions during the three years ended September 30, 1999:

August 1999 – Acquisition of 61% interest in SpecTran Corporation, a designer and manufacturer of specialty optical fiber and fiber-optic products. Lucent expects to acquire the remaining shares of SpecTran by the end of the first quarter of fiscal year 2000

July 1999 – Merger with Nexabit, a developer of high-speed switching equipment and software that directs traffic along telecommunications networks

Merger with Mosaix Inc., a provider of software that links companies' front and back offices and helps them deliver more responsive and efficient customer service

June 1999 – Merger with Ascend, a developer, manufacturer and seller of wide area networking solutions

March 1999 – Acquisition of the Ethernet LAN component business of Enable Semiconductor

February 1999 – Merger with Kenan, a developer of third-party billing and customer care software

Acquisition of Sybarus, a semiconductor design company

January 1999 – Acquisition of the remaining 80% interest in WaveAccess, a developer of high-speed systems for wireless data communications

October 1998 – Acquisition of Quadritek, a start-up developer of next-generation Internet protocol ("IP") network administration software solutions

Ascend acquisition of Stratus, a manufacturer of fault-tolerant computer systems

September 1998 – Acquisition of JNA, an Australian telecom equipment manufacturer, reseller and system integrator

August 1998 – Acquisition of LANNET, an Israel-based supplier of Ethernet and asynchronous transfer mode ("ATM") switching solutions

July 1998 – Acquisition of SDX, a United Kingdom-based provider of business communications systems

Acquisition of MassMedia, a developer of next-generation network interoperability software

May 1998 – Acquisition of Yurie, a provider of ATM access technology and equipment for data, voice and video networking

April 1998 – Acquisition of Optimay, a Germany-based developer of software products and services for chip sets to be used for Global System for Mobile Communications cellular phones

January 1998 – Acquisition of Prominet, a participant in the emerging Gigabit Ethernet networking industry

December 1997 – Acquisition of Livingston, a global provider of equipment used by Internet service providers to connect their subscribers to the Internet

September 1997 – Acquisition of Octel Communications Corporation, a provider of voice, fax and electronic messaging technologies

June 1997 – Ascend merger with Cascade Communications Corp., a developer and manufacturer of wide area network switches

April 1997 – Ascend merger with Whitetree, Inc., a developer and manufacturer of high-speed ATM switching products

February 1997 – Ascend acquisition of InterCon Systems Corporation, a developer of remote access client software products

January 1997 – Ascend acquisition of Sahara Networks, Inc., a developer of scalable high-speed broadband access products

Lucent has also sought to divest itself of non-core businesses:

October 1, 1997 – Lucent contributed its Consumer Products business to a new venture formed by Lucent and Philips Electronics N.V. ("Philips") in exchange for 40% ownership of the venture. The venture, Philips Consumer Communications ("PCC"), was formed to create a worldwide provider of personal communications products. On October 22, 1998, Lucent and Philips announced their intention to end the venture in PCC. The venture was terminated in late 1998. In December 1998, Lucent sold certain assets of its wireless handset business to Motorola. Lucent is continuing to look for opportunities to sell the remaining consumer products business.

October 1997 – Sale of ATS unit

December 1996 – Sale of interconnect products and Custom Manufacturing Services ("CMS") businesses

In addition, subsequent to the 1999 fiscal year-end, Lucent merged with the following:

On October 15, 1999, Lucent merged with INS, a global provider of network consulting and software solutions

On November 3, 1999, Lucent merged with Excel, a provider of open switching solutions for telecom carriers

On November 12, 1999, Lucent merged with Xedia Corporation, a developer of high-performance Internet access routers for wide area networks

Lucent's Formation

Lucent was formed from the systems and technology units that were formerly part of AT&T Corp., including the research and development capabilities of Bell Laboratories. Prior to February 1, 1996, AT&T conducted Lucent's original business through various divisions and subsidiaries. On February 1, 1996, AT&T began executing its decision to separate Lucent into a stand-alone company by transferring to Lucent the assets and liabilities related to its business. In April 1996, Lucent completed the initial public offering of its common stock ("IPO") and on September 30, 1996, became independent of AT&T when AT&T distributed to its shareowners all of its Lucent shares.

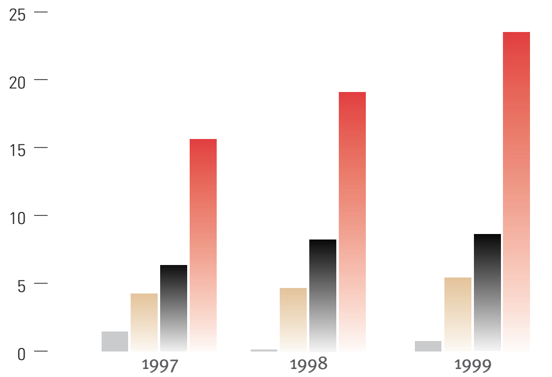
Operating Segments

Lucent operates in the global telecommunications networking industry and has three reportable segments: Service Provider Networks ("SPN"), Enterprise Networks ("Enterprise"), and Microelectronics and Communications Technologies ("MCT"). SPN provides public networking systems and software to telecommunications service providers and public network operators around the world. Enterprise develops, manufactures, markets and services advanced communications products and data networking systems for business customers. MCT designs and manufactures high-performance integrated circuits, power systems and optoelectronic components for applications in the communications and computing industries. In addition, MCT includes network products, new ventures and intellectual property. The results of other smaller units and corporate operations are reported in Other and Corporate.

The three reportable operating segments are strategic market units that offer distinct products and services. These segments were determined based on the customers and the markets that Lucent serves. Each market unit is managed separately as each operation requires different technologies and marketing strategies.

SEGMENT REVENUES

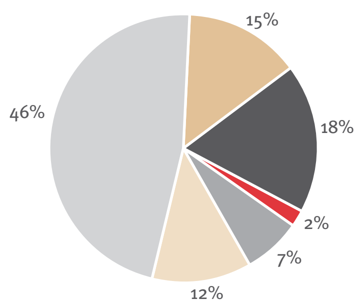
for the year ended September 30, 1997, 1998, and 1999
(dollars in billions)



Lucent's Service Provider Networks segment represents about 62% of the total external sales for 1999. Lucent offers a wide range of products and services that represent a full-service package for the next generation of networks.

PRODUCTS AND SERVICE REVENUES

for the year ended September 30, 1999



Lucent's segments include products and services businesses focused on developing and delivering systems and technologies to our customers.

Key Business Challenges

Lucent continues to face significant competition and expects that the level of competition on pricing and product offerings will intensify. Lucent expects that new competitors will enter its markets as a result of the trend toward global expansion by U.S. and non-U.S. competitors as well as continued changes in technology and public policy. These competitors may include entrants from the telecommunications, software, data networking, cable television and semiconductor industries. Existing competitors have, and new competitors may have, strong financial capabilities, technological expertise, well-recognized brand names and a global presence. Such competitors may include Alcatel Alsthom, Cisco Systems, Inc., Ericsson, Nortel Networks, and Siemens AG. Lucent's management periodically assesses market conditions and redirects the Company's resources to meet new challenges. Steps Lucent may take include acquiring or investing in new businesses and ventures, partnering with other companies, delivering new technologies, closing and consolidating facilities, disposing of assets, reducing work force levels and withdrawing from markets.

Historically, revenues and earnings were higher in the first fiscal quarter primarily because many of Lucent's large customers delay a disproportionate percentage of their capital expenditures until the fourth quarter of the calendar year (Lucent's first fiscal quarter). Lucent has taken measures to manage the seasonality of its business by changing the date on which its fiscal year ends to September 30 and its compensation programs for employees, resulting in a more uniform distribution of revenues and earnings throughout the year.

The purchasing behavior of Lucent's largest customers has increasingly been characterized by the use of fewer, larger contracts. These contracts typically involve longer negotiating cycles, require the dedication of substantial amounts of working capital and other resources, and in general require costs that may substantially precede the recognition of associated revenues. Moreover, in return for larger, longer-term purchase commitments, customers often demand more stringent acceptance criteria, which can also cause revenue recognition delays. Lucent has increasingly provided or arranged long-term financing for customers as a condition to obtain or bid on infrastructure projects. Certain multiyear contracts involve new technologies that may not have been previously deployed on a large-scale commercial basis. On its multiyear contracts, Lucent may incur significant initial cost overruns and losses that are recognized in the quarter in which they become ascertainable. Further, profit estimates on such contracts are revised periodically over the lives of the contracts, and such revisions can have a significant impact on reported earnings in any one quarter.

Historically, a limited number of customers have provided a substantial portion of Lucent's total revenues. These customers include AT&T, which continues to be a significant customer, and the Regional Bell Operating Companies ("RBOCs"). The communications industry is experiencing a consolidation of both U.S. and non-U.S. companies. The loss of any of these customers, or any substantial reduction in orders by any of these customers, could materially adversely affect the Company's operating results.

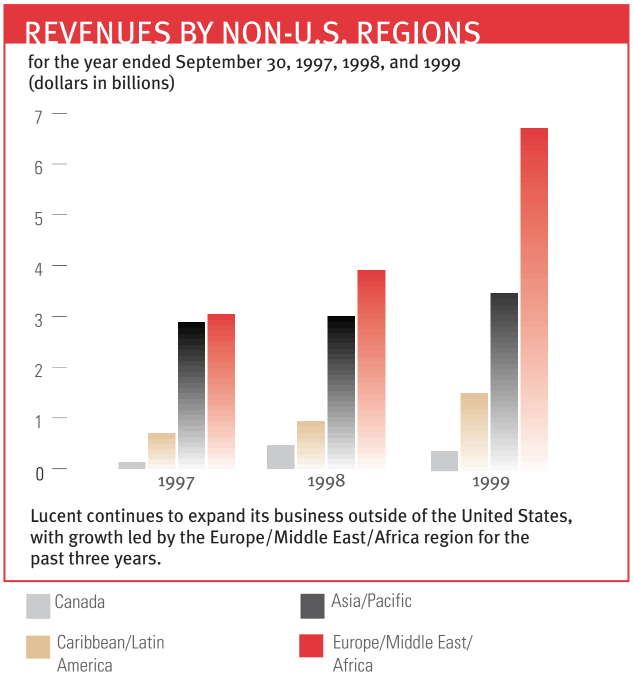
Lucent is diversifying its customer base and seeking out new types of customers globally. These new types of customers include competitive access providers and local exchange carriers, wireless service providers, cable television network operators and computer manufacturers.

Results of Operations

Revenues

Total revenues for 1999 increased 20.4% to $38,303 million compared with 1998, due to increases in sales from all reportable operating segments, as well as Other and Corporate. Revenue growth was driven by sales increases globally. For 1999, sales within the United States grew 11.1% compared with 1998. Non-U.S. revenues increased 47.0% compared with 1998.

These non-U.S. sales represented 31.8% of total revenues compared with 26.1% in 1998.



Lucent continues to expand its business outside of the United States, with growth led by the Europe/Middle East/Africa region for the past three years.

Total revenues for 1998 increased 15.2% to $31,806 million compared with 1997, due to increases in sales from all reportable operating segments. Revenue growth was driven by sales increases globally. For 1998, U.S. sales grew 12.7% compared with 1997 and non-U.S. sales increased 22.8% compared with 1997. These sales represented 26.1% of total revenues compared with 24.5% in 1997.

The following table presents Lucent's revenues by segment and the approximate percentage of total revenues for the years ended September 30, 1999, 1998, and 1997:

	1999		1998		1997	
		% of Total		% of Total		% of Total
Service Provider Networks	$23,562	62	$19,108	60	$15,675	57
Enterprise Networks	8,559	22	7,954	25	6,257	23
Microelectronics and Communications Technologies	5,424	14	4,628	15	4,238	15
Other and Corporate	758	2	116	–	1,441	5
Total Lucent	$38,303	100	$31,806	100	$27,611	100

Revenues in 1999 from the SERVICE PROVIDER NETWORKS segment increased by 23.3%, or $4,454 million compared with 1998, and increased 21.9%, or $3,433 million for 1998 compared with 1997. These increases resulted primarily from higher sales of switching and wireless systems products with associated software, optical networking and data networking systems and communications software. Continued demand for voice, data and wireless services, as well as the need for increased network capacity contributed to the group's revenues.

U.S. revenues in 1999 from the Service Provider Networks segment increased by 9.0% over 1998, and by 22.3% comparing 1998 with 1997. The 1999 U.S. revenue increase was led by sales to local exchange carriers, wireless service providers and long distance carriers. The 1998 U.S. revenue increase was led by sales to RBOCs, local exchange carriers, wireless service providers and long distance carriers. Non-U.S. revenues for 1999 increased 64.8% compared with 1998 due to revenue growth in the Europe/Middle East/Africa, Caribbean/Latin America and Asia/Pacific regions and represented 34.2% of revenues for 1999 compared with 25.6% in 1998. Non-U.S. revenues for 1998 increased 20.8% compared with 1997 due to growth in all non-U.S. regions, led by the Europe/Middle East/Africa region. Non-U.S. revenues represented 25.8% of revenues in 1997.

Revenues in 1999 from the ENTERPRISE NETWORKS segment increased by 7.6%, or $605 million compared with 1998. This increase was led by sales of DEFINITY enterprise communication servers, including those with call center applications and messaging systems. Revenue gains were partially offset by decreased sales of SYSTIMAX® structured cabling systems. Revenues in 1998 increased 27.1%, or $1,697 million compared with 1997. This increase was led by sales of messaging systems, including systems provided by Octel, SYSTIMAX structured cabling and services. Non-U.S. revenues increased by 16.3% in 1999 compared with 1998 and 52.0% in 1998 compared with 1997 due to growth in all non-U.S. regions, led by the Europe/Middle East/Africa region. Non-U.S. revenues represented 20.6% of the revenues for 1999 compared with 19.0% for 1998 and 15.9% for 1997. For 1999, U.S. sales increased 5.6% compared with 1998 and 22.4% for 1998 compared with 1997.

Revenues in 1999 from the MICROELECTRONICS AND COMMUNICATIONS TECHNOLOGIES segment increased 17.2%, or $796 million compared with 1998, due to higher sales of optoelectronic components, and integrated circuits for high-speed communications, data networking, wireless, and computing systems. Increased sales of power systems also contributed to the increase. Revenues increased 9.2%, or $390 million for 1998 compared with 1997, due to higher sales of chips for computing and communications, including semiconductor components for broadband and narrowband networks, data networking, wireless telephones and infrastructure, high-end workstations, optoeletronic transmission systems, power systems and the licensing of intellectual property. U.S. sales in 1999 increased 11.8% compared with 1998 and 8.2% in 1998 compared with 1997. Non-U.S. revenues increased 25.0% compared with 1998 driven by sales in the Asia/Pacific and the Europe/Middle East/Africa regions. Non-U.S. revenues increased 10.7% in 1998 compared with 1997 due to growth in all non-U.S. regions, led by the Europe/Middle East/Africa region. Non-U.S. revenues represented 43.6% of sales compared with 40.8% in 1998 and 40.3% in 1997.

Revenues in 1999 from sales of OTHER AND CORPORATE increased $642 million compared with 1998, primarily due to the consolidation of the businesses regained from the PCC venture. On October 22, 1998, Lucent and Philips announced they would end their PCC venture. The venture was terminated in late 1998. The results of operations and net assets of the remaining businesses Lucent previously contributed to PCC had been consoli-

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dated as of October 1, 1998. The revenues are included in Other and Corporate. In December 1998, Lucent sold certain assets of the wireless handset portion of the remaining businesses to Motorola, Inc. Lucent is continuing to look for opportunities to sell the remaining consumer products businesses. Revenues for 1998 decreased 92.0%, or $1,325 million, compared with 1997. The reduction in revenues was primarily due to Lucent's contribution of its Consumer Products business in exchange for 40% ownership of PCC in October 1997. In addition, the sale of Lucent's ATS and CMS businesses contributed to the decrease in Other and Corporate.

COSTS AND GROSS MARGIN

(dollars in millions)

	1999	1998	1997
Costs	$19,688	$16,715	$15,318
Gross margin	$18,615	$15,091	$12,293
Gross margin %	48.6%	47.4%	44.5%

Total costs in 1999 increased $2,973 million, or 17.8%, compared with 1998, and $1,397 million, or 9.1%, in 1998 compared with 1997 due to the increase in sales volume. Gross margin percentage increased 1.2 percentage points from 1998. The increase in gross margin percentage for the year was due to a more favorable mix of products. Gross margin percentage increased 2.9 percentage points in 1998 from 1997 due to an overall favorable mix of higher margin products and services sales.

OPERATING EXPENSES – SG&A

(dollars in millions)

	1999	1998	1997
Selling, general and administrative ("SG&A")	$8,417	$6,867	$6,254
As a percentage of revenues	22.0%	21.6%	22.7%
As a percentage of revenues excluding amortization of goodwill and existing technology	20.9%	21.1%	22.5%

SG&A expenses increased $1,550 million, or 22.6%, and increased 0.4 percentage points as a percentage of revenues comparing 1999 with 1998 and increased $613 million, or 9.8%, and decreased 1.1 percentage points as a percentage of revenues comparing 1998 with 1997. The dollar increases are attributable to higher sales volume, investment in growth initiatives, and increased amortization of goodwill and existing technology. In addition, the 1998 increase reflects the implementation of SAP, an integrated software platform.

Amortization expense associated with goodwill and existing technology was $394 million, $149 million and $32 million for the years ended September 30, 1999, 1998, and 1997, respectively. The 1999 increase largely relates to the write-off of Livingston goodwill and existing technology. For further detail see IN-PROCESS RESEARCH AND DEVELOPMENT below. The 1998 increase relates to increased business acquisition activity in 1998.

In addition, 1999 includes a $118 million reversal of 1995 business restructuring charges compared with $66 million in 1998 and $174 million in 1997. The 1998 period also includes an $18 million reversal of merger-related costs associated with the acquisition of Cascade.

OPERATING EXPENSES – R&D

(dollars in millions)

	1999	1998	1997
Research and development ("R&D")	$4,510	$3,903	$3,185
As a percentage of revenues	11.8%	12.3%	11.5%
Purchased in-process research and development	$ 282	$1,683	$1,255

R&D expenses in 1999 increased $607 million, or 15.6%, and decreased 0.5 percentage points as a percentage of revenues compared with 1998, and increased $718 million, or 22.5%, and increased 0.8 percentage points in 1998 as a percentage of revenues compared with 1997. The dollar increases were primarily due to increased expenditures in support of wireless, data networking, optical networking, switching and microelectronic products. The 1998 increase also reflected increased expenditures in support of software development and sales. The 1999 decrease in R&D as a percentage of revenues includes more custom contract work that is recorded in Costs as opposed to R&D.

Purchased in-process research and development expenses for 1999 reflect charges associated with the acquisitions of Stratus, Quadritek, Sybarus, WaveAccess and Enable, compared with 1998 expenses associated with the acquisitions of Stratus, JNA, LANNET, MassMedia, SDX, Optimay, Yurie, Prominet and Livingston and with 1997 expenses associated with the acquisitions of Octel, InterCon, Sahara and Agile Networks, Inc.

In 1999, $24 million of in-process research and development charges related to the acquisition of Stratus by Ascend were reversed. Since the proceeds received by Ascend in the divestiture of the non-telecommunications business units of Stratus exceeded the carrying value of the assets held for sale, a portion of the original charge for purchased in-process research and development was reversed, reducing the amount of the purchase price allocated to non-current assets on a pro-rata basis. The Stratus acquisition is reported in the 1999 and 1998 fiscal years as a result of the merger with Ascend, which had a different year-end than Lucent.

OTHER INCOME – NET, INTEREST EXPENSE AND PROVISION FOR INCOME TAXES

(dollars in millions)

	1999	1998	1997
Other income – net	$ 443	$ 128	$ 97
Interest expense	$ 406	$ 254	$ 238
Provision for income taxes	$ 1,985	$ 1,477	$ 1,009
Effective income tax rate	36.5%	58.8%	69.2%
Adjusted income tax rate*	33.9%	35.3%	36.8%

**Excludes non-tax deductible purchased in-process research and development expenses and merger-related costs.*

Other income – net in 1999 increased $315 million compared with 1998. This increase was primarily due to the $274 million gain on the sale of an equity investment in Juniper Networks and lower net equity losses in 1999, partially offset by the $149 million gain on the sale of the Company's ATS business in 1998. For 1998, the increase was $31 million compared with 1997. This increase was primarily due to gains recorded on the sale of certain business operations, including the gain on ATS. The 1998 gain was partially offset by higher net losses associated with Lucent's equity investments, primarily from the PCC investment. Also included in Other income – net for 1998 is a charge of $110 million related to a write-down associated with Lucent's investment in the PCC venture. This charge was offset by one-time gains of $103 million primarily related to the sale of an investment and the sale of certain business operations including Bell Labs Design Automation Group.

Interest expense for 1999 increased $152 million compared with 1998 and $16 million for 1998 compared with 1997. The increases in interest expense are due to higher debt levels in each comparable period.

The effective income tax rates for 1998 and 1997 exceed the U.S. federal statutory income tax rates primarily due to the write-offs of purchased in-process research and development costs and merger-related expenses that are not deductible for tax purposes. Excluding the impact of non-tax deductible purchased in-process research and development expenses and certain merger-related costs, the effective income tax rate decreased 1.4 percentage points in 1999 compared with 1998. This decrease was primarily due to a reduced state effective tax rate and the tax impact of foreign activity. Excluding the impact of the purchased in-process research and development expenses associated with acquisitions, the effective income tax rate decreased 1.5 percentage points in 1998 compared with 1997. This decrease was primarily due to a reduced state effective tax rate and increased research tax credits.

The 1998 and 1997 effective income tax rates do not include a federal income tax provision for Kenan since Kenan was an S-Corporation during those years.

CASH FLOWS

(dollars in millions)

	1999	1998	1997
Net cash (used in) provided by:			
Operating activities	$ (276)	$ 1,860	$ 2,129
Investing activities	$(1,787)	$(3,100)	$(3,371)
Financing activities	$ 2,685	$ 849	$ 297

Cash from operating activities decreased $2,136 million in 1999 compared with 1998. This decrease was primarily due to increases in receivables and inventories as well as a decrease in payroll and benefit-related liabilities. Cash payments of $77 million were charged against the 1995 business restructuring reserves in 1999, compared with $176 million in 1998. As of September 30, 1999, $18 million of reserves remained, and substantially all of the 23,000 positions that Lucent announced it would eliminate in connection with the 1995 restructuring charges have been eliminated.

Cash provided by operating activities decreased $269 million in 1998 compared with 1997. This decrease in cash was largely due to the increase in receivables, partially offset by the increase in payroll and benefit-related liabilities. Cash payments of $176 million were charged against the December 1995 business restructuring reserves in 1998 compared with $483 million in 1997.

The restructuring reserves were established in December 1995 after AT&T decided to spinoff Lucent, but before the formal transfer of assets and personnel. The restructuring plans included the exit of certain businesses as well as consolidating and re-engineering numerous corporate and business unit operations. The reserves were in support of Lucent's intention to focus on the technologies and markets it viewed as critical to its long-term success as a stand-alone entity.

Many of the 1995 restructuring projects were significant and complex initiatives, some of which could not be completed until new enterprisewide information technology systems, centralized back office support hubs and provisioning centers were in place. At the time the restructuring plans were adopted, the estimated time lines and project plans indicated that substantially all projects would be complete within two years. Some of the restructuring projects have taken longer than anticipated to complete due to their complicated nature and size, and the complicated nature and size of other projects that needed to be completed first. All projects have been substantially completed as of September 30, 1999.

Cash used in investing activities decreased $1,313 million in 1999 compared with 1998, primarily due to increased sales of investment securities and a reduction in cash used for acquisitions, partially offset by increased capital expenditures.

Cash used in investing activities decreased $271 million in 1998 compared with 1997, primarily due to a decrease in cash used for acquisitions as well as an increase in proceeds from sales of investment securities, partially offset by an increase in cash used to purchase investment securities. In 1998, cash was used in the acquisitions of Yurie, Optimay, SDX, LANNET and JNA. The acquisitions of Livingston, Stratus and Prominet in 1998 were completed through the issuance of stock and options and did not require the use of cash. The use of cash in 1998 was partially offset by proceeds from the sale of ATS and $269 million of cash acquired as part of the acquisition of Stratus. In 1997, Lucent acquired Octel, InterCon, Sahara and Agile and disposed of its interconnect products and CMS businesses. The 1997 acquisition of Sahara was completed through the issuance of stock and options and did not require the use of cash.

Capital expenditures were $2,215 million, $1,791 million and $1,744 million for 1999, 1998, and 1997, respectively. Capital expenditures relate to expenditures for equipment and facilities used in manufacturing and research and development, including expansion of manufacturing capacity, and expenditures for cost reduction efforts and non-U.S. growth.

Cash provided by financing activities increased $1,836 million in 1999 compared with 1998. This increase was primarily due to increased issuances of long-term debt. Cash provided by financing activities increased $552 million in 1998 compared with 1997. The increase was due to increased issuances of long-term debt and common stock when compared with the prior year.

FINANCIAL CONDITION

(dollars in millions)

	1999	1998
Total assets	$38,775	$29,363
Total liabilities	$25,191	$21,654
Working capital	$10,153	$ 4,899
Debt to total capital (debt plus equity)	34.1%	37.6%
Inventory turnover ratio	4.5x	5.6x
Average days outstanding – receivables	85 days	71 days

Total assets as of September 30, 1999, increased $9,412 million, or 32.1%, from September 30, 1998. This increase was largely due to increases in cash and cash equivalents, receivables, prepaid pension costs, inventories and other current assets of $662 million, $3,033 million, $2,421 million, $1,769 million and $1,031 million, respectively. Cash increased primarily due to the securitization of certain customer receivables. The increase in receivables reflects higher sales volume and a higher percentage of sales from outside the United States. Prepaid pension costs increased due to the change in accounting for pensions. The increase in inventories resulted from the need to meet current and anticipated sales commitments to customers. The increase in other current assets is largely due to increases in notes receivable and prepaid expenses.

Total liabilities increased $3,537 million, or 16.3%, from September 30, 1998. This increase was due primarily to higher short- and long-term debt levels, including debt recorded in connection with the sale of certain customer receivables with recourse.

Working capital, defined as current assets less current liabilities, increased $5,254 million from September 30, 1998, primarily resulting from the increase in receivables and inventories, partially offset by higher short-term debt and accounts payable.

Debt to total capital decreased 350 basis points due to the increase in shareowners' equity, partially offset by the increase in total debt.

For the year ended September 30, 1999, Lucent's inventory turnover ratio decreased 1.1 times compared with the year ended September 30, 1998. The decrease includes the build-up of inventory to meet current and anticipated sales to customers. Inventory turnover ratio is calculated by dividing cost of sales for the three months ended September 30 by the fourth quarter average ending inventory balance, using a two-point average.

Average days outstanding – receivables were up 14 days in 1999 compared with 1998 reflecting the growth in Lucent's sales outside the United States, which typically carry longer payment terms. Average days outstanding is calculated by dividing the fourth quarter average ending receivables balance, using a two-point average, by total revenues for the three months ended September 30.

The fair value of Lucent's pension plan assets is greater than the projected pension obligations. Lucent records pension income when the expected return on plan assets plus amortization of the transition asset is greater than the interest cost on the projected benefit obligation plus service cost for the year. Consequently, Lucent continued to have a net pension credit that added to prepaid pension costs in 1999 and which is expected to continue in the near term.

Liquidity and Capital Resources

Lucent expects that, from time to time, outstanding commercial paper balances may be replaced with short- or long-term borrowings as market conditions permit. At September 30, 1999, Lucent maintained approximately $4.7 billion in credit facilities, of which a portion is used to support Lucent's commercial paper program. At September 30, 1999, approximately $4.4 billion was unused.

Future financings will be arranged to meet Lucent's requirements with the timing, amount and form of issue depending on the prevailing market and general economic conditions. Lucent anticipates that borrowings under its bank credit facilities, the issuance of additional commercial paper, cash generated from operations, short- and long-term debt financings and receivable securitizations will be adequate to satisfy its future cash requirements, although there can be no assurance that this will be the case.

Network operators worldwide are requiring their suppliers to arrange or provide long-term financing for them as a condition of obtaining or bidding on infrastructure projects. These projects may require financing in amounts ranging from modest sums to more than a billion dollars. Lucent has increasingly provided or arranged long-term financing for customers. As market conditions permit, Lucent's intention is to lay off these long-term financing arrangements, which may include both commitments and drawn-down borrowings, to financial institutions and other investors. This enables Lucent to reduce the amount of its commitments and free up additional financing capacity.

As of September 30, 1999, Lucent had made commitments or entered into agreements to extend credit to certain network operators, including personal communications services and wireless operators, for an aggregate of approximately $7.1 billion. As of September 30, 1999, approximately $1.6 billion had been advanced and was outstanding under these agreements.

In September 1999, a subsidiary of Lucent sold approximately $625 million of accounts receivable to a non-consolidated qualified special purpose entity ("QSPE") which, in turn, sold an undivided ownership interest in these receivables to entities managed by an unaffiliated financial institution. Additionally, Lucent transferred a designated pool of qualified accounts receivable of approximately $700 million to the QSPE as collateral for the initial sale. Lucent's retained interest in the QSPE's designated pool of qualified accounts receivable has been included in Receivables. Lucent will continue to service, administer and collect the receivables on behalf of the purchaser. The impact of the above transaction reduced Receivables and increased cash flows from operating activities in the Consolidated Statements of Cash Flows by $600 million.

As part of the revenue recognition process, Lucent assesses the collectibility of its receivables relating to contracts with customers for which Lucent provides financing.

In addition to the above arrangements, Lucent will continue to provide or commit to financing where appropriate for its business. The ability of Lucent to arrange or provide financing for its customers will depend on a number of factors, including Lucent's capital structure and level of available credit, and its continued ability to lay off commitments and drawn-down borrowings on acceptable terms. Lucent believes that it will be able to access the capital markets on terms and in amounts that will be satisfactory to Lucent and that it will be able to obtain bid and performance bonds, to arrange or provide customer financing as necessary, and to engage in hedging transactions on commercially acceptable terms, although there can be no assurance that this will be the case.

IN-PROCESS RESEARCH AND DEVELOPMENT

In connection with the acquisitions of Octel, Livingston and Yurie, Lucent allocated a significant portion of the purchase price to purchased in-process research and development. In addition, in connection with the purchase of Stratus, Lucent allocated $267 million to purchased in-process research and development. As part of the process of analyzing each of these acquisitions, Lucent made a decision to buy technology that had not yet been commercialized rather than develop the technology internally. Lucent based this decision on factors such as the amount of time it would take to bring the technology to market. Lucent also considered Bell Labs' resource allocation and its progress on comparable technology, if any. Lucent management expects to use the same decision process in the future.

Lucent estimated the fair value of in-process research and development for each of the above acquisitions using an income approach. This involved estimating the fair value of the in-process research and development using the present value of the estimated after-tax cash flows expected to be generated by the purchased in-process research and development, using risk-adjusted discount rates and revenue forecasts as appropriate. The selection of the discount rate was based on consideration of Lucent's weighted average cost of capital, as well as other factors, including the useful life of each technology, profitability levels of each technology, the uncertainty of technology advances that were known at the time, and the stage of completion of each technology. Lucent believes that the estimated in-process research and development amounts so determined represent fair value and do not exceed the amount a third party would pay for the projects.

Where appropriate, Lucent deducted an amount reflecting the contribution of the core technology from the anticipated cash flows from an in-process research and development project. At the date of acquisition, the in-process research and development projects had not yet reached technological feasibility and had no alternative future uses. Accordingly, the value allocated to these projects was capitalized and immediately expensed at acquisition. If the projects are not successful or completed in a timely manner, management's product pricing and growth rates may not be achieved and Lucent may not realize the financial benefits expected from the projects.

Set forth below are descriptions of certain acquired in-process research and development projects, including their status at the end of fiscal 1999.

Octel

On September 29, 1997, Lucent completed the purchase of Octel for $1,819 million. Octel was a public company involved in the development of voice, fax and electronic messaging technologies. The allocation of $945 million to in-process research and development represented its estimated fair value using the methodology described above. The $945 million was allocated to the following projects: Unified Messenger ($245 million), Phoenix/Intelligent Messaging Architecture ("IMA") ($540 million), Octel Network Services ("ONS") Projects ($111 million) and three other projects ($49 million in total).

Unified Messenger – Revenues attributable to Unified Messenger were estimated to be $5 million in 1998 and $46 million in 1999. Revenue was expected to peak in 2004 and decline thereafter through the end of the product's life (2008) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 179% in 2000 to 20% in 2004, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the initial release of the project were expected to be $3 million.

Phoenix/IMA – Revenues attributable to Phoenix/IMA were estimated to be $94 million in 1998 and $508 million in 1999. Revenue was expected to peak in 2004 and decline thereafter through the end of the product's life (2010) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 59% in 2000 to 10% in 2004, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the Phoenix/IMA project were expected to be $49 million.

ONS Projects – Revenues attributable to the ONS Projects were estimated to be $18 million in 1998 and $93 million in 1999. Revenue was expected to peak in 2003 and decline thereafter through the end of the product's life (2006) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 52% in 2000 to 10% in 2003, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the ONS Projects were expected to be less than $1 million.

An average risk-adjusted discount rate of 20% was utilized to discount projected cash flows.

There have not been any significant departures from the planned efforts for Unified Messenger. The Phoenix and ONS efforts have been completed. The IMA research and development effort has been delayed twice as a result of the inclusion of new capability specifications, first, in January 1998 to include unified messaging capabilities and, second, in September 1998 to include significant new hardware platform capabilities and incorporate Internet software capabilities. This enhanced version reached technological feasibility, a beta stage, in August 1999, and is scheduled for shipment in December 1999. Since intermediate milestones for IMA have been met on schedule and Phoenix will continue to earn revenues through completion of IMA development, the completion and exploitation of this project and current market conditions make it reasonable that estimated revenue and cash flow levels will be achieved, although on a delayed basis. The IMA version enhancements and the rescheduled market introduction are not expected to impact the originally forecasted market penetration rates.

Livingston

On December 15, 1997, Lucent completed the purchase of Livingston for $610 million. Livingston was involved in the development of equipment used by Internet service providers to connect subscribers to the Internet. The allocation to in-process research and development of $427 million represented its estimated fair value using the methodology described above. Approximately $421 million was allocated to the PortMaster4, a remote access concentrator targeted at large independent telecommunication companies, cable television companies, and Internet service providers, and the remaining $6 million was allocated to another project.

Revenues attributable to the PortMaster4 were estimated to be $48 million in 1998 and $261 million in 1999. Revenue was expected to peak in 2002 and decline thereafter through the end of the product's life (2007) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 69% in 2000 to 11% in 2002, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the PortMaster4 were expected to be $5 million.

A risk-adjusted discount rate of 20% was utilized to discount projected cash flows.

Livingston's PortMaster4 was commercially released in July 1998 and started generating revenues immediately after commercial launch. As a result of the merger between Lucent and Ascend, the decision was made to discontinue future development and sales of the PortMaster4 platform in order to maximize research and development efficiency by concentrating on the MAX TNT platform. Instead of having two platforms to address the full spectrum of access switching products, Lucent will be able to have one platform that can address a broad spectrum of applications while minimizing duplicative research and development.

Yurie

On May 29, 1998, Lucent completed the purchase of Yurie for $1,056 million. Yurie was involved in the development of ATM access solutions. The allocation to in-process research and development of $620 million represented its estimated fair value using the methodology described above. The $620 million was allocated to the following projects: (i) LDR 50/200/250 ($609 million) and (ii) LDR 4 ($11 million).

Revenues attributable to the LDR 50/200/250 were estimated to be $132 million in 1999. Revenue was expected to peak in 2000 and decline thereafter through the end of the product's life (2009) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 84% in 2000 to 9% in 2007, and be negative for the remainder of the projection period. Costs to complete the research and development efforts related to the LDR 50/200/250 were expected to be $29 million at the acquisition date.

A risk-adjusted discount rate of 20% was utilized to discount projected cash flows.

The LDR 50, LDR 200 and LDR 250 were all completed on time or have met all of their scheduled milestones. Some of the product releases have been renamed.

Stratus

On October 20, 1998, Ascend completed the purchase of Stratus for $917 million. Stratus was a manufacturer of fault-tolerant computer systems. The allocation to in-process research and development of $267 million represented its estimated fair value using the methodology described above. The primary projects that made up the in-process research and development were as follows: HP-UX, Continuum 1248, Continuum 448, M708, SPHINX, HARMONY, LNP, CORE IN, Personal Number Portability (PN), Signaling System 7 (SS7) Gateway and Internet Gateway.

Revenues attributable to the projects were estimated to be $84 million in 1999 and $345 million in 2000. Revenue was expected to peak in 2002 and decline thereafter through the end of the product's life (2009) as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 310% in 2000 to 6% in 2002, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the projects were expected to be $48 million.

A risk-adjusted discount rate of 35% was utilized to discount projected cash flows.

The actual results to date have been consistent, in all material respects, with our assumptions at the time of the acquisition, except as noted below. During fiscal 1999 the product development relating to the HARMONY, SPHINX, and Continuum 448 projects were discontinued due to management's reprioritization of product direction. In addition, it was decided that the development relating to the Continuum 1248 will cease by the quarter ending December 31, 1999. Consequently, Lucent will not realize the forecasted revenues from these projects.

Risk Management

Lucent is exposed to market risk from changes in foreign currency exchange rates and interest rates that could impact its results of operations and financial condition. Lucent manages its exposure to these market risks through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. Lucent uses derivative financial instruments as risk management tools and not for speculative or trading purposes. In addition, derivative financial instruments are entered into with a diversified group of major financial institutions in order to manage Lucent's exposure to nonperformance on such instruments.

Lucent uses foreign currency exchange contracts, and to a lesser extent foreign currency options, to reduce significant exposure to the risk that the eventual net cash inflows and outflows resulting from the sale of products to non-U.S. customers and purchases from non-U.S. suppliers will be adversely affected by changes in exchange rates. Foreign currency exchange contracts are designated for recorded, firmly committed or anticipated purchases and sales. The use of these derivative financial instruments allows Lucent to reduce its overall exposure to exchange rate movements, since the gains and losses on these contracts substantially offset losses and gains on the assets, liabilities and transactions being hedged. As of September 30, 1999, Lucent's primary net foreign currency market exposures included Canadian dollars and Brazilian reals.

As of September 30, 1998, Lucent's primary net foreign currency market exposures included German marks and British pounds. In 1999, Lucent revised its hedging policy regarding anticipated purchase and sales transaction exposures. Prior to the revision, the Company hedged 100% of all recorded, firmly committed and anticipated transactions with amounts over $1 million. Beginning on August 31, 1999, Lucent's policy is to hedge 50% of the first six months of a 12-month anticipated exposure forecast, with the hedging of the remainder of the forecast to be evaluated on an ongoing basis. This applies to all transactions with value equal to the lesser of $5 million or 10% of the relevant subsidiary's 12-month trailing net revenues. These revisions provide greater risk management flexibility in cases where hedging costs may be excessive relative to the actual risk and when there is greater cash flow uncertainty. Management does not expect that this revised policy will have any material impact on the results of operations or financial condition of the Company. In addition, management does not foresee or expect any significant changes in foreign currency exposure in the near future.

The fair value of foreign currency exchange contracts is sensitive to changes in foreign currency exchange rates. As of September 30, 1999 and 1998, a 10% appreciation in foreign currency exchange rates from the prevailing market rates would increase the related net unrealized gain by approximately $41 million and $11 million, respectively. Conversely, a 10% depreciation in these currencies from the prevailing market rates would decrease the related net unrealized gain by approximately $55 million and $18 million, as of September 30, 1999 and 1998, respectively. Consistent with the nature of the economic hedge of such foreign currency exchange contracts, such unrealized gains or losses would be offset by corresponding decreases or increases, respectively, of the underlying instrument or transaction being hedged.

While Lucent hedges certain foreign currency transactions, the decline in value of non-U.S. dollar currencies, may, if not reversed, adversely affect Lucent's ability to contract for product sales in U.S. dollars because Lucent's products may become more expensive to purchase in U.S. dollars for local customers doing business in the countries of the affected currencies.

The fair value of Lucent's fixed rate long-term debt is sensitive to changes in interest rates. Interest rate changes would result in gains/losses in the market value of this debt due to differences between the market interest rates and rates at the inception of the debt obligation. Based on a hypothetical immediate 150 basis point increase in interest rates at September 30, 1999 and 1998, the market value of Lucent's fixed rate long-term debt would be impacted by a net decrease of approximately $360 million and $209 million, respectively. Conversely, a 150 basis point decrease in interest rates would result in a net increase in the market value of Lucent's fixed rate long-term debt outstanding at September 30, 1999 and 1998 of approximately $456 million and $247 million, respectively.

Forward-Looking Statements

This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this report contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industries in which Lucent operates, management's beliefs and assumptions made by management. In addition, other written or oral statements that constitute forward-looking statements may be made by or on behalf of the Company. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("Future Factors") that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Future Factors include increasing price and products and services competition by non-U.S. and U.S. competitors, including new entrants; rapid technological developments and changes and the Company's ability to continue to introduce competitive new products and services on a timely, cost-effective basis; the mix of products and services; the achievement of lower costs and expenses; customer demand for the Company's products and services; the ability to successfully integrate the operations and business of acquired companies; readiness for Year 2000; the impact of Year 2000 on customer spending habits; U.S. and non-U.S. governmental and public policy changes that may affect the level of new investments and purchases made by customers; changes in environmental and other U.S. and non-U.S. governmental regulations; protection and validity of patent and other intellectual property rights; reliance on large customers; technological, implementation and cost/financial risks in the increasing use of large, multiyear contracts; the cyclical nature of the Company's business; the outcome of pending and future litigation and governmental proceedings and continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support the Company's future business. These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general U.S. and non-U.S. economic conditions, including interest rate and currency exchange rate fluctuations and other Future Factors.

Competition

See discussion above under KEY BUSINESS CHALLENGES.

Dependence on New Product Development

The markets for the Company's principal products are characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and evolving methods of building and operating communications systems for network operators and business customers. The Company's operating results will depend to a significant extent on its ability to continue to introduce new systems, products, software and services successfully on a timely basis and to reduce costs of existing systems, products, software and services. The success of these and other new offerings is dependent on several factors, including proper identification of customer needs, cost, timely completion and introduction, differentiation from offerings of the Company's competitors and market acceptance. In addition, new technological innovations generally require a substantial investment before any assurance is available as to their commercial viability, including, in some cases, certification by non-U.S. and U.S. standard-setting bodies.

Reliance on Major Customers

See discussion above under KEY BUSINESS CHALLENGES.

Readiness for Year 2000

Lucent is in the final phase of a major effort to minimize the impact of the Year 2000 date change on Lucent's products, information technology systems, facilities and production infrastructure.

The Year 2000 challenge is a priority within Lucent at every level of the Company. Primary Year 2000 preparedness responsibility rests with program offices which have been established within each of Lucent's product groups and corporate centers. A corporatewide Lucent Year 2000 Program Office ("LYPO") monitors and reports on the progress of these offices. Each program office has a core of full-time individuals augmented by a much larger group who have been assigned specific Year 2000 responsibilities in addition to their regular assignments. Further, Lucent has engaged third parties to assist in its readiness efforts in certain cases. LYPO has established a methodology to measure, track and report Year 2000 readiness status consisting of five steps: inventory; assessment; remediation; testing; and deployment. In addition, LYPO tracks and reports on the development and deployment of Year 2000 contingency plans.

Lucent has completed programs to make its commercially available products Year 2000 ready and has developed evolution strategies for customers who own non-Year 2000 ready Lucent products. All of the upgrades and products needed to support customer migration are generally available.

Lucent is completing its extensive efforts to alert customers who have non-Year 2000 ready products, including direct mailings, phone contacts and participation in user and industry groups. Lucent also has a Year 2000 Web site www.lucent.com/y2k, which provides Year 2000 product information. Lucent continues to cooperate in the Year 2000 information sharing efforts of the Federal Communications Commission and other governmental bodies.

Lucent believes it has sufficient resources to provide timely support to its customers who require product migrations or upgrades. However, because this effort is heavily dependent on customer cooperation, Lucent monitors customer response and takes steps to encourage customer responsiveness, as necessary.

With very few exceptions, Lucent has completed the five steps of its Year 2000 readiness program with respect to its factories, information systems and facilities. LYPO has developed a formal "exceptions" tracking process to approve and track a small number of cases in which factors such as third-party dependencies prevented project completion by Lucent's internal readiness target date of June 30, 1999. Virtually all of the exceptions identified have since been closed. In addition, Lucent has implemented various change management mechanisms to allow the Company to maintain Year 2000 readiness even as systems are modified or replaced to address non-Year 2000 business needs.

To ensure the continued delivery of third-party products and services, Lucent's procurement organization has analyzed Lucent's supplier base and has sent surveys to approximately 5,000 suppliers. To supplement this effort, Lucent has conducted more detailed readiness reviews of the Year 2000 status of the suppliers ranked as most critical based on the nature of their relationship with Lucent, the product/service provided and/or the content of their survey responses. Over 90% of Lucent's critical suppliers have reported completion of their Year 2000 readiness efforts. However, Lucent continues to monitor the Year 2000 status of all of its critical suppliers to minimize its Year 2000 supply chain risk and is developing appropriate contingency responses as the risks become clearer.

Lucent has committed considerable resources to Year 2000 contingency planning throughout the enterprise. These plans focus on risks posed by the Year 2000 date change, as well as other sensitive dates such as February 29, 2000. Lucent's plans are designed both to mitigate the impact of Year 2000 failures, as well as providing emergency response mechanisms and supporting the prompt resumption of regular operations. Lucent is currently in the process of completing the preparations necessary to support the implementation of its contingency plans. In addition, the plans are updated as new information is obtained, the risks posed by external dependencies become clearer and customer support needs become more focused.

A network of corporate center and business group communications centers, staffed on a continuous basis during the period before and after the Year 2000 date transition, will support Lucent's contingency planning efforts. These communications centers will facilitate the handling of Year 2000 issues that may arise. An initial test of the Lucent communications center network was conducted in connection with the September 9, 1999, date change. The September 9, 1999, date change passed with no reported impacts on Lucent's business.

The risk to Lucent resulting from the failure of third parties in the public and private sectors to attain Year 2000 readiness is the same as other firms in Lucent's industry and other business enterprises generally. The following are representative of the types of risks that could result in the event of one or more major failures of Lucent's information systems, factories or facilities to be Year 2000 ready, or similar major failures by one or more major third-party suppliers to Lucent: (1) information systems – could include interruptions or disruptions of business and transaction processing such as customer billing, payroll, accounts payable and other operating and information processes, until systems can be remedied or replaced; (2) factories and facilities – could include interruptions or disruptions of manufacturing processes and facilities with delays in delivery of products, until non-compliant conditions or components can be remedied or replaced; and (3) major suppliers to Lucent – could include interruptions or disruptions of the supply of raw materials, supplies and Year 2000 ready components, that could cause interruptions or disruptions of manufacturing and delays in delivery of products, until the third-party supplier remedied the problem or contingency measures were implemented. Risks of major failures of Lucent's principal products could include adverse functional impacts experienced by customers, the costs and resources for Lucent to remedy problems or replace products where Lucent is obligated or undertakes to take such action, and delays in delivery of new products.

Lucent believes it is taking the necessary steps to resolve Year 2000 issues; however, given the possible consequences of failure to resolve significant Year 2000 issues, there can be no assurance that any one or more such failures would not have a material adverse effect on Lucent. Lucent estimates that the costs of efforts to prepare for Year 2000 from calendar year 1997 through 2000 is about $560 million, of which an estimated $515 million has been spent as of September 30, 1999. Lucent has been able to reprioritize work projects to largely address Year 2000 readiness needs within its existing organizations. As a result, most of these costs represent costs that would have been incurred in any event. These amounts cover costs of the Year 2000 readiness work for inventory, assessment, remediation, testing, deployment and contingency planning, including fees and charges of contractors for outsourced work and consultant fees. Costs for previously contemplated updates and replacements of Lucent's internal systems and information systems infrastructure have been excluded without attempting to establish whether the timing of non-Year 2000 replacement or upgrading was accelerated.

While the Year 2000 cost estimates above include additional costs, Lucent believes, based on available information, that it will be able to manage its total Year 2000 transition without any material adverse effect on its business operations, products or financial prospects.

The actual outcomes and results could be affected by Future Factors including, but not limited to, the continued availability of skilled personnel, cost control, the ability to locate and remediate software code problems, critical suppliers and subcontractors meeting their commitments to be Year 2000 ready and provide Year 2000 ready products, and timely actions by customers.

European Monetary Union – Euro

On January 1, 1999, 11 member countries of the European Union established fixed conversion rates between their existing sovereign currencies, and adopted the Euro as their new common legal currency. The Euro is currently trading on currency exchanges and the legacy currencies will remain legal tender in the participating countries for a transition period between January 1, 1999, and January 1, 2002. During the transition period, cash-less payments can be made in the Euro, and parties can elect to pay for goods and services and transact business using either the Euro or a legacy currency. Between January 1, 2002, and July 1, 2002, the participating countries will introduce Euro notes and coins and withdraw all legacy currencies so that they will no longer be available.

Lucent has in place a joint European-United States team representing affected functions within the Company. This team is evaluating Euro related issues affecting the Company that include its pricing/marketing strategy, conversion of information technology systems, existing contracts and currency risk and risk management in the participating countries. The Euro conversion may affect cross-border competition by creating cross-border price transparency.

Lucent will continue to evaluate issues involving introduction of the Euro as further accounting, tax and governmental legal and regulatory guidance is available. Based on current information and Lucent's current assessment, Lucent does not expect that the Euro conversion will have a material adverse effect on its business or financial condition.

Employee Relations

On September 30, 1999, Lucent employed approximately 153,000 persons, including 76.5% located in the United States. Of these domestic employees, approximately 40% are represented by unions, primarily the Communications Workers of America ("CWA") and the International Brotherhood of Electrical Workers ("IBEW"). Lucent entered into new five-year agreements with the CWA and IBEW expiring May 31, 2003.

Multiyear Contracts

Lucent has significant contracts for the sale of infrastructure systems to network operators that extend over multiyear periods, and expects to enter into similar contracts in the future, with uncertainties affecting recognition of revenues, stringent acceptance criteria, implementation of new technologies and possible significant initial cost overruns and losses. See also discussion above under LIQUIDITY AND CAPITAL RESOURCES and KEY BUSINESS CHALLENGES.

Seasonality

See discussion above under KEY BUSINESS CHALLENGES.

Future Capital Requirements

See discussion above under LIQUIDITY AND CAPITAL RESOURCES.

Non-U.S. Growth, Foreign Exchange and Interest Rates

Lucent intends to continue to pursue growth opportunities in non-U.S. markets. In many non-U.S. markets, long-standing relationships between potential customers of Lucent and their local providers, and protective regulations, including local content requirements and type approvals, create barriers to entry. In addition, pursuit of such non-U.S. growth opportunities may require significant investments for an extended period before returns on such investments, if any, are realized. Such projects and investments could be adversely affected by reversals or delays in the opening of non-U.S. markets to new competitors, exchange controls, currency fluctuations, investment policies, repatriation of cash, nationalization, social and political risks, taxation, and other factors, depending on the country in which such opportunity arises. Difficulties in non-U.S. financial markets and economies, and of non-U.S. financial institutions, could adversely affect demand from customers in the affected countries.

See discussion above under RISK MANAGEMENT with respect to foreign exchange and interest rates. A significant change in the value of the U.S. dollar against the currency of one or more countries where Lucent sells products to local customers or makes purchases from local suppliers may materially adversely affect Lucent's results. Lucent attempts to mitigate any such effects through the use of foreign currency contracts, although there can be no assurances that such attempts will be successful.

Legal Proceedings and Environmental Matters

See discussion in Note 14 to the Consolidated Financial Statements.

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA (UNAUDITED)

Lucent Technologies Inc. and Subsidiaries
(dollars in millions, except share amounts)

	Year Ended September 30, (12 Months)				Nine Months Ended September 30,		Year Ended December 31, (12 Months)
RESULTS OF OPERATIONS	1999	1998	1997	1996	1996[1]	1995	1995
Revenues	$38,303	$31,806	$ 27,611	$24,215	$16,639	$14,247	$21,718
Gross margin	18,615	15,091	12,293	9,506	7,085	6,315	8,669
Depreciation and amortization expense	1,806	1,411	1,499	1,350	957	1,112	1,504
Operating income (loss)	5,406	2,638	1,599	(656)	734	503	(921)
Income (loss) before cumulative effect of accounting change	3,458	1,035	449	(604)	382	197	(813)
Cumulative effect of accounting change	1,308	–	–	–	–	–	–
Net income (loss)	4,766	1,035	449	(604)	382	197	(813)
Earnings (loss) per common share – basic[2] [3]:							
Income (loss) before cumulative effect of accounting change	1.14	0.35	0.16	(0.23)	0.14	0.08	(0.34)
Cumulative effect of accounting change	0.43	–	–	–	–	–	–
Net income (loss)	1.57	0.35	0.16	(0.23)	0.14	0.08	(0.34)
Earnings (loss) per common share – diluted[2] [3]:							
Income (loss) before cumulative effect of accounting change	1.10	0.34	0.15	(0.23)	0.14	0.08	(0.34)
Cumulative effect of accounting change	0.42	–	–	–	–	–	–
Net income (loss)	1.52	0.34	0.15	(0.23)	0.14	0.08	(0.34)
Earnings (loss) per common share – pro forma[3] [4]	n/a	n/a	n/a	(0.21)	0.13	0.07	(0.28)
Dividends per common share[3]	0.08	0.0775	0.0563	0.0375	0.0375	–	–
FINANCIAL POSITION							
Total assets	$38,775	$29,363	$25,006	$23,572	$23,572	$18,714	$20,217
Working capital	10,153	4,899[5]	2,529	2,728	2,728	523	(50)
Total debt	7,026	4,640	4,203	3,997	3,997	4,196	4,018
Shareowners' equity	13,584	7,709	4,379	3,462	3,462	3,198	1,917
OTHER INFORMATION							
Selling, general and administrative expenses as a percentage of revenues	22.0%	21.6%	22.7%	31.0%	26.6%	28.8%	33.0%
Research and development expenses as a percentage of revenues	11.8	12.3	11.5	10.9	11.5	12.0	11.2
Gross margin percentage	48.6	47.4	44.5	39.3	42.6	44.3	39.9
Ratio of total debt to total capital (debt plus equity)	34.1	37.6	49.0	53.6	53.6	56.7	67.7
Capital expenditures	$ 2,215	$ 1,791	$ 1,744	$ 1,507	$ 1,002	$ 803	$ 1,302

(1) *Beginning September 30, 1996, Lucent changed its fiscal year-end from December 31 to September 30 and reported results for the nine-month transition period ended September 30, 1996.*

(2) *The calculation of earnings per share on a historical basis includes the retroactive recognition to January 1, 1995, of the 2,098,499,576 shares (524,624,894 shares on a pre-split basis) owned by AT&T on April 10, 1996.*

(3) *All per share data has been restated to reflect the two-for-one splits of Lucent's common stock that became effective on April 1, 1998, and April 1, 1999.*

(4) *The calculation of earnings (loss) per share on a pro forma basis assumes that all 2,896,214,012 shares outstanding on April 10, 1996, were outstanding since January 1, 1995, and gives no effect to the use of proceeds from the IPO.*

(5) *Reflects the reclassification from debt maturing within one year to long-term debt as a result of the November 19, 1998, sale of $500 ($495 net of unamortized costs) of 10-year notes.*

n/a *Not applicable.*

Pro Forma Segment Reporting Information (Unaudited)

(dollars in millions)

The following table presents Lucent's revenues and operating income by reportable operating segment for the years ended September 30, 1999, 1998, and 1997, and has been prepared giving effect to the mergers of Lucent with Excel and INS under the pooling-of-interests method of accounting, on a pro forma basis as if the mergers had occurred before Lucent's fiscal year-end.

EXTERNAL REVENUES	1999	1998	1997
Service Provider Networks	$23,815	$19,274	$15,795
Enterprise Networks	8,777	8,090	6,329
Microelectronics and Communications Technologies	5,424	4,628	4,238
Total reportable segments	38,016	31,992	26,362
Other and corporate	758	116	1,441
Total revenues	$38,774	$32,108	$27,803

OPERATING INCOME	1999	1998	1997
Service Provider Networks	$ 4,587	$ 3,139	$ 1,543
Enterprise Networks	651	650	675
Microelectronics and Communications Technologies	944	608	549
Total reportable segments[(a)]	6,182	4,397	2,767
Acquisition/integration-related costs	(530)	(1,690)	(1,439)
Goodwill and existing technology amortization	(396)	(149)	(32)
Other and corporate	187	122	336
Operating income	5,443	2,680	1,632
Other income – net	452	137	100
Interest expense	(407)	(254)	(239)
Income before income taxes	$ 5,488	$ 2,563	$ 1,493

(a) Segment operating income excludes goodwill and existing technology amortization, acquisition/integration-related costs, and one-time gains and charges.

The following table provides external revenue for groups of similar products and services, on a pro forma basis as if the Excel and INS mergers had occurred before Lucent's fiscal year-end for the years ended September 30, 1999, 1998, and 1997:

PRODUCTS AND SERVICES REVENUES	1999	1998	1997
Core Networking Systems[(a)]	$17,906	$14,541	$ 12,621
Wireless Products	5,516	4,456	2,984
Business Communications Systems[(b)]	6,977	6,399	5,077
Microelectronics	2,827	2,405	2,214
NetCare Professional Services	1,083	656	374
Other[(c)]	4,465	3,651	4,533
Totals	$38,774	$32,108	$27,803

(a) Core Networking Systems includes switching and access products, data networking systems for service providers, optical networking products, communications software and engineering services.

(b) Business Communications Systems includes advanced communications products and messaging services.

(c) "Other" principally includes network products.

Report of Management

Management is responsible for the preparation of Lucent Technologies Inc.'s consolidated financial statements and all related information appearing in this Annual Report. The consolidated financial statements and notes have been prepared in conformity with generally accepted accounting principles and include certain amounts that are estimates based on currently available information and management's judgment of current conditions and circumstances.

To provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that accounting records are reliable for preparing financial statements, management maintains a system of accounting and other controls, including an internal audit function. Even an effective internal control system, no matter how well designed, has inherent limitations – including the possibility of circumvention or overriding of controls – and therefore can provide only reasonable assurance with respect to financial statement presentation. The system of accounting and other controls is improved and modified in response to changes in business conditions and operations and recommendations made by the independent accountants and the internal auditors.

The Audit and Finance Committee of the Board of Directors, which is composed of directors who are not employees, meets periodically with management, the internal auditors and the independent accountants to review the manner in which these groups of individuals are performing their responsibilities and to carry out the Audit and Finance Committee's oversight role with respect to auditing, internal controls and financial reporting matters. Periodically, both the internal auditors and the independent accountants meet privately with the Audit and Finance Committee and have access to its individual members.

Lucent engaged PricewaterhouseCoopers LLP, independent accountants, to audit the consolidated financial statements in accordance with generally accepted auditing standards, which include consideration of the internal control structure. Their report appears on this page.

Rich McGinn

Richard A. McGinn
Chairman and
Chief Executive Officer

Donald K Peterson

Donald K. Peterson
Executive Vice President and
Chief Financial Officer

Report of Independent Accountants

*To the Board of Directors and
Shareowners of Lucent Technologies Inc.:*

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and changes in shareowners' equity and of cash flows present fairly, in all material respects, the financial position of Lucent Technologies Inc. and its subsidiaries at September 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
New York, New York
October 25, 1999

CONSOLIDATED STATEMENTS OF INCOME

Lucent Technologies Inc. and Subsidiaries
(dollars in millions, except per share amounts)

	Year Ended September 30, 1999	1998	1997
REVENUES			
Revenues	$38,303	$31,806	$ 27,611
Costs	19,688	16,715	15,318
GROSS MARGIN			
Gross margin	18,615	15,091	12,293
OPERATING EXPENSES			
Selling, general and administrative	8,417	6,867	6,254
Research and development	4,510	3,903	3,185
Purchased in-process research and development	282	1,683	1,255
Total operating expenses	**13,209**	**12,453**	**10,694**
OPERATING INCOME			
Operating income	5,406	2,638	1,599
Other income – net	443	128	97
Interest expense	406	254	238
Income before income taxes	5,443	2,512	1,458
Provision for income taxes	1,985	1,477	1,009
Income before cumulative effect of accounting change	3,458	1,035	449
Cumulative effect of accounting change (net of income taxes of $842)	1,308	–	–
Net income	**$ 4,766**	**$ 1,035**	**$ 449**
EARNINGS PER COMMON SHARE – BASIC			
Income before cumulative effect of accounting change	$ 1.14	$ 0.35	$ 0.16
Cumulative effect of accounting change	0.43	–	–
Net income	**$ 1.57**	**$ 0.35**	**$ 0.16**
EARNINGS PER COMMON SHARE – DILUTED			
Income before cumulative effect of accounting change	$ 1.10	$ 0.34	$ 0.15
Cumulative effect of accounting change	0.42	–	–
Net income	**$ 1.52**	**$ 0.34**	**$ 0.15**
Dividends per common share	**$ 0.08**	**$ 0.0775**	**$ 0.0563**

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

Lucent Technologies Inc. and Subsidiaries
(dollars in millions, except per share amounts)

	September 30, 1999	1998
ASSETS		
Cash and cash equivalents	$ 1,816	$ 1,154
Receivables less allowances of $362 in 1999 and $416 in 1998	10,438	7,405
Inventories	5,048	3,279
Contracts in process (net of progress billings of $5,565 in 1999 and $3,036 in 1998)	1,103	1,259
Deferred income taxes – net	1,583	1,775
Other current assets	1,943	912
Total current assets	**21,931**	**15,784**
Property, plant and equipment – net	6,847	5,693
Prepaid pension costs	6,175	3,754
Deferred income taxes – net	–	761
Capitalized software development costs	470	298
Other assets	3,352	3,073
Total assets	**$38,775**	**$29,363**
LIABILITIES		
Accounts payable	$ 2,878	$ 2,157
Payroll and benefit-related liabilities	2,300	2,592
Postretirement and postemployment benefit liabilities	137	187
Debt maturing within one year	2,864	2,231
Other current liabilities	3,599	3,718
Total current liabilities	**11,778**	**10,885**
Postretirement and postemployment benefit liabilities	6,305	6,380
Long-term debt	4,162	2,409
Other liabilities	2,946	1,980
Total liabilities	**$25,191**	**$21,654**
Commitments and contingencies		
SHAREOWNERS' EQUITY		
Preferred stock – par value $1 per share Authorized shares: 250,000,000 Issued and outstanding shares: none	$ –	$ –
Common stock – par value $.01 per share Authorized shares: 6,000,000,000 Issued and outstanding shares: 3,071,750,726 at September 30, 1999; 3,022,369,264 at September 30, 1998	31	30
Additional paid-in capital	7,731	6,589
Guaranteed ESOP obligation	(33)	(49)
Retained earnings	6,099	1,422
Accumulated other comprehensive income (loss)	(244)	(283)
Total shareowners' equity	**$13,584**	**$ 7,709**
Total liabilities and shareowners' equity	**$38,775**	**$29,363**

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

Lucent Technologies Inc. and Subsidiaries
(dollars in millions)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Guaranteed ESOP Obligation	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareowners' Equity	Total Comprehensive Income
Balance at October 1, 1996	**–**	**29**	**3,141**	**(106)**	**421**	**(23)**	**3,462**	
Net Income (excluding undistributed S-Corp earnings)					416			416
Reclass of undistributed earnings of S-Corp			33					33
Foreign currency translation adjustment						(175)		(175)
Unrealized holding gains on certain investments						40		40
Minimum pension liability adjustment						9		9
Total comprehensive income								323
Effect of poolings			23		(18)			
Dividends declared					(146)			
Amortization of ESOP obligation				29				
Issuance of common stock			281					
Tax benefit from employee stock options			88					
Issuance of common stock for acquisitions			213					
Conversion of common stock related to acquisitions			116					
S-Corp distributions			(19)					
Other			27					
Balance at September 30, 1997	**–**	**29**	**3,903**	**(77)**	**673**	**(149)**	**4,379**	
Net Income (excluding undistributed S-Corp earnings)					950			950
Reclass of undistributed earnings of S-Corp			85					85
Foreign currency translation adjustment						(89)		(89)
Unrealized holding losses on certain investments						(37)		(37)
Minimum pension liability adjustment						(8)		(8)
Total comprehensive income								901
Effect of poolings								
Dividends declared					(201)			
Amortization of ESOP obligation				28				
Issuance of common stock		1	645					
Tax benefit from employee stock options			271					
Issuance of common stock for acquisitions			1,525					
Conversion of common stock related to acquisitions			186					
S-Corp distributions			(26)					
Balance at September 30, 1998	**–**	**30**	**6,589**	**(49)**	**1,422**	**(283)**	**7,709**	
Net Income (excluding undistributed S-Corp earnings)					4,758			4,758
Reclass of undistributed earnings of S-Corp			8					8
Foreign currency translation adjustment						(33)		(33)
Unrealized holding gains on certain investments (net of tax of $235)						307		307
Reclassification adjustment (net of tax of $178)						(246)		(246)
Minimum pension liability adjustment (net of tax of $6)						11		11
Total comprehensive income								4,805
Effect of poolings			106		(26)			
Dividends declared					(222)			
Amortization of ESOP obligation				16				
Issuance of common stock		1	695					
Tax benefit from employee stock options			367					
Adjustment to conform pooled companies fiscal year					169			
S-Corp distributions			(40)					
Other			6		(2)			
Balance at September 30, 1999	**–**	**31**	**7,731**	**(33)**	**6,099**	**(244)**	**13,584**	

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Lucent Technologies Inc. and Subsidiaries
(dollars in millions)

	Year Ended September 30, 1999	1998	1997
OPERATING ACTIVITIES			
Net income	$4,766	$ 1,035	$ 449
Adjustments to reconcile net income to net cash (used in) provided by operating activities, net of effects from acquisitions of businesses:			
Cumulative effect of accounting change	(1,308)	–	–
Business restructuring reversal	(141)	(100)	(201)
Asset impairment and other charges	236	–	81
Depreciation and amortization	1,806	1,411	1,499
Provision for uncollectibles	75	149	136
Tax benefit from stock options	367	271	88
Deferred income taxes	1,026	56	(21)
Purchased in-process research and development	15	1,683	1,255
Adjustment to conform Ascend and Kenan's fiscal years	169	–	–
Increase in receivables – net	(3,183)	(2,161)	(484)
Increase in inventories and contracts in process	(1,612)	(403)	(316)
Increase (decrease) in accounts payable	668	231	(18)
Changes in other operating assets and liabilities	(2,320)	155	(397)
Other adjustments for non-cash items – net	(840)	(467)	58
Net cash (used in) provided by operating activities	**(276)**	**1,860**	**2,129**
INVESTING ACTIVITIES			
Capital expenditures	(2,215)	(1,791)	(1,744)
Proceeds from the sale or disposal of property, plant and equipment	97	57	108
Purchases of equity investments	(307)	(212)	(149)
Sales of equity investments	156	71	12
Purchases of investment securities	(450)	(1,082)	(483)
Sales or maturity of investment securities	1,132	686	356
Dispositions of businesses	72	329	181
Acquisitions of businesses – net of cash acquired	(264)	(1,078)	(1,584)
Cash from mergers	61	–	–
Other investing activities – net	(69)	(80)	(68)
Net cash used in investing activities	**(1,787)**	**(3,100)**	**(3,371)**
FINANCING ACTIVITIES			
Repayments of long-term debt	(13)	(93)	(16)
Issuance of long-term debt	2,175	375	52
Proceeds from issuance of common stock	696	645	281
Dividends paid	(222)	(201)	(192)
S-Corp distribution to stockholder	(40)	(26)	(19)
Increase in short-term borrowings – net	89	149	191
Net cash provided by financing activities	**2,685**	**849**	**297**
Effect of exchange rate changes on cash and cash equivalents	40	(61)	(11)
Net increase (decrease) in cash and cash equivalents	662	(452)	(956)
Cash and cash equivalents at beginning of period	1,154	1,606	2,562
Cash and cash equivalents at end of period	**$ 1,816**	**$ 1,154**	**$ 1,606**

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(dollars in millions, except per share amounts)

1. Basis of Presentation

On June 24, 1999, Lucent Technologies Inc. (the "Company") merged with Ascend Communications, Inc. Each share of Ascend common stock was converted into 1.65 shares of Lucent common stock. Lucent issued approximately 371 million shares in exchange for all of the outstanding shares of Ascend. On February 26, 1999, under the terms of the Kenan Systems Corporation merger agreement, Lucent issued approximately 26 million shares (post April 1, 1999 stock split) of Lucent common stock in exchange for all the outstanding shares of Kenan. These transactions were accounted for as pooling-of-interests and, accordingly, the consolidated financial statements of Lucent were restated for all periods prior to the mergers to include the accounts and operations of Ascend and Kenan.

Before merging with Lucent, both Ascend and Kenan had December 31 fiscal year ends. Lucent financial information for fiscal 1998 and earlier years was computed by adding financial information for corresponding quarters of Ascend's and Kenan's fiscal year. Thus, the consolidated statements of income for the years ended September 30, 1998, and 1997 were derived by combining the results of operations of Lucent for the years ended September 30, 1998, and 1997, respectively, with the results of operations of Ascend and Kenan for the years ended December 31, 1998, and 1997, respectively. The consolidated balance sheet at September 30, 1998, was derived by combining the financial position of Lucent at September 30, 1998, with the financial position of Ascend and Kenan at December 31, 1998. The consolidated statements of cash flows for the years ended September 30, 1998, and 1997 were derived by combining the cash flows of Lucent for the years ended September 30, 1998, and 1997 with the cash flows of Ascend and Kenan for the years ended December 31, 1998, and 1997.

The results of operations, financial position and cash flows as of and for the three months ended December 31, 1998, for Ascend and Kenan were included in Lucent's financial statements as of and for the year ended September 30, 1998. The results of operations for the three months ended December 31, 1998, also were included in Lucent's financial statements for the year ended September 30, 1999. As a result, the consolidated balance sheet of Lucent at September 30, 1999, includes an adjustment to retained earnings to eliminate the income recognized from both Ascend and Kenan for the three months ended December 31, 1998. In addition, information from the statements of cash flows for Ascend and Kenan for the three months ended December 31, 1998, has been eliminated from the consolidated statements of cash flows for the year ended September 30, 1999, since Ascend's and Kenan's activity for this period has been included in the consolidated statements of cash flows for the year ended September 30, 1998.

On April 1, 1998, and April 1, 1999, two-for-one splits of Lucent's common stock became effective. Shareowners' equity has been restated to give retroactive recognition to the stock splits for all periods presented by reclassifying from retained earnings to common stock the par value of the additional shares issued as a result of the stock splits. In addition, all references in the financial statements and notes to number of shares, per share amounts, stock option data and market prices have been restated to reflect these stock splits.

Acquisitions

Purchase Method

The following table presents information about certain acquisitions by Lucent in the fiscal years ended September 30, 1999, 1998, and 1997. All the acquisitions were accounted for under the purchase method of accounting, and the acquired technology valuation included both existing technology and purchased in-process research and development. All charges were recorded in the quarter in which the transaction was completed.

1999	Acquisition Date	Purchase Price	Goodwill	Existing Technology	Purchased IPRD (after-tax)	Amortization Period Goodwill (in years)	Amortization Period Existing Tech. (in years)
Stratus[1]	10/98	$ 917	$ 0	$130	$267*	n/a	10
Other[2]	various	187	133	17	29	4-8	6-7
1998							
Yurie[3]	5/98	$1,056	$292	$ 40	$620	7	5
Prominet[4]	1/98	199	35	23	157	5	6
Livingston[5]	12/97	610	114	69	427	5	8
Other[6]	various	453	137	67	208	5-10	5-10
1997							
Octel[7]	9/97	$1,819	$ 181	$186	$945	7	5
InterCon[8]	2/97	22	0	3	18	n/a	3
Sahara[9]	1/97	219	0	0	213	n/a	n/a

(1) Stratus Computer, Inc. was a manufacturer of fault-tolerant computer systems, acquired by Ascend.

(2) Other acquisitions include the Ethernet LAN business of Enable Semiconductor ("Enable Ethernet"), Sybarus Technologies, WaveAccess Ltd., and Quadritek Systems, Inc.

(3) Yurie Systems, Inc. was a provider of ATM access technology and equipment for data, voice and video networking.

(4) Prominet Corporation was a participant in the emerging Gigabit Ethernet networking industry. The merger involved $164 of Lucent stock and options. In addition, under the terms of the agreement, Lucent had contingent obligations to pay former Prominet shareowners $35 in stock. The $35 of stock was paid by Lucent in July 1998 and recorded primarily as goodwill.

(5) Livingston Enterprises, Inc. was a global provider of equipment used by Internet service providers to connect their subscribers to the Internet.

(6) Other acquisitions include JNA Telecommunications Limited, LANNET, MassMedia Communications, Inc., SDX Business Systems plc, and Optimay GmbH. The purchase price for MassMedia has been deemed immaterial.

(7) Octel Communications Corporation was a provider of voice, fax and electronic messaging technologies.

(8) InterCon Systems Corporation was a developer of remote access client software products, acquired by Ascend.

(9) Sahara Networks, Inc. was a developer of scalable high-speed broadband access products, acquired by Ascend.

n/a Not applicable.

** $24 of purchased in-process research and development was subsequently reversed in March 1999.*

Included in the purchase price for the above acquisitions was purchased in-process research and development, which was a non-cash charge to earnings as this technology had not reached technological feasibility and had no future alternative use. The remaining purchase price was allocated to tangible assets and intangible assets, including goodwill and existing technology, less liabilities assumed.

The value allocated to purchased in-process research and development was determined utilizing an income approach that included an excess earnings analysis reflecting the appropriate cost of capital for the investment. Estimates of future cash flows related to the in-process research and development were made for each project based on Lucent's estimates of revenue, operating expenses and income taxes from the project. These estimates were consistent with historical pricing, margins and expense levels for similar products.

Revenues were estimated based on relevant market size and growth factors, expected industry trends, individual product sales cycles and the estimated life of each product's underlying technology. Estimated operating expenses, income taxes, and charges for the use of contributory assets were deducted from estimated revenues to determine estimated after-tax cash flows for each project. Estimated operating expenses include cost of goods sold; selling, general and administrative expenses; and research and development expenses. The research and development expenses include estimated costs to maintain the products once they have been introduced into the market and generate revenues and costs to complete the in-process research and development.

The discount rates utilized to discount the projected cash flows were based on consideration of Lucent's weighted average cost of capital, as well as other factors including the useful life of each project, the anticipated profitability of each project, the uncertainty of technology advances that were known at the time and the stage of completion of each project.

Management is primarily responsible for estimating the fair value of the assets and liabilities acquired, and has conducted due diligence in determining the fair value. Management has made estimates and assumptions that affect the reported amounts of assets, liabilities and expenses resulting from such acquisitions. Actual results could differ from those amounts.

SpecTran Corporation

On July 21, 1999, Lucent began its cash tender offer for the outstanding shares of SpecTran Corporation, a designer and manufacturer of specialty optical fiber and fiber-optic products. The tender offer expired on August 31, 1999, and Lucent thereafter accepted and paid for shares giving it a 61% interest in SpecTran. The acquisition was accounted for under the purchase method of accounting. Lucent expects to acquire the remaining shares of SpecTran by the end of the first quarter of fiscal year 2000, resulting in a total purchase price of approximately $68.

Pooling-of-Interests Mergers

Ascend Communications

On June 24, 1999, Lucent merged with Ascend, a developer, manufacturer and seller of wide area networking solutions. As a result, the outstanding Ascend common stock was converted into approximately 371 million shares of Lucent common stock, based on an exchange ratio of 1.65 shares of Lucent common stock for each share of Ascend common stock. In addition, Lucent assumed Ascend stock options equivalent to approximately 65 million shares of Lucent common stock. The merger was accounted for as a pooling-of-interests under Accounting Principles Board Opinion No. 16, and accordingly, Lucent's consolidated financial statements have been restated for all periods prior to the merger to include the results of operations, financial position and cash flows of Ascend as though it had always been a part of Lucent. Intercompany transactions for fiscal 1999 have been eliminated. Intercompany transactions prior to 1999 were immaterial. In connection with the merger, Lucent recorded a third fiscal quarter charge to operating expenses of approximately $79 (non-tax deductible) for merger-related costs. The merger-related costs consisted primarily of fees for investment bankers, attorneys, accountants and financial printing. Certain reclassifications were made to Ascend's accounts to conform to Lucent's presentation. The results of operations for the separate companies and the combined amounts presented in the consolidated financial statements are as follows:

(dollars in millions, except per share amounts)

	Nine Months Ended June 30,	Twelve Months Ended September 30,	
REVENUES	1999	1998	1997
Lucent	$26,256	$30,328	$26,444
Ascend	1,610	1,478	1,167
Eliminations	(138)	–	–
Combined	$27,728	$31,806	$ 27,611
NET INCOME (LOSS)			
Lucent	$ 3,838[(a)]	$ 1,055[(c)]	$ 573[(e)]
Ascend	66[(b)]	(20)[(d)]	(124)[(f)]
Eliminations	(86)	–	–
Combined	$ 3,818	$ 1,035	$ 449

(a) Includes $108 of one-time after-tax charges related to Lucent's acquisitions of Quadritek, WaveAccess, Sybarus and Enable Ethernet and the merger-related costs for Ascend as well as $1,308 after-tax gain from the cumulative effect of the accounting change (see Note 10 – EMPLOYEE BENEFIT PLANS).

(b) Includes $243 of one-time after-tax charges related to Ascend's acquisition of Stratus. The original charge of $267 was reduced by $24 in the second fiscal quarter of 1999.

(c) Includes $1,412 of one-time after-tax charges related to Lucent's acquisitions of Livingston, Prominet, Optimay, Yurie, SDX, LANNET, MassMedia and JNA as well as the $95 after-tax gain on the sale of Advanced Technology Systems ("ATS") business.

(d) Includes $267 of one-time after-tax charges related to Ascend's acquisition of Stratus.

(e) Includes $966 of one-time after-tax charges related to Lucent's acquisition of Octel.

(f) Includes $335 one-time after-tax charges related to Ascend's acquisitions of Sahara and InterCon and Ascend's mergers with Whitetree, Inc. and Cascade Communications Corp.

Kenan Systems
On February 26, 1999, Lucent merged with Kenan Systems Corporation, a developer of third-party billing and customer software. Under the terms of the Kenan merger agreement, Lucent issued approximately 26 million shares (post April 1, 1999 stock split) of Lucent common stock in exchange for all the outstanding shares of Kenan.

Mosaix
On July 15, 1999, Lucent completed its merger with Mosaix, a provider of software that links companies' front and back offices and helps them deliver more responsive and efficient customer service. Under the terms of the agreement, the outstanding common stock of Mosaix was converted into the right to receive approximately 2.6 million shares of Lucent common stock. Lucent has not restated its historical financial statements to reflect its pooling-of-interests with Mosaix.

Nexabit Networks
On July 19, 1999, Lucent completed its merger with Nexabit, a developer of high-speed switching equipment and software that directs traffic along telecommunications networks. Under the terms of the agreement, the outstanding stock of Nexabit was converted into the right to receive approximately 13.7 million shares of Lucent common stock. Lucent has not restated its historical financial statements to reflect its pooling-of-interests with Nexabit.

Cascade Communications
On June 30, 1997, Ascend completed its merger with Cascade, a developer and manufacturer of wide area network switches.

Whitetree
On April 1, 1997, Ascend completed its merger with Whitetree, a developer and manufacturer of high-speed ATM switching products. Ascend did not restate its historical financial statements to reflect its pooling-of-interests with Whitetree.

2. Summary of Significant Accounting Policies

Basis of Consolidation
The consolidated financial statements include all majority-owned subsidiaries in which Lucent exercises control. Investments in which Lucent exercises significant influence, but which it does not control (generally a 20% – 50% ownership interest), are accounted for under the equity method of accounting. All material intercompany transactions and balances have been eliminated.

Use of Estimates
The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. Actual results could differ from those estimates. Estimates are used in accounting for long-term contracts, allowances for uncollectible receivables, inventory obsolescence, product warranty, depreciation, employee benefits, taxes, restructuring reserves and contingencies. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the financial statements in the period they are determined to be necessary.

Foreign Currency Translation
For operations outside the United States that prepare financial statements in currencies other than the U.S. dollar, results of operations and cash flows are translated at average exchange rates during the period, and assets and liabilities are translated at end-of-period exchange rates. Translation adjustments are

included as a separate component of accumulated other comprehensive income (loss) in shareowners' equity.

Revenue Recognition

Revenue is generally recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured. Revenue from product sales of hardware and software is recognized at time of delivery and acceptance, and after consideration of all the terms and conditions of the customer contract. Sales of services are recognized at time of performance, and rental revenue is recognized proportionately over the contract term. Revenues and estimated profits on long-term contracts are generally recognized under the percentage-of-completion method of accounting using either a units-of-delivery or a cost-to-cost methodology. Profit estimates are revised periodically based on changes in facts. Any losses on contracts are recognized immediately.

Research and Development Costs

Research and development costs are charged to expense as incurred. However, the costs incurred for the development of computer software that will be sold, leased or otherwise marketed are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated future revenues and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when the product is available for general release. Amortization is provided on a product-by-product basis on either the straight-line method over periods not exceeding two years or the sales ratio method. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product are expensed immediately.

Cash and Cash Equivalents

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents.

Inventories

Inventories are stated at the lower of cost (determined principally on a first-in, first-out basis) or market.

Contracts in Process

Contracts in process are valued at cost plus accrued profits less progress billings.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is determined using a combination of accelerated and straight-line methods on either the unit or group methods over the estimated useful lives of the various asset classes. The unit method is used for manufacturing and laboratory equipment and large computer systems. The group method is used for other depreciable assets.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

Financial Instruments

Lucent uses various financial instruments, including foreign currency exchange contracts and interest rate swap agreements to manage and reduce risk to Lucent by generating cash flows, which offset the cash flows of certain transactions in foreign currencies or underlying financial instruments in relation to their amount and timing. Lucent's derivative financial instruments are for purposes other than trading and are not entered into for speculative purposes. Lucent's non-derivative financial instruments include letters of credit, commitments to extend credit and guarantees of debt. Lucent generally does not require collateral to support its financial instruments.

Goodwill

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. Goodwill is amortized on a straight-line basis over the periods benefited, principally in the range of 5 to 15 years. Goodwill is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 1999 presentation.

3. Recent Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 establishes new accounting and reporting standards for derivative financial instruments and for hedging activities. SFAS 133 requires Lucent to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on Lucent's rights or obligations under the applicable derivative contract. In June 1999, the FASB issued SFAS No. 137 which deferred the effective date of adoption of SFAS 133 for one year. Lucent will adopt SFAS 133 no later than the first quarter of fiscal year 2001. SFAS 133 is not expected to have a material impact on Lucent's consolidated results of operations, financial position or cash flows.

In March 1998, the American Institute of Certified Public Accountants (the "AICPA") issued Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). SOP 98-1 provides guidance on accounting for the costs of computer software developed or obtained for internal use. This pronouncement identifies the characteristics of internal use software and provides guidance on new cost recognition principles. Certain costs that were previously expensed as incurred will be capitalized and amortized on a straight-line basis over three years. Lucent will adopt SOP 98-1 on October 1, 1999. The implementation of SOP 98-1 will decrease costs and expenses in fiscal year 2000, the initial year of adoption, and thereafter is expected to increase year-over-year costs and expenses as the capitalized amounts are amortized. Costs for general and administrative, overhead, maintenance and training, as well as the cost of software that does not add functionality to the existing system, will be expensed as incurred.

(dollars in millions, except per share amounts)

4. Supplementary Financial Information

SUPPLEMENTARY INCOME STATEMENT INFORMATION

INCLUDED IN COSTS	1999	1998	1997
Amortization of software development costs	$ 249	$ 234	$ 380
INCLUDED IN SELLING, GENERAL AND ADMINISTRATIVE EXPENSES			
Amortization of goodwill and existing technology	$ 394	$ 149	$ 32
INCLUDED IN COSTS AND OPERATING EXPENSES			
Depreciation and amortization of property, plant and equipment	$1,296	$ 996	$1,057
OTHER INCOME – NET			
Interest income	$ 124	$ 112	$ 155
Minority interests in earnings of subsidiaries	(27)	(24)	(35)
Net equity losses from investments	(25)	(209)	(64)
Gain (loss) on foreign currency transactions	1	(44)	(12)
Gain on sale of equity investments	359	38	–
Gain on businesses sold	40	208	–
Miscellaneous – net	(29)	47	53
Total other income – net	**$ 443**	**$ 128**	**$ 97**
DEDUCTED FROM INTEREST EXPENSE			
Capitalized interest	$ 20	$ 17	$ 14

SUPPLEMENTARY BALANCE SHEET INFORMATION

	September 30,	
INVENTORIES	1999	1998
Completed goods	$ 2,946	$ 1,644
Work in process and raw materials	2,102	1,635
Inventories	**$ 5,048**	**$ 3,279**
PROPERTY, PLANT AND EQUIPMENT – NET		
Land and improvements	$ 360	$ 306
Buildings and improvements	3,951	3,187
Machinery, electronic and other equipment	9,981	8,838
Total property, plant and equipment	14,292	12,331
Less: Accumulated depreciation and amortization	(7,445)	(6,638)
Property, plant and equipment – net	**$ 6,847**	**$ 5,693**
OTHER CURRENT LIABILITIES		
Advance billings and customer deposits	$ 488	$ 548

SUPPLEMENTARY CASH FLOW INFORMATION

	Year Ended September 30,		
	1999	1998	1997
Interest payments, net of amounts capitalized	$ 409	$ 255	$ 240
Income tax payments	$1,025	$ 776	$ 826
Acquisitions of businesses: Fair value of assets acquired, net of cash acquired	$ 394	$2,092	$1,838
Less: Fair value of liabilities assumed	$ 130	$1,014	$ 254
Acquisitions of businesses, net of cash acquired	$ 264	$1,078	$1,584

For the year ended September 30, 1999, the Consolidated Statements of Cash Flows excludes the issuance of common stock related to the mergers with Nexabit and Mosaix.

On October 1, 1997, Lucent contributed its Consumer Products business to a new venture formed by Lucent and Philips Electronics N.V. in exchange for 40% ownership of Philips Consumer Communications ("PCC"). On October 22, 1998, Lucent and Philips announced their intention to end the PCC venture and agreed to regain control of their original businesses. The results of operations and net assets of the remaining businesses Lucent previously contributed to PCC have been consolidated as of October 1, 1998. However, for the years ended September 30, 1998, and 1999, the Consolidated Statements of Cash Flows exclude both the contribution and the regaining of Lucent's Consumer Products business.

For the year ended September 30, 1999, costs and operating expenses include a $236 charge primarily associated with asset impairments and integration-related charges associated with the Ascend and Nexabit mergers.

For the year ended September 30, 1998, Other income – net includes a charge of $110 related to a write-down associated with Lucent's investment in the PCC venture. This charge was offset by gains of $103, primarily related to the sale of an investment and the sale of certain business operations, including Bell Laboratories Design Automation Group.

For the year ended September 30, 1998, the Consolidated Statements of Cash Flows excludes the issuance of common stock related to the acquisitions of Livingston, Prominet, and Stratus and the conversion of stock options related to the acquisitions of Livingston, Prominet, Yurie, Optimay, and Stratus.

For the year ended September 30, 1997, the Consolidated Statements of Cash Flows excludes the conversion of stock options related to the acquisition of Octel and the issuance of common stock and the conversion of stock options related to the acquisition of Sahara. For information on the 1999, 1998 and 1997 acquisitions, see Note 1.

For the year ended September 30, 1997, research and development expenses include a $127 write-down of special purpose Bell Laboratories assets no longer being used.

5. Earnings per Common Share

Basic earnings per common share was calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share was calculated by dividing net income by the sum of the weighted average number of common shares outstanding plus all additional common shares that would have been outstanding if potentially dilutive securities or common stock equivalents had been issued.

The following table reconciles the number of shares utilized in the earnings per share calculations:

	Year Ended September 30, 1999	1998	1997
Net income	$ 4,766	$ 1,035	$ 449
Earnings per common share – basic: Income before cumulative effect of accounting change	$ 1.14	$ 0.35	$ 0.16
Cumulative effect of accounting change	0.43	–	–
Net income	$ 1.57	$ 0.35	$ 0.16
Earnings per common share – diluted: Income before cumulative effect of accounting change	$ 1.10	$ 0.34	$ 0.15
Cumulative effect of accounting change	0.42	–	–
Net income	$ 1.52	$ 0.34	$ 0.15

Number of shares (in millions)

	1999	1998	1997
Common shares – basic	3,035.8	2,963.8	2,894.6
Effect of dilutive securities: Stock options	101.0	71.9	37.5
Other	5.9	4.0	0.2
Common shares – diluted	3,142.7	3,039.7	2,932.3
Options excluded from the computation of earnings per share – diluted since option exercise price was greater than the average market price of the common shares for the period	5.5	13.4	15.9

6. Comprehensive Income

Lucent has adopted SFAS No. 130, "Reporting Comprehensive Income" as of October 1, 1998, that requires new standards for reporting and display of comprehensive income and its components that Lucent has displayed in its Consolidated Statements of Changes in Shareowners' Equity. However, it does not affect net income or total shareowners' equity.

The after-tax components of accumulated other comprehensive income (loss) are as follows:

	Foreign Currency Translation Adjustment	Unrealized Holding Gains/ (Losses)	Minimum Pension Liability Adjustment	Total Accumulated Other Comprehensive Income/ (Loss)
Beginning balance October 1, 1996	$ (16)	$ 15	$(22)	$ (23)
Current-period change	(175)	40	9	(126)
Ending balance, September 30, 1997	$ (191)	$ 55	$ (13)	$ (149)
Current-period change	(89)	(37)	(8)	(134)
Ending balance, September 30, 1998	$(280)	$ 18	$ (21)	$(283)
Current-period change	(33)	61	11	39
Ending balance, September 30, 1999	$(313)	$ 79	$ (10)	$(244)

The foreign currency translation adjustments are not currently adjusted for income taxes since they relate to indefinite investments in non-United States subsidiaries.

7. Business Restructuring and Other Charges

In the fourth quarter of calendar year 1995, a pre-tax charge of $2,801 was recorded to cover restructuring costs of $2,613 and asset impairment and other charges of $188. The restructuring plans included the exit of certain businesses as well as consolidating and re-engineering numerous corporate and business unit operations.

Total deductions to Lucent's business restructuring reserves were $233 and $318 for the years ended September 30, 1999, and 1998, respectively. Included in these deductions were cash payments of $77 and $176 and non-cash related charges of $15 and $42 for the years ended September 30, 1999, and 1998, respectively. The non-cash related charges were primarily related to assets for product lines and businesses that Lucent exited as part of its restructuring activities. The related costs were included in the 1995 restructuring plan. The assets did not benefit activities that were to continue, nor were they used to generate future revenues. The reserves were charged as the product lines and businesses were exited during 1999 and 1998. In addition, Lucent reversed $141 and $100 of business restructuring reserves primarily related to favorable experience in employee separations as well as, other projects being completed at a cost lower than originally estimated for the years ended September 30, 1999, and 1998, respectively. As of September 30, 1999, all restructuring plans were substantially completed and the remaining reserves of $18 are related to outstanding litigation for certain product lines that were exited.

The following table displays a rollforward of the liabilities for business restructuring from September 30, 1997, to September 30, 1999:

Type of Cost	September 30, 1997 Balance	1998 Deductions	1998 Balance	1999 Deductions	1999 Balance
Employee separation	$348	$(235)	$ 113	$ (113)	$ –
Facility closing	66	(23)	43	(43)	–
Other	155	(60)	95	(77)	18
Total	**$569**	**$(318)**	**$251**	**$(233)**	**$18**

(dollars in millions, except per share amounts)

In 1997, Lucent recorded a pre-tax charge of approximately $150 in connection with the acquisition of Cascade Communications Corp. and Whitetree, Inc. The total charge included $54 of merger-related costs and $96 of integration expenses. Included in the integration expenses were $7 for severance and outplacement costs for approximately 275 employees involved in duplicate functions; $67 for redundant assets and assets related to duplicate product lines; and $22 for the cancellation of redundant facility leases and other contracts and obligations. In 1998, Lucent reversed $18 of these costs. There were no reserves remaining as of September 30, 1998.

8. Income Taxes

The following table presents the principal reasons for the difference between the effective tax rate and the United States federal statutory income tax rate:

	Year Ended September 30, 1999	1998	1997
U.S. federal statutory income tax rate	35.0 %	35.0 %	35.0 %
State and local income taxes, net of federal income tax effect	2.5 %	3.3 %	5.4 %
Foreign earnings and dividends taxed at different rates	0.3 %	1.0 %	0.8 %
Research credits	(2.6)%	(2.6)%	(2.4)%
Acquisition-related costs[a]	2.6 %	23.5 %	32.4 %
Other differences – net	(1.3)%	(1.4)%	(2.0)%
Effective income tax rate	**36.5 %**	**58.8 %**	**69.2 %**
Effective income tax rate excluding acquisition-related costs[a]	33.9 %	35.3 %	36.8 %

(a) Includes non-tax deductible purchased in-process research and development and merger-related expenses.

The following table presents the United States and foreign components of income before income taxes and the provision for income taxes:

INCOME BEFORE INCOME TAXES	Year Ended September 30, 1999	1998	1997
United States	$4,702	$2,144	$ 861
Foreign	741	368	597
Income before income taxes	**$5,443**	**$2,512**	**$1,458**
PROVISION FOR INCOME TAXES			
CURRENT			
Federal	$ 505	$ 987	$ 554
State and local	38	168	148
Foreign	336	213	228
Sub-total	879	1,368	930
DEFERRED			
Federal	992	63	11
State and local	183	36	72
Foreign	(69)	10	(4)
Sub-total	1,106	109	79
Provision for income taxes	**$1,985**	**$1,477**	**$1,009**

As of September 30,1999, Lucent had tax credit carryforwards of $80 and federal, state and local, and foreign net operating loss carryforwards (tax effected) of $146, all of which expire primarily after the year 2000.

The components of deferred tax assets and liabilities at September 30, 1999, and 1998 are as follows:

DEFERRED INCOME TAX ASSETS	September 30, 1999	1998
Employee pensions and other benefits – net	$ 442	$1,520
Business restructuring	6	165
Reserves and allowances	1,009	1,137
Net operating loss/credit carryforwards	226	239
Valuation allowance	(179)	(261)
Other	344	526
Total deferred tax assets	**$1,848**	**$3,326**
DEFERRED INCOME TAX LIABILITIES		
Property, plant and equipment	$ 628	$ 399
Other	511	391
Total deferred tax liabilities	**$ 1,139**	**$ 790**

Lucent has not provided for United States deferred income taxes or foreign withholding taxes on $3,211 of undistributed earnings of its non-United States subsidiaries as of September 30, 1999, since these earnings are intended to be reinvested indefinitely.

9. Debt Obligations

DEBT MATURING WITHIN ONE YEAR	September 30, 1999	1998
Commercial paper	$ 1,828	$2,106*
Long-term debt	34	39
Secured borrowings and other	1,002	86
Total debt maturing within one year	**$2,864**	**$2,231**
WEIGHTED AVERAGE INTEREST RATES		
Commercial paper	5.0%	5.6%
Long-term debt, secured borrowings and other	9.7%	7.9%

Lucent had revolving credit facilities at September 30, 1999, aggregating $4,711 (a portion of which is used to support Lucent's commercial paper program), $4,000 with domestic lenders and $711 with foreign lenders. The total credit facilities available at September 30, 1999, with domestic and foreign lenders were $4,000 and $351, respectively.

LONG-TERM DEBT	September 30, 1999	1998
6.90% notes due July 15, 2001	$ 750	$ 750
7.25% notes due July 15, 2006	750	750
5.50% notes due November 15, 2008	500	–
6.50% debentures due January 15, 2028	300	300
6.45% debentures due March 15, 2029	1,360	–
Commercial paper refinanced after September 30, 1998	–	495*
Long-term lease obligations	79	1
Secured borrowings and other (8.40% weighted average interest rate for both years)	502	164
Less: Unamortized discount	45	12
Total long-term debt	4,196	2,448
Less: Amounts maturing within one year	34	39
Net long-term debt	**$4,162**	**$2,409**

** On November 19, 1998, Lucent sold $500 ($495 net of unamortized costs) of 10-year 5.5% notes due November 15, 2008, and reclassified the amount from debt maturing within one year to long-term debt. The proceeds were used to pay down a portion of Lucent's commercial paper during the first quarter of fiscal 1999.*

Lucent has an effective shelf registration statement for the issuance of debt securities up to $1,800, all of which remains available at September 30, 1999.

This table shows the maturities, by year, of the $4,196 in total long-term debt obligations:

September 30, 2000	2001	2002	2003	2004	Later Years
$34	$850	$26	$128	$107	$3,051

In the normal course of business, Lucent sells trade accounts receivable and notes receivable to unaffiliated financial institutions with and without recourse. Certain sales with recourse are accounted for as secured borrowings and amounted to $1,037 at September 30, 1999. As a result of these recourse transactions, these receivables remained in the Consolidated Balance Sheets and increased cash flows from financing activities in the Consolidated Statements of Cash Flows by $1,037. See Note 13 for further discussion of sales of receivables without recourse.

10. Employee Benefit Plans

Pension and Postretirement Benefits

Lucent maintains defined benefit pension plans covering the majority of its employees and retirees, and postretirement benefit plans for retirees that include health care benefits and life insurance coverage.

	Pension Benefits September 30,		Postretirement Benefits September 30,	
CHANGE IN BENEFIT OBLIGATION	1999	1998	1999	1998
Benefit obligation at October 1	$27,846	$ 23,187	$ 9,193	$ 7,939
Service cost	509	331	80	63
Interest cost	1,671	1,631	537	540
Actuarial (losses) gains	(2,182)	3,811	(240)	919
Amendments	1,534	626	(359)	324
Benefits paid	(1,977)	(1,740)	(607)	(592)
Benefit obligation at September 30	$27,401	$27,846	$ 8,604	$ 9,193
CHANGE IN PLAN ASSETS				
Fair value of plan assets at October 1	$ 36,191	$36,204	$ 3,959	$ 4,152
Actual return on plan assets	7,114	1,914	776	349
Company contributions	14	12	29	53
Benefits paid	(1,977)	(1,740)	(607)	(592)
Other (including transfer of assets from pension to postretirement plans)	(275)	(199)	310	(3)
Fair value of plan assets at September 30	$41,067	$ 36,191	$ 4,467	$ 3,959
Funded (unfunded) status of the plan	$13,666	$ 8,345	$(4,137)	$(5,234)
Unrecognized prior service cost	2,583	1,509	121	533
Unrecognized transition asset	(645)	(944)	–	–
Unrecognized net gain	(9,466)	(5,175)	(1,014)	(408)
Net amount recognized	$ 6,138	$ 3,735	$(5,030)	$ (5,109)
Amounts recognized in the Consolidated Balance Sheets consist of:				
Prepaid pension costs	$ 6,175	$ 3,754	$ –	$ –
Accrued benefit liability	(63)	(44)	(5,030)	(5,109)
Intangible asset	9	4	–	–
Accumulated other comprehensive income	17	21	–	–
Net amount recognized	$ 6,138	$ 3,735	$(5,030)	$ (5,109)

(dollars in millions, except per share amounts)

Pension plan assets include $256 and $159 of Lucent common stock at September 30, 1999, and 1998, respectively. Postretirement plan assets include $20 and $11 of Lucent common stock at September 30, 1999, and 1998, respectively.

Components of Net Periodic Benefit Cost

	Year Ended September 30,		
PENSION COST	1999	1998	1997
Service cost	$ 509	$ 331	$ 312
Interest cost on projected benefit obligation	1,671	1,631	1,604
Expected return on plan assets	(2,957)	(2,384)	(2,150)
Amortization of unrecognized prior service costs	461	164	149
Amortization of transition asset	(300)	(300)	(300)
Amortization of net loss	2	–	–
Charges for plan curtailments	–	–	56
Net pension credit	**$ (614)**	**$ (558)**	**$ (329)**
POSTRETIREMENT COST			
Service cost	$ 80	$ 63	$ 57
Interest cost on accumulated benefit obligation	537	540	554
Expected return on plan assets	(308)	(263)	(264)
Amortization of unrecognized prior service costs	53	53	35
Amortization of net loss (gain)	6	3	(15)
Charges for plan curtailments	–	–	26
Net postretirement benefit cost	**$ 368**	**$ 396**	**$ 393**
PENSION AND POSTRETIREMENT BENEFITS			
Weighted-average assumptions as of September 30			
Discount rate	7.25%	6.0%	7.25%
Expected return on plan assets	9.0%	9.0%	9.0%
Rate of compensation increase	4.5%	4.5%	4.5%

Effective October 1, 1998, Lucent changed its method for calculating the market-related value of plan assets used in determining the expected return-on-asset component of annual net pension and postretirement benefit costs. Under the previous accounting method, the calculation of the market-related value of plan assets included only interest and dividends immediately, while all other realized and unrealized gains and losses were amortized on a straight-line basis over a five-year period. The new method used to calculate market-related value includes immediately an amount based on Lucent's historical asset returns and amortizes the difference between that amount and the actual return on a straight-line basis over a five-year period. The new method is preferable under Statement of Financial Accounting Standards No. 87 because it results in calculated plan asset values that are closer to current fair value, thereby lessening the accumulation of unrecognized gains and losses while still mitigating the effects of annual market value fluctuations.

The cumulative effect of this accounting change related to periods prior to fiscal year 1999 of $2,150 ($1,308 after-tax, or $0.43 and $0.42 per basic and diluted share, respectively) is a one-time, non-cash credit to fiscal 1999 earnings. This accounting change also resulted in a reduction in benefit costs in the year ended September 30, 1999 that increased income by $427 ($260 after-tax, or $0.09 and $0.08 per basic and diluted share, respectively) as compared with the previous accounting method. A comparison of pro forma amounts below shows the effects if the accounting change were applied retroactively:

	Year Ended September 30,	
	1998	1997
Pro forma net income	$1,276	$ 657
Earnings per share – basic	$ 0.43	$ 0.23
Earnings per share – diluted	$ 0.42	$ 0.22

In 1999, Lucent changed its pension plan benefit for management, technical pay plan, and non-represented occupational employees hired on or after January 1, 1999, and certain U.S. employees of companies acquired since October 1, 1996, who are not participating currently in a defined benefit pension plan. These employees will receive a different pension benefit known as an account balance program, effective January 1, 2000. All other employees will retain their current pension benefits and are not affected by the new account balance program.

Lucent has several non-pension postretirement benefit plans. For postretirement health care benefit plans, Lucent assumed a 9.2% annual health care cost trend rate for 2000, gradually declining to 3.9% by the year 2005, after which the trend rate would remain at that level. The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

	1 Percentage Point	
	Increase	Decrease
Effect on total of service and interest cost components	$ 23	$ 20
Effect on postretirement benefit obligation	$371	$344

Savings Plans

Lucent's savings plans allow employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. Lucent matches a percentage of the employee contributions up to certain limits. Savings plan expense amounted to $314, $316 and $183 for the years ended September 30, 1999, 1998, and 1997, respectively.

Employee Stock Ownership Plan

Lucent's leveraged Employee Stock Ownership Plan ("ESOP") funds the employer contributions to the Long-Term Savings and Security Plan ("LTSSP") for non-management employees. The ESOP obligation is reported as debt and as a reduction in shareowners' equity. Cash contributions to the ESOP are determined based on the ESOP's total debt service less dividends paid on ESOP shares. As of September 30, 1999, the ESOP contained 18.8 million shares of Lucent's common stock. Of the 18.8 million shares, 16.2 million have been allocated under the ESOP and 2.6 million were unallocated. As of September 30, 1999, the unallocated shares had a fair value of $169.

11. Stock Compensation Plans

Lucent has stock-based compensation plans under which outside directors and certain employees receive stock options and other equity-based awards. The plans provide for the grant of stock options, stock appreciation rights, performance awards, restricted stock awards and other stock unit awards.

Stock options generally are granted with an exercise price equal to 100% of the market value of a share of common stock on the date of grant, have a 10-year term and vest within four years from the date of grant. Subject to customary anti-dilution adjustments and certain exceptions, the total number of shares of common stock authorized for option grants under the plans was 264 million shares at September 30, 1999.

In connection with certain of Lucent's acquisitions, outstanding stock options held by employees of acquired companies became exercisable, according to their terms, for Lucent common stock effective at the acquisition date. These options did not reduce the shares available for grant under any of Lucent's other option plans. For acquisitions accounted for as purchases, the fair value of these options was included as part of the purchase price.

Lucent established an Employee Stock Purchase Plan (the "ESPP") effective October 1, 1996. Under the terms of the ESPP, eligible employees may have up to 10% of eligible compensation deducted from their pay to purchase common stock through June 30, 2001. The per share purchase price is 85% of the average high and low per share trading price of common stock on the New York Stock Exchange on the last trading day of each month. The amount that may be offered pursuant to this plan is 200 million shares. In 1999, 1998 and 1997, 6.8 million, 8.9 million and 12.5 million shares, respectively, were purchased under the ESPP and the employee stock purchase plan of an acquired company, at a weighted average price of $46.04, $23.93 and $12.77, respectively.

Lucent has adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," and as permitted under SFAS No. 123, applies Accounting Principles Board Opinion ("APB") No. 25 and related interpretations in accounting for its plans. Compensation expense recorded under APB No. 25 was $48, $77 and $37 for the years ended September 30, 1999, 1998, and 1997, respectively. If Lucent had elected to adopt the optional recognition provisions of SFAS No. 123 for its stock option plans and employee stock purchase plans, net income and earnings per share would have been changed to the pro forma amounts indicated below:

	Year Ended September 30,		
NET INCOME	1999	1998	1997
As reported	$4,766	$1,035	$ 449
Pro forma	$4,263	$ 756	$ 201
EARNINGS PER SHARE – BASIC			
As reported	$ 1.57	$ 0.35	$0.16
Pro forma	$ 1.40	$ 0.26	$0.07
EARNINGS PER SHARE – DILUTED			
As reported	$ 1.52	$ 0.34	$0.15
Pro forma	$ 1.31	$ 0.24	$0.07

The fair value of stock options used to compute pro forma net income and earnings per share disclosures is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

WEIGHTED AVERAGE ASSUMPTIONS	1999	1998	1997
Dividend yield	0.12%	0.18%	0.38%
Expected volatility:			
Lucent	33.8%	28.2%	22.4%
Acquisitions(1)	57.5%	61.0%	66.0%
Risk-free interest rate	5.2%	5.3%	6.3%
Expected holding period (in years)	3.6	4.1	4.4

(1) Pre-merger assumptions for companies acquired in a pooling-of-interests.

Presented below is a summary of the status of Lucent stock options and the related transactions for the years ended September 30, 1999, 1998, and 1997.

	Shares (000s)	Weighted Average Exercise Price
Options outstanding at October 1, 1996	**86,266**	**$ 14.55**
Granted/assumed* (1) (2)	176,170	$ 15.19
Exercised	(15,967)	$ 6.88
Forfeited/expired (2)	(63,310)	$24.92
Options outstanding at September 30, 1997	**183,159**	**$12.26**
Granted/assumed* (3)	123,075	$27.95
Exercised	(39,404)	$ 9.78
Forfeited/expired	(15,014)	$20.25
Options outstanding at September 30, 1998	**251,816**	**$19.84**
Granted/assumed*	52,576	$48.77
Exercised	(27,067)	$13.54
Forfeited/expired	(10,870)	$23.00
Options outstanding at September 30, 1999	**266,455**	**$26.06**

* *Includes options converted in acquisitions.*

(1) Includes options covering 51,013 shares of common stock granted under a broad-based employee plan at a weighted average exercise price of $11.15.

(2) Grants and forfeitures include options covering 23,039 and 25,598 shares of common stock exchanged or amended under pre-merger stock option repricing programs of a company acquired in a pooling-of-interests, at new exercise prices of $21.18 and $14.81, respectively.

(3) Includes options covering 32,355 shares of common stock granted under a broad-based employee plan at a weighted average exercise price of $37.34.

The weighted average fair value of Lucent stock options, calculated using the Black-Scholes option-pricing model, granted during the years ended September 30, 1999, 1998, and 1997 is $15.92, $12.26 and $3.65 per share, respectively.

The following table summarizes the status of stock options outstanding and exercisable at September 30, 1999:

	Stock Options Outstanding			Stock Options Exercisable	
Range of exercise prices	Shares (000s)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares (000s)	Weighted Average Exercise Price
$ 0.01 to $ 11.14	72,396[1]	6.7	$10.29	12,792	$ 7.42
$ 11.15 to $ 23.07	70,150[1]	7.5	16.59	31,110	15.52
$23.08 to $ 29.09	21,947	8.8	27.42	20,715	27.48
$29.10 to $ 40.87	60,567	8.9	35.15	9,005	34.78
$40.88 to $ 61.78	25,587	9.2	49.86	5,964	52.44
$61.79 to $102.48	15,808	9.9	65.08	72	67.37
Total	**266,455**		**$26.06**	**79,658**	**$22.32**

(1) Approximately 43,869 options granted under a broad-based employee plan became exercisable on October 1, 1999.

Other stock unit awards are granted under certain award plans. The following table presents the total number of shares of common stock represented by awards granted to employees for the years ended September 30, 1999, 1998, and 1997:

	Year Ended September 30, 1999	1998	1997
Other stock unit awards granted (000s)	532	1,730	8,756
Weighted average market value of shares granted during the period	$31.82	$22.23	$12.00

12. Operating Segments

Lucent adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," beginning with this Annual Report. This standard requires disclosure of segment information on the same basis used internally for evaluating segment performance and for deciding how to allocate resources to segments.

Lucent operates in the global telecommunications networking industry and has three reportable operating segments: Service Provider Networks ("SPN"), Enterprise Networks ("Enterprise"), and Microelectronics and Communications Technologies ("MCT"). SPN provides public networking systems and software to telecommunications service providers and public network operators around the world. Enterprise develops, manufactures, markets and services advanced communications products and data networking systems for business customers. MCT designs and manufactures high-performance integrated circuits, power systems and optoelectronic components for applications in the communications and computing industries. MCT also includes network products, new ventures and intellectual property.

The three reportable operating segments are strategic market units that offer distinct products and services. These segments were determined based on the customers and the markets that Lucent serves. Each market unit is managed separately as each operation requires different technologies and marketing strategies. Intersegment transactions that occur are based on current market prices and all intersegment profit is eliminated in consolidation.

Performance measurement and resource allocation for the reportable operating segments are based on many factors. The primary financial measure used is Operating income, exclusive of goodwill and existing technology amortization, and of purchased in-process R&D and other costs from business acquisitions (acquisition/integration-related costs).

Lucent employs shared service concepts to realize economies of scale and efficient use of resources. The costs of shared services, and other corporate center operations managed on a common basis, are allocated to the segments based on usage, where possible, or other factors based on the nature of the activity. The accounting policies of the reportable operating segments are the same as those described in the Summary of Significant Accounting Policies (see Note 2).

Reportable Segments

Year Ended 9/30/99	SPN	Enterprise	MCT	Other* & Corporate	Consolidated Totals
External revenues	$23,562	$8,559	$5,424	$ 758	$38,303
Intersegment revenues	183	195	1,318	(1,696)	–
Total revenues	23,745	8,754	6,742	(938)	38,303
Depreciation & amortization	690	134	489	493	1,806
Operating income/(loss)	4,563	616	944	(717)	5,406
Assets	16,939	3,884	4,095	13,857	38,775
Capital expenditures	675	266	707	567	2,215

Year Ended 9/30/98	SPN	Enterprise	MCT	Other* & Corporate	Consolidated Totals
External revenues	$19,108	$7,954	$4,628	$ 116	$31,806
Intersegment revenues	128	148	1,074	(1,350)	–
Total revenues	19,236	8,102	5,702	(1,234)	31,806
Depreciation & amortization	638	128	366	279	1,411
Operating income/(loss)	3,107	633	608	(1,710)	2,638
Assets	12,978	3,421	3,298	9,666	29,363
Capital expenditures	525	281	646	339	1,791

Year Ended 9/30/97	SPN	Enterprise	MCT	Other* & Corporate	Consolidated Totals
External revenues	$15,675	$6,257	$4,238	$ 1,441	$ 27,611
Intersegment revenues	136	130	905	(1,171)	–
Total revenues	15,811	6,387	5,143	270	27,611
Depreciation & amortization	730	218	332	219	1,499
Operating income/(loss)	1,517	668	549	(1,135)	1,599
Assets	9,057	2,486	2,928	10,535	25,006
Capital expenditures	447	202	686	409	1,744

**The results of other smaller units and corporate operations are reported in Other and Corporate, including eliminations of internal business. Assets included in Other and Corporate consist principally of cash and cash equivalents, deferred income taxes, and prepaid pension costs.*

Reconciling Items

A reconciliation of the totals reported for the operating segments to the applicable line items in the consolidated financial statements is as follows:

	Year Ended September 30, 1999	1998	1997
EXTERNAL REVENUES			
Total reportable segments	$37,545	$31,690	$26,170
Other operations	745	70	1,362
Corporate miscellaneous	13	46	79
Total revenues	$38,303	$31,806	$ 27,611
OPERATING INCOME			
Total reportable segments	$ 6,123	$ 4,348	$ 2,734
Acquisition/integration-related costs	(510)	(1,683)	(1,439)
Goodwill and existing technology amortization	(394)	(149)	(32)
Other and corporate	187	122	336
Operating income	5,406	2,638	1,599
Other income – net	443	128	97
Interest expense	(406)	(254)	(238)
Income before income taxes	$ 5,443	$ 2,512	$ 1,458

Notes to Consolidated Financial Statements

(dollars in millions, except per share amounts)

Products and Services Revenues

The table below presents external revenue for groups of similar products and services:

Year Ended 9/30	1999	1998	1997
Core Networking Systems[a]	$17,750	$14,412	$12,529
Wireless Products	5,516	4,456	2,984
Business Communications Systems[b]	6,977	6,399	5,077
Microelectronics	2,827	2,405	2,214
NetCare Professional Services	768	483	274
Other[c]	4,465	3,651	4,533
Totals	$38,303	$31,806	$27,611

(a) Core Networking Systems includes switching and access products, data networking systems for service providers, optical networking products, communications software and engineering services.

(b) Business Communications Systems includes advanced communications products and messaging services.

(c) "Other" principally includes network products.

Geographic Information

September 30,	External Revenues[a] Year Ended 1999	1998	1997	Long-Lived Assets[b] 1999	1998	1997
United States	$ 26,116	$23,513	$20,858	$6,244	$5,422	$4,696
Foreign countries	12,187	8,293	6,753	1,812	1,531	1,188
Totals	$38,303	$31,806	$ 27,611	$8,056	$6,953	$5,884

(a) Revenues are attributed to geographic areas based on the location of customers.

(b) Represents property, plant and equipment (net), and goodwill and existing technology.

Concentrations

Historically, Lucent has relied on a limited number of customers for a substantial portion of its total revenues. Revenues from AT&T Corp. accounted for approximately, 12%, 12% and 14% of consolidated revenues in the years 1999, 1998 and 1997, respectively, principally in the SPN segment. Lucent expects that a significant portion of its future revenues will continue to be generated by a limited number of customers. The loss of any of these customers or any substantial reduction in orders by any of these customers could materially and adversely affect Lucent's operating results. Lucent does not have a concentration of available sources of supply materials, labor, services or other rights that, if eliminated suddenly, could impact its operations severely.

13. Financial Instruments

The carrying values and estimated fair values of financial instruments, including derivative financial instruments were as follows:

	September 30, 1999 Carrying Amount	Fair Value	September 30, 1998 Carrying Amount	Fair Value
ASSETS				
Derivative and off-balance-sheet instruments:				
Foreign currency forward exchange contracts/options	$ 18	$ 17	$ 26	$ 4
Letters of credit	–	2	–	2
LIABILITIES				
Long-term debt[1] [2]	$4,083	$3,956	$2,408	$2,559
Derivative and off-balance-sheet instruments:				
Foreign currency forward exchange contracts/options	36	27	25	(4)

(1) Excluding long-term lease obligations of $79 at September 30, 1999 and $1 at September 30, 1998.

(2) For September 30, 1998 reflects the reclassification of debt maturing within one year to long-term debt as a result of the November 19, 1998 sale of $500 ($495 net of unamortized costs) of 10-year notes.

The following methods were used to estimate the fair value of each class of financial instruments:

Financial Instrument	Valuation Method
Long-term debt	Market quotes for instruments with similar terms and maturities
Foreign currency forward exchange contracts/ options	Market quotes
Letters of credit	Fees paid to obtain the obligations

The carrying amounts of cash and cash equivalents, investments, receivables and debt maturing within one year contained in the Consolidated Balance Sheets approximate fair value.

Credit Risk and Market Risk

By their nature, all financial instruments involve risk, including credit risk for non-performance by counterparties. The contract or notional amounts of these instruments reflect the extent of involvement Lucent has in particular classes of financial instruments. The maximum potential loss may exceed any amounts recognized in the Consolidated Balance Sheets. However, Lucent's maximum exposure to credit loss in the event of non-performance by the other party to the financial instruments for commitments to extend credit and financial guarantees is limited to the amount drawn and outstanding on those instruments.

Lucent seeks to reduce credit risk on financial instruments by dealing only with financially secure counterparties. Exposure to credit risk is controlled through credit approvals, credit limits and monitoring procedures. Lucent seeks to limit its exposure to credit risks in any single country or region.

All financial instruments inherently expose the holders to market risk, including changes in currency and interest rates. Lucent manages its exposure to these market risks through its regular operating and financing activities and when appropriate, through the use of derivative financial instruments.

Derivative Financial Instruments

Lucent conducts its business on a multinational basis in a wide variety of foreign currencies. Consequently, Lucent enters into various foreign exchange forward and option contracts to manage its exposure against adverse changes in those foreign exchange rates. The notional amounts for foreign exchange forward and option contracts represent the U.S. dollar equivalent of an amount exchanged. Generally, foreign currency exchange contracts are designated for firmly committed or forecasted sales and purchases that are expected to occur in less than one year. Gains and losses on all hedged contracts for firmly committed transactions and option contracts for anticipated transactions are deferred in Other current assets and liabilities, are recognized in income when the transactions occur, and are not material to the consolidated financial statements at September 30, 1999, and 1998. All other gains and losses on foreign currency exchange contracts are recognized in Other income – net as the exchange rates change.

Lucent engages in foreign currency hedging activities to reduce the risk that changes in exchange rates will adversely affect the eventual net cash flows resulting from the sale of products to foreign customers and purchases from foreign suppliers. Hedge accounting treatment is appropriate for a derivative instrument when changes in the value of the derivative instrument are substantially equal, but opposite, to changes in the value of the exposure being hedged. Lucent believes that it has achieved risk reduction and hedge effectiveness, because the gains and losses on its derivative instruments substantially offset the gains on the assets, liabilities and transactions being hedged. Hedge effectiveness is periodically measured by comparing the change in fair value of each hedged foreign currency exposure at the applicable market rate with the change in market value of the corresponding derivative instrument.

The following table summarizes the notional amounts of these derivative financial instruments in U.S. dollars. In 1999, these notional amounts principally represent contracts in Canadian dollars, Brazilian reals, Singapore dollars, British pounds and Euro currencies (primarily Dutch guilders and German marks). Notional amounts represent the face amount of the contractual arrangements and the basis on which U.S. dollars are to be exchanged and are not a measure of market or credit exposure.

	Notional Amounts September 30,	
	1999	1998
Foreign exchange forward contracts	$1,871	$1,518
Foreign exchange option contracts	$ 303	$ 130

Lucent may enter into certain interest rate swap agreements to manage its risk between fixed, floating and variable interest rates and long-term and short-term maturity debt instruments. There were no material interest rate swap agreements in effect during 1999 and 1998.

Non-derivative and Off-Balance-Sheet Instruments

Requests for providing commitments to extend credit and financial guarantees are reviewed and approved by senior management. Management regularly reviews all outstanding commitments, letters of credit and financial guarantees, and the results of these reviews are considered in assessing the adequacy of Lucent's reserve for possible credit and guarantee losses. At September 30, 1999, and 1998, in management's opinion, there was no significant risk of loss in the event of non-performance of the counterparties to these financial instruments.

The following table presents Lucent's non-derivative and off-balance-sheet instruments for amounts committed but not drawn-down and the amounts drawn-down on such instruments. These instruments may exist or expire without being drawn upon. Therefore, the amounts committed but not drawn-down do not necessarily represent future cash flows.

	Amounts Committed But Not Drawn-down September 30,		Amounts Drawn-down and Outstanding September 30,	
	1999	1998	1999	1998
Commitments to extend credit	$5,544	$2,086	$1,574	$536
Guarantees of debt	$ 108	$ 87	$ 312	$205

Commitments to Extend Credit

Commitments to extend credit to third parties are conditional agreements generally having fixed expiration or termination dates and specific interest rates and purposes.

Guarantees of Debt

From time to time, Lucent guarantees the financing for product purchases by customers and the debt of certain unconsolidated joint ventures. Requests for providing such guarantees are reviewed and approved by senior management. Certain financial guarantees are backed by amounts held in trust for Lucent or assigned to a third-party reinsurer.

Letters of Credit

Letters of credit are purchased guarantees that ensure Lucent's performance or payment to third parties in accordance with specified terms and conditions which amounted to $931 and $805 as of September 30, 1999 and 1998, respectively.

Securitization

In September 1999, a subsidiary of Lucent sold approximately $625 of accounts receivable to a non-consolidated qualified special purpose entity ("QSPE") which, in turn, sold an undivided ownership interest in these receivables to entities managed by an unaffiliated financial institution. Additionally, Lucent transferred a designated pool of qualified accounts receivable of approximately $700 to the QSPE as collateral for the initial sale. Lucent's retained interest in the QSPE's designated pool of qualified accounts receivable has been included in Receivables. Lucent will continue to service, administer and collect the receivables on behalf of the purchaser. The impact of the above transaction reduced Receivables and increased cash flows from operating activities in the Consolidated Statements of Cash Flows by $600.

14. Commitments and Contingencies

In the normal course of business, Lucent is subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to environmental and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at September 30, 1999, cannot be ascertained. While these matters could affect the operating results of any one quarter when resolved in future periods and while there can be no assurance with respect thereto, management believes that after final disposition, any monetary liability or financial impact to Lucent beyond that provided for at September 30, 1999, would not be material to the annual consolidated financial statements.

In connection with the formation of Lucent from certain units of AT&T Corp. and the associated assets and liabilities of those units (the "Separation") and AT&T's distribution of its remaining interest in Lucent to its shareowners (the "Distribution"), Lucent, AT&T and NCR Corporation executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996, as amended and restated (the "Separation and Distribution Agreement"), and certain related agreements. The Separation and Distribution Agreement, among other things, provides that Lucent will indemnify AT&T and NCR for all liabilities relating to Lucent's business and operations and for all contingent liabilities relating to Lucent's business and operations or otherwise assigned to Lucent. In addition to contingent liabilities relating to the present or former business of Lucent, any contingent liabilities relating to AT&T's discontinued computer operations (other than those of NCR) were assigned to Lucent. The Separation and Distribution Agreement provides for the sharing of contingent liabilities not allocated to one of the parties, in the following proportions: AT&T: 75%, Lucent: 22%, and NCR: 3%. The Separation and Distribution Agreement also provides that each party will share specified portions of contingent liabilities related to the business of any of the other parties that exceed specified levels.

Environmental Matters

Lucent's current and historical operations are subject to a wide range of environmental protection laws. In the United States, these laws often require parties to fund remedial action regardless of fault. Lucent has remedial and investigatory activities under way at numerous current and former facilities. In addition, Lucent was named a successor to AT&T as a potentially responsible party ("PRP") at numerous "Superfund" sites pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") or comparable state statutes. Under the Separation and Distribution Agreement, Lucent is responsible for all liabilities primarily resulting from or relating to the operation of Lucent's business as conducted at any time prior to or after the Separation including related businesses discontinued or disposed of prior to the Separation, and Lucent's assets including, without limitation, those associated with these sites. In addition, under such Separation and Distribution Agreement, Lucent is required to pay a portion of contingent liabilities paid out in excess of certain amounts by AT&T and NCR, including environmental liabilities.

It is often difficult to estimate the future impact of environmental matters, including potential liabilities. Lucent records an environmental reserve when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. This practice is followed whether the claims are asserted or unasserted. Management expects that the amounts reserved will be paid out over the periods of remediation for the applicable sites, which typically range from 5 to 30 years. Reserves for estimated losses from environmental remediation are, depending on the site, based primarily on internal or third-party environmental studies, and estimates as to the number, participation level and financial viability of any other PRPs, the extent of the contamination and the nature of required remedial actions. Accruals are adjusted as further information develops or circumstances change. The amounts provided for in Lucent's consolidated financial statements for environmental reserves are the gross undiscounted amount of such reserves, without deductions for insurance or third-party indemnity claims. In those cases where insurance carriers or third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts are reflected as receivables in the financial statements. Although Lucent believes that its reserves are adequate, there can be no assurance that the amount of capital expenditures and other expenses which will be required relating to remedial actions and compliance with applicable environmental laws will not exceed the amounts reflected in Lucent's reserves or will not have a material adverse effect on Lucent's financial condition, results of operations or cash flows. Any possible loss or range of possible loss that may be incurred in excess of that provided for at September 30, 1999, cannot be estimated.

Lease Commitments

Lucent leases land, buildings and equipment under agreements that expire in various years through 2020. Rental expense under operating leases was $545, $425 and $335 for the years ended September 30, 1999, 1998 and 1997, respectively. The table below shows the future minimum lease payments due under non-cancelable leases at September 30, 1999. Such payments total $1,509 for operating leases. The net present value of such payments on capital leases was $81 after deducting imputed interest of $15.

	Year Ended September 30,					
	2000	2001	2002	2003	2004	Later Years
Operating leases	$321	$265	$200	$163	$114	$446
Capital leases	2	41	20	20	13	–
Minimum lease payments	$323	$306	$220	$183	$127	$446

15. Subsequent Events

International Network Services

On October 15, 1999, Lucent merged with International Network Services ("INS"), a global provider of network consulting, design and integration. Pursuant to the merger agreement, the outstanding INS stock was converted into the right to receive approximately 49 million shares of Lucent common stock. In addition, Lucent assumed outstanding employee stock options covering approximately 16 million shares of Lucent common stock. The transaction will be accounted for as a pooling-of-interests.

Excel Switching Corporation

On November 3, 1999, Lucent merged with Excel Switching Corporation, a Hyannis, Massachusetts-based developer of programmable switches. Under the terms of the agreement, the outstanding Excel stock was converted into the right to receive approximately 22.3 million shares of Lucent common stock. The transaction will be accounted for as a pooling-of-interests.

Xedia Corporation

On November 12, 1999, Lucent merged with Xedia Corporation, a privately held Acton, Massachusetts-based maker of routers for corporate networks. Under the terms of the agreement, the outstanding Xedia capital stock and warrants were converted into the right to receive approximately 3.86 million shares of Lucent common stock. The transaction will be accounted for as a pooling-of-interests.

(dollars in millions, except per share amounts)

16. Quarterly Information (unaudited)

YEAR ENDED SEPTEMBER 30, 1999	First	Second	Third	Fourth	Total
	Fiscal Year Quarters				
Revenues	$ 9,741	$8,672	$9,315	$10,575	**$38,303**
Gross margin	5,159	4,178	4,481	4,797	**18,615**
Income before cumulative effect of accounting change	1,231[a]	529[b]	750[c]	948[d]	**3,458**[a,b,c,d]
Cumulative effect of accounting change	1,308	–	–	–	**1,308**
Net income	$ 2,539[a]	$ 529[b]	$ 750[c]	$ 948[d]	**$ 4,766**[a,b,c,d]
Earnings per common share – basic:					
Income before cumulative effect of accounting change	$ 0.41[a]	$ 0.17[b]	$ 0.25[c]	$ 0.31[d]	**$ 1.14**[a,b,c,d]
Cumulative effect of accounting change	0.43	–	–	–	**0.43**
Net income	$ 0.84[a]	$ 0.17[b]	$ 0.25[c]	$ 0.31[d]	**$ 1.57**[a,b,c,d]
Earnings per common share – diluted:					
Income before cumulative effect of accounting change	$ 0.40[a]	$ 0.17[b]	$ 0.24[c]	$ 0.30[d]	**$ 1.10**[a,b,c,d]
Cumulative effect of accounting change	0.42	–	–	–	**0.42**
Net income	$ 0.82[a]	$ 0.17[b]	$ 0.24[c]	$ 0.30[d]	**$ 1.52**[a,b,c,d]
Dividends per share	$ 0.04	$ 0.00	$ 0.02	$ 0.02	**$ 0.08**
Stock price:[i]					
High	56 15/16	60	68 11/16	79 3/4	**79 3/4**
Low	26 23/32	47	51 7/8	60	**26 23/32**
Quarter-end close	54 31/32	54	67 7/16	64 7/8	**64 7/8**

YEAR ENDED SEPTEMBER 30, 1998	First	Second	Third	Fourth	Total
Revenues	$ 9,079	$ 6,511	$7,642	$ 8,574	$31,806
Gross margin	4,447	2,958	3,555	4,131	15,091
Net income (loss)	877[e]	88[f]	(150)[g]	220[h]	1,035[e,f,g,h]
Earnings (loss) per common share – basic	$ 0.30[e]	$ 0.03[f]	$ (0.05)[g]	$ 0.07[h]	$ 0.35[e,f,g,h]
Earnings (loss) per common share – diluted	$ 0.29[e]	$ 0.03[f]	$ (0.05)[g]	$ 0.07[h]	$ 0.34[e,f,g,h]
Dividends per share	$0.0375	$ 0.00	$ 0.02	$ 0.02	$0.0775
Stock price:[i]					
High	22 35/64	32 1/16	41 27/32	54 1/4	54 1/4
Low	18 3/32	18 23/64	32	34 3/16	18 3/32
Quarter-end close	19 31/32	31 31/32	41 19/32	34 5/8	34 5/8

(a) As a result of the 1999 acquisitions of Quadritek and Stratus, Lucent recorded an after-tax charge of $281 in the first quarter for purchased in-process research and development.

(b) As a result of the 1999 acquisitions of WaveAccess, Enable Ethernet, and Sybarus, Lucent recorded an after-tax charge of $15 in the second quarter for purchased in-process research and development. In addition, $24 of Stratus purchased in-process research and development was reversed.

(c) As a result of the merger with Ascend, Lucent recorded a charge to operating expenses of approximately $79 million (non-tax impacting) in the third quarter for direct merger related costs.

(d) As a result of the mergers with Ascend and Nexabit, Lucent recorded pretax costs of $258 million ($191 million after-tax) in the fourth quarter primarily associated with assets impairments, integration-related charges and merger expenses. These costs principally include the write-off of Livingston goodwill and existing technology, certain product and system integration and direct merger expenses related to Nexabit.

(e) As a result of the 1998 acquisition of Livingston, Lucent recorded a non-tax charge of $427 in the first quarter for purchased in-process research and development.

(f) As a result of the 1998 acquisition of Prominet, Lucent recorded a non-tax charge of $157 in the second quarter for purchased in-process research and development.

(g) As a result of the 1998 acquisitions of Yurie and Optimay, Lucent recorded a non-tax charge of $668 in the third quarter for purchased in-process research and development.

(h) As a result of the 1998 acquisitions of SDX, MassMedia, LANNET, JNA and Stratus, Lucent recorded a charge of $431 ($427 after-tax) in the fourth quarter for purchased in-process research and development.

(i) Obtained from the Composite Tape. Stock prices have been restated to reflect the two-for-one splits of the Company's common stock effective April 1, 1998, and April 1, 1999.

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Information

For Our Investors

Shareowner Hotline

If you are a registered shareowner and have a question about your account, or you would like to report a change in your name or address, please call Lucent's shareowner services and transfer agent, The Bank of New York, toll-free at 1 888 LUCENT6 (1 888 582-3686). If you are outside the United States, call collect at 908 769-9611. If you use a telecommunications device for the deaf (TDD) or a teletypewriter (TTY), call 1 800 711-7072. Customer service representatives are available Monday through Friday from 8 a.m. to 6 p.m. Eastern time. Shareowners also may send questions electronically to the e-mail address at The Bank of New York: lu-shareholders-svcs@email.bony.com

Or you may write to:
Lucent Technologies
c/o The Bank of New York
P. O. Box 11009
Church Street Station
New York, NY 10286-1009

Annual Shareowners' Meeting

The 2000 annual meeting of shareowners will be held Wednesday, Feb. 16, 2000, at 9 a.m., in the Jewett Ballroom of the Oakland Marriott City Center, 1001 Broadway, Oakland, Calif. 94607. As a convenience, shareowners of record may vote their proxies via the Internet at http://proxy.shareholder.com/lu. Or to vote by phone, call toll-free 1 800 480-0407. If a brokerage firm holds your shares, you also may be eligible to vote over the Internet or by telephone. To find out how, please consult the information from your broker.

Quarterly Earnings

Lucent usually reports its earnings during the latter part of January, April, July and October.

Dividend Reinvestment Plan

The BuyDIRECT* dividend reinvestment and direct stock purchase plan provides a convenient way to reinvest dividends and purchase initial/additional shares of Lucent stock. You may call The Bank of New York directly at 1 888 LUCENT6 (1 888 582-3686) for a plan brochure and enrollment form, or write directly to the address above. Also, please visit The Bank of New York's Web site to view the plan brochure online or to download an enrollment form: http://stock.bankofny.com/lucent

Direct Deposit of Dividends

The Bank of New York offers its registered shareowners, at no charge, the option of having dividends deposited directly into their checking or savings accounts at any financial institution participating in the Automated Clearing House system. To sign up for this service, please call The Bank of New York at 1 888 LUCENT6 (1 888 582-3686).

Stock Data

Lucent stock is traded in the United States on the New York Stock Exchange under the ticker symbol LU. Shares outstanding as of Oct. 1, 1999: 3,071,784,797. Shareowners of record as of Oct. 1, 1999: 1,749,384.

Copies of Reports

If you would like to order additional copies of this report, please call 1 888 LUCENT6 (1 888 582-3686). To view this report and investor highlights online, or to order copies of our latest filings with the U.S. Securities and Exchange Commission, please visit our Investor Relations Web site at: http://www.lucent.com/investor

Other Information

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For information about products and services, call our special toll-free number: 1 888 4LUCENT (1 888 458-2368).

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