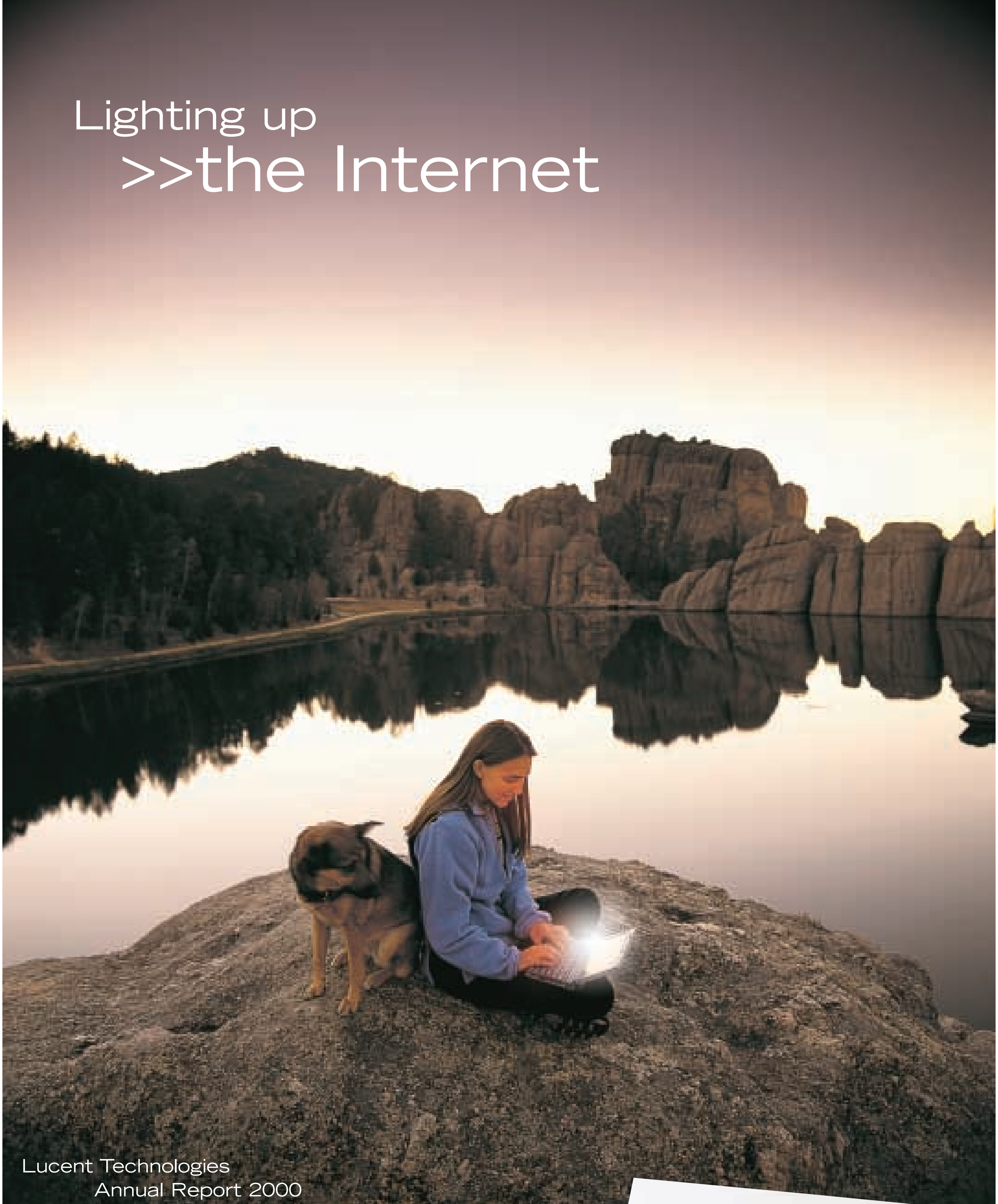
Lighting up
>>the Internet



Lucent Technologies
Annual Report 2000

Lighting up
>>the Internet

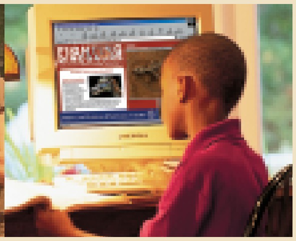
lu2000

Lucent is lighting up a new kind of Internet. The new Internet will be broadband, a high-speed network of glass and light that will open the door to the rich applications of tomorrow and allow people the world over to communicate without limit.

The new Internet will be mobile, letting users on the go tap the power of the World Wide Web from 'Net phones and other wireless devices. E-business, e-entertainment and e-education will be enriched and will enrich their users.

We're also building a new Lucent, a revitalized company intent on seizing the vast opportunities of the emerging e-world.

In the following pages, you'll learn how Lucent is a global powerhouse in the technologies that will underpin the next-generation Internet. Our triple play of optical, data and wireless networking—with the software and the services to support them—will help bring to life the new networks and services that will change people's lives.



Henry B. Schacht Chairman and Chief Executive Officer

2000 Financial Highlights[a]

Lucent Technologies Inc. and Subsidiaries

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

OPERATIONS	Year ended 9/30/00 (b)	Year ended 9/30/99 (c)	Change
Revenues	$33,577	$29,910	12.3%
Gross margin	14,166	14,802	(4.3%)
Selling, general and administrative	5,573	5,118	8.9%
Research and development	4,007	4,158	(3.6%)
Operating income	4,586	5,526	(17.0%)
Income from continuing operations, net	3,093	3,593	(13.9%)
Earnings per share from continuing operations – diluted	$ 0.93	$ 1.12	(17.0%)
FINANCIAL POSITION			
Total assets	$48,792	$35,372	37.9%
Working capital	10,613	10,090	5.2%
Shareowners' equity	26,172	13,936	87.8%
OTHER INFORMATION			
Capital expenditures	$ 2,701	$ 2,042	32.3%
Return on assets	8.7%[d]	12.2%[d]	(3.5 points)
Debt to total capital	20.0%	29.6%	(9.6 points)
Stock price	$ $30\frac{1}{2}$	$ $64\frac{7}{8}$	(53.0%)

(a) All results have been restated to reflect the September 30, 2000, spinoff of the Enterprise Networks business (Avaya Inc.).

(b) Excludes the impact of a $189 gain associated with the sale of an equity investment; $551 amortization of goodwill and other acquired intangibles; charge of $61 to operating expenses primarily associated with the mergers with International Network Services, Excel Switching Corporation and Xedia Corporation; $1,005 of purchased in-process research and development (IPRD) costs associated with the acquisitions of Spring Tide Networks, Chromatis Networks, Herrmann Technology, Ortel Corporation, Agere, Inc., and VTC Inc.; and the results of the Consumer Products business sold in fiscal 2000. Including the impact of these items, Lucent reported income from continuing operations of $1,681 and diluted earnings per share from continuing operations of $0.51.

(c) Excludes the impact of a $274 gain associated with the sale of an equity investment; $310 amortization of goodwill and other acquired intangibles, which includes a $109 write-off of Livingston goodwill and other acquired intangibles; $110 of merger-related costs; $127 of integration-related charges associated with pooling acquisitions; $292 of IPRD costs associated with the acquisitions of Stratus Computer, Inc., XNT Systems, Inc., Quantum Telecom Solutions, Inc., InterCall Communications and Consulting, Inc., Quadritek Systems, Inc., WaveAccess Ltd., Sybarus Technologies, and the Ethernet local area network component business of Enable Semiconductor; and the results of the Consumer Products business sold in fiscal 2000. Including the impact of these items, Lucent reported income from continuing operations of $3,026 and diluted earnings per share from continuing operations of $0.94.

(d) Return on assets is calculated by dividing income from continuing operations, which excludes the impact of items in notes (b) and (c) for the years ended September 30, 2000 and 1999, respectively, by the average ending total asset balance. The average ending total asset balance excludes goodwill and other acquired intangibles and net assets from discontinued operations.

>> To Our Shareowners:

This was a tough year for Lucent Technologies.

While a number of factors contributed to the company's financial performance in fiscal year 2000, clearly, missing a major growth opportunity in the optical networking market with our OC-192 product was a big setback. As a result, we saw less-than-expected revenues and lower gross margins in our optical networking business—which makes the high-speed networks that help service providers move phone calls, video, e-mail messages, Web pages and other data around the world on beams of laser light.

We also saw a greater-than-anticipated decline in circuit switching sales and margins, which was not offset by growth in other areas of the business.

In addition, we had other issues of execution and focus. In late October, the Lucent board of directors concluded that a different set of skills was needed to address the company's challenges. I agreed to assume the duties of chairman and chief executive officer and to work to address those challenges.

As I have said to the people of Lucent, this is a time to look forward, not back. Lucent is blessed with a great many strengths and opportunities.

Our strengths include world-class technology, industry-leading products and services, deep customer relationships and the best people in the industry.

The marketplace is rich with opportunities that play directly to our strengths. The issues we face are ones of execution and focus, and they are fixable.

We view 2001 as a transition year, a year for us to fix our business and position it for long-term growth.

By the end of the second fiscal quar-

Lucent has all the building blocks of tomorrow's Internet—a triple play of data, optical and wireless solutions, supported by professional services and software.

ter of 2001, we expect to make the initial public stock offering for Agere Systems, which is the new name of our microelectronics business.* Later in the year, we expect to distribute the remaining shares in a tax-free distribution. This spinoff will enable us to fully focus our business on delivering the next-generation Internet—an Internet that will be faster, more reliable, richer in content, more widely available, more mobile and with more capacity than any network before it.

We are aggressively investing in solutions for next-generation networks for customers and in the technologies that will power the broadband and mobile Internet, including Internet infrastructure, optical networking and next-generation wireless systems. We will continue to expand into global markets even as we restructure our business for growth.

We have launched a number of key operational initiatives to improve execution, reduce complexity and increase efficiencies. We are examining our product portfolio to streamline our offerings and ensure profitability. We are deploying resources to exploit the highest-value opportunities, and we are aligning marketing and sales resources closer to customers. We are consolidating Lucent's corporate infrastructure to reflect a more streamlined business, and we are removing impediments to the swift delivery of new products from Bell Labs to the marketplace.

In many ways, I view this as a rebirth

QSC AG, Germany's leading alternative service provider of digital subscriber line broadband infrastructure and applications, is one of the first to deploy the latest compact version of our STINGER™ product, which enables high-speed communications over ordinary phone lines. Here, an executive in Nuremberg checks e-mail.

of Lucent, a Lucent recommitted to the mission that we articulated when we launched the company five years ago:

"To provide our customers with the world's best and most innovative communications systems, products, technologies and customer support.

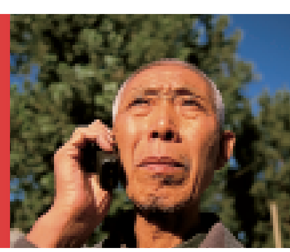
"Powered by excellent people and technology, we will be a customer-driven, high-performance company that delivers superior, sustained shareowner value."

Financial Summary

For the fiscal year ended September 30, 2000, pro forma revenues from continuing operations rose 12.3 percent over fiscal year 1999, to $33.6 billion. Pro forma earnings per share from continuing operations–diluted were $0.93, a decrease of 17.0 percent from last year. (Pro forma results are explained in notes *b* and *c* of the 2000 Financial Highlights table on page 1.)

Revenues from our Service Provider

** This does not constitute an offering of any securities, which will be made only by a prospectus filed with the U.S. Securities and Exchange Commission.*



Networks Group, which will remain at the heart of Lucent as we move ahead with restructuring, increased 6.8 percent, to $26.5 billion, driven by growth in our service provider Internet infrastructure, wireless systems and professional services.

Revenues from our Microelectronics and Communications Technologies Group rose 38.3 percent, to $7.0 billion, reflecting growth in optical fiber, optoelectronic components, power systems, wired and wireless local area network systems, and customized chips for computing and high-speed communications systems.

On September 30, 2000, we completed the spinoff of our Enterprise Networks business, which is now known as Avaya Inc., and have accounted for the financial results of that business as discontinued operations. The results from discontinued operations for the fiscal year were a net loss of $462 million.

Rebuilding and Refocusing the Business

Despite our financial performance, we are encouraged by a number of positive developments in fiscal 2000. For example, we saw significant revenue growth in four areas: Internet infrastructure, wireless systems, professional services and optical fiber.

Going forward, the business will move increasingly toward the high-growth areas of the new economy. As we completed fiscal year 2000, more than 65 percent of

Lucent's next-generation optical networking equipment will help Beijing Telecom connect millions of customers such as this Web surfer at an Internet café in China's capital city of Beijing. Lucent products include the WaveStar™ TDM 10G system, which will increase the capacity of Beijing Telecom's network.

We're helping Verizon Wireless increase network capacity and add next-generation services, giving customers access to information from wherever they are. Above, a business traveler uses the carrier's Mobile Web service to get last-minute information before a flight.

our business—in optical, data and wireless systems, software, and professional services—was generated in markets growing more than 18 percent annually.

In addition, as we make the transition to new technologies such as the next generation of optical networking and mobile systems, we expect that the opportunities for wireless, optical and Internet infrastructure will eventually be larger than for circuit switching. We also are leveraging our strong position in circuit switching to provide a bridge to next-generation converged networks.

We announced several moves this year to strengthen our focus on the service provider market. The Avaya spinoff, the announced sale of our power systems business and the expected spinoff of Agere Systems will enable us to fully focus on building the broadband and mobile Internet. (See pages 8 and 11 for overviews of Avaya and Agere Systems, respectively.)

We've added key technologies and people by acquiring industry-leading companies in the service provider space, such as Spring Tide Networks for network switching equipment and Chromatis Networks for fast-growing metropolitan optical networking systems.

We're entering new markets such as the CyberCarrier space, helping emerging service providers connect data centers to businesses via high-speed optical links. We created a new product group focused on Internet content delivery and distribution with the goal of improving the Internet experience for users.

We're expanding in high-growth areas. We significantly increased our manufacturing capacity in optical networking in the past year, and we are in the midst of a $1 billion investment to add capacity to our optical fiber manufacturing worldwide. We're also gaining ground in the international marketplace, scoring wins in optical, wireless, data networking and software in China, Australia, Brazil, Sweden, Germany and elsewhere.

We've consolidated our customer-facing operations under Vice Chairman Ben Verwaayen, and product organizations and operations under Executive Vice President Bob Holder. We were able to attract Debby Hopkins as our new chief financial officer and have moved chief information officer and process responsibilities to her position.

And we're honing our approach for the new Internet, focusing on a triple play of optical, data and wireless solutions, with the software and services to support them, as we deliver end-to-end solutions to our customers.

As the optical and mobile Internet unfolds, as the demand for data networking solutions skyrockets, Lucent is poised to light the way with a comprehensive optical networking portfolio.

Lighting Up the Internet

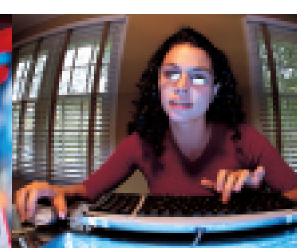
To refocus and energize our optical networking efforts, we've created two business units to address the needs of customers for network products in the high-speed core, as well as for products that route Internet, voice and data traffic along fiber-optic lines to businesses and residential customers in metropolitan areas. "Metro" is one of the fastest growing areas of optical networking—it's expected to more than triple in size by 2003, according to industry sources.

Lucent was first to market with a dense wavelength division multiplexing (DWDM) system in 1995 and has since shipped more DWDM systems than any other vendor. We signed a three-year, multimillion-dollar contract with Germany's Deutsche Telekom for our DWDM solution to build a high-speed optical network across Germany.

In a technology breakthrough from Bell Labs, we announced the world's first high-capacity all-optical switch. The WaveStar LAMBDAROUTER™ can direct 10 times the traffic of today's worldwide Internet in one second. Global Crossing has begun network testing of the new switch.

To date, we have 15 customers for our new 10-gigabit (10G) optical networking products—which can send about 2 million one-page e-mail messages between New York and San Francisco in one second. Our 10G successes include BT and Global Crossing.

Lucent's location-based software will help Australia's third largest service provider, AAPT, establish itself in the mobile market. AAPT customers, like this tour guide, will be able to access personalized information from their mobile handsets.



As Lucent lays the foundation for tomorrow's wireless networks, mobile services that span industries—from education to entertainment, from commerce to health care—will soon be indispensable in our daily lives.

Looking to the next generation of optical networking, we have been working closely with incumbent and leading-edge emerging carriers on the testing and development of our 40-gigabit (40G) optical systems, which are four times faster than today's commercially available counterparts. We plan to make our next-generation 40G systems available to customers in 2001.

China's mobile communications market, currently at 70 million subscribers and expected to grow more than 50 percent a year over the next three to five years, represents a great opportunity for Lucent. We signed a third GSM contract with Liaoning Unicom to expand its network to cover 12 cities, bringing mobile service to 1.35 million subscribers, like this shopper at a vegetable market in Liaoning Province.

Lucent Worldwide Services and Microsoft have teamed up to roll out the software giant's Windows® 2000 operating system to customers. Key players on the project include, from left, Ken Gaddis, Microsoft network specialist, and Lucent's Wendy Mattaini, network engineer, and James Ange, business development director.

Building a More Powerful Internet

Lucent is the market leader in Internet infrastructure for service providers. Our systems are hard at work in virtually all the world's largest service providers' networks.

In fiscal year 2000, we extended our leadership in the Internet infrastructure arena. In addition to our acquisitions of Chromatis Networks and Spring Tide Networks, we merged with Excel Switching and Xedia Corporation, each adding muscle to our strong product portfolio.

In all, we added more than 20 new products and enhancements to our Internet infrastructure portfolio in 2000. Customers welcomed our newest offerings, such as the STINGER DSL access concentrator, which allows high-speed Internet access over ordinary phone lines. In just one year, STINGER systems have been purchased by more than 75 service providers in 15 countries, and we've shipped more than 12,000 systems to date.

Other new products include our APX 8000™ multiservice access switch for service providers, which packs more circuits into less space than any currently available competitor's offering and supports any voice or data access service. At the high-speed network core, we added new capabilities to our GX 550™ multiservice wide area network switch.

Two of our new Internet infrastructure customers are Sprint and Omniplex, for which a broad array of our products will deliver a high-speed network to bring voice, data and Internet services to business customers. This is a good example of the ways we're capitalizing on innovations from Bell Labs, as well as on those from acquisitions such as Ascend Communications and Spring Tide Networks.

Our next-generation 7R/E™ packet switching solution helps service providers transition from circuit to packet switching. It puts voice on packets, yet captures everything voice networks do best, including delivering any of 3,000 networking and calling features.

Creating a Mobile Internet

The new Internet will be mobile, using third-generation (3G) wireless technology. 3G means high-speed wireless data capabilities, increased capacity and faster Internet access.

Lucent is the leading wireless provider in North America, offering customers solutions for all major standards. In the 3G arena, we're helping customers merge wireless and Internet services into offerings for businesses and consumers. We also launched the Ocelot™ software system, which boosts the capacity and coverage of current and 3G wireless networks.

In fiscal year 2000, we signed 18 multiyear contracts with customers. For example, we have agreements with Verizon Wireless (two-year contract valued at up to $1.5 billion), Leap (five-year contract valued at approximately $900 million) and Telecom New Zealand (five-year contract valued at $100 million). We announced agreements with JIGAMI Corporation and MapInfo to develop applications and services, and with Sanyo for handset compatibility, for the mobile Internet. In Germany, we helped wireless operator T-Mobil introduce high-speed mobile Internet service in record time.

Software: The Engine for New Services

In the new economy, innovative services—quickly developed, efficiently supported and rapidly deployed—will separate market leaders from also-rans.

Our software applications are helping service providers merge their voice and data businesses to create seamless new networks. For example, more than 40 customers are now using our Softswitch to help manage growing Internet and data traffic. Sprint selected the product as part of a $200 million contract.

Windows is a registered trademark of Microsoft Corporation.

Avaya at a Glance

Employees:
Approximately 30,000 worldwide

Location:
Headquarters in Basking Ridge, N.J.

Leadership:
Don Peterson, president and CEO

Revenues:
Approximately $7.6 billion
(FY 2000, as reported)

Portfolio:
Communications systems, software and services for enterprises; voice, converged voice and data; customer relationship management; messaging; multiservice networking; and structured cabling products

Market Leadership:
World's leading supplier in voice messaging and a leader in customer relationship management/call centers; a leader in the United States in enterprise voice switching systems; a worldwide leader in voice services; more than 78 percent of the *Fortune* 500 as customers; more than 1.5 million user sites in 90 countries; almost a half-million businesses with service agreements

Key Markets:
IP telephony; virtual private networks; Gigabit Ethernet; unified communications; customer relationship management solutions; network software; professional and value-added services

We're increasingly designing our software into one-stop shopping suites and making it modular to operate in networks with other vendors' products. Lucent's products offer carriers exceptional billing, customer care and network management support. Our PacketIN portfolio provides Internet protocol network operators with the revenue-generating voice services their customers demand, along with next-generation services that capitalize on the strengths of the Internet.

Our software helps customers make the mobile Internet, e-commerce and unified communications a reality.

Customers of Cavalier Telephone of Richmond, Va., no longer need to miss phone calls while surfing the Web. Our Online Communications Center application gives business and residential customers, like the one shown here, options for answering and forwarding calls received while connected to the Internet—all over one phone line.

Services: A Key Competitive Advantage

As part of our reorganization to serve our customers better and to meet the challenges we face, we have consolidated all our services businesses into a single organization called Lucent Worldwide Services.

The move creates a complete services organization capable of meeting all the needs of our customers—with offerings that range from maintenance, installation, testing and service activation to planning and designing the complex, integrated, multivendor networks of the new economy.

Our services business serves more than 10,000 clients worldwide, including more than half of the *Fortune* 100 companies, one-third of the *Fortune* 1000, and a major share of established and emerging telecommunications service providers.

A recent alliance with IBM Global Services allows us to help emerging service providers, called CyberCarriers, to speed next-generation network-based services to enterprises and consumers. According to industry sources, CyberCarriers are expected to spend $130 billion on data centers and infrastructure over the next three years—about half for professional services.

Bell Labs: 75 Years of Innovation

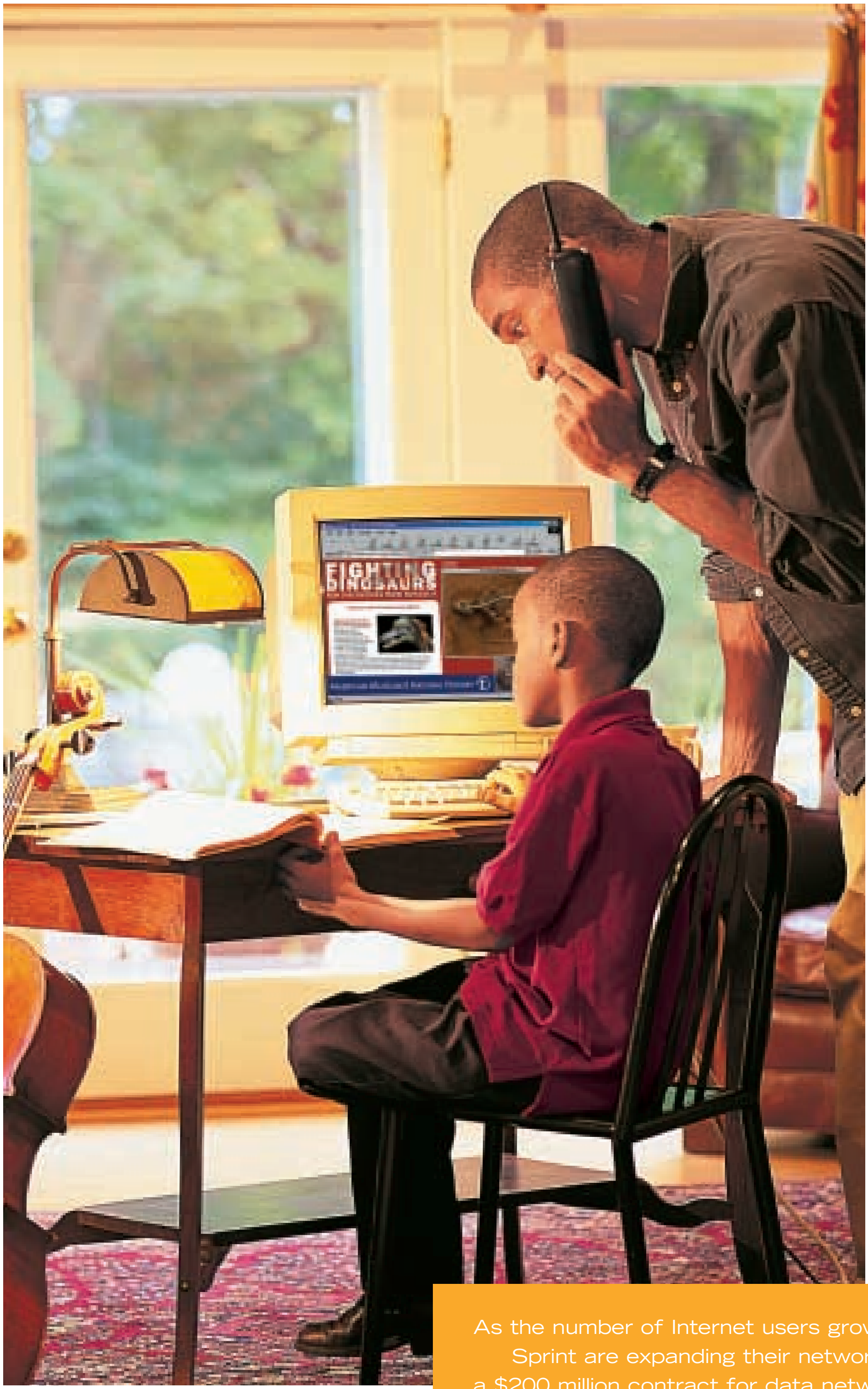
Our research and development powerhouse, Bell Labs, supports all of the above efforts. The year 2000 marked the Labs' 75th anniversary as an innovator in communications technology and scientific research.

With nearly 6,000 network engineers and consultants in almost 70 countries, Lucent Worldwide Services handles virtually all the tasks needed to keep complex networks humming.

Our scientists achieved a number of breakthroughs in communications research. They set a world record for long-distance data transmission when they sent 3.28 trillion bits of data a second over 300 kilometers of a single Lucent TrueWave® fiber. Bell Labs scientists also devised a technique for transmitting 3-D images that is 12 times more efficient than the standard approach.

Bell Labs researchers teamed up with Oxford University colleagues to build tiny motors based on DNA, the chemical that stores the genetic code of living things.

Lucent developers Teri LaRochelle (left) and Vineet Mehta test the next-generation multiservice 10G Metro optical networking system. Metro deploys fiber-optic technology in networks of Internet service providers, thereby relieving bottlenecks.



These DNA motors, resembling tweezers, are 1/1000th the size of the head of a pin. They could someday be used to assemble very tiny electronic circuitry.

Bell Labs continues to cut the time it takes to get new technologies into customers' hands—the LAMBDAROUTER optical switch took 16 months to develop, the WaveStar OLS 400G 14 months, and the PathStar™ access server 12 months.

Serving Our Communities

The Lucent Technologies Foundation, which supports 10 major education initiatives, is dedicated to helping young people from early childhood through high school reach their highest potential.

Our initiatives include the Global Science Scholars Program, which awards scholarships and internships to high school students in the United States and first-year engineering students around the world. It also provides these students with mentoring by Lucent scientists.

The Science Literacy Program promotes early interest in science, math and technology in public schools and science centers around the world.

The Lucent Technologies Foundation also helps women and minorities by providing opportunities and encouragement for them to pursue studies in science and engineering. And our matching gifts program provides a dollar-for-dollar match for the donations employees make to education, the arts and cultural organizations.

As the number of Internet users grows, service providers such as Sprint are expanding their networks. Lucent and Sprint signed a $200 million contract for data networking equipment, including our APX 8000 multiservice access switch and our Softswitch. Here, a father and son use the Internet to complete a homework assignment.

Bell Labs celebrated its 75th anniversary as a global technology powerhouse in 2000. Two-thirds of its researchers are developing next-generation software and applications.

Regaining Momentum

Clearly, Lucent Technologies faces a number of challenges as we strive for leadership in building networks for the new economy. The people of Lucent remain steadfast and dedicated to building a high-performance company and delivering consistent, sustainable, profitable growth that produces superior shareowner value. We are proud of our company and confident in its future.

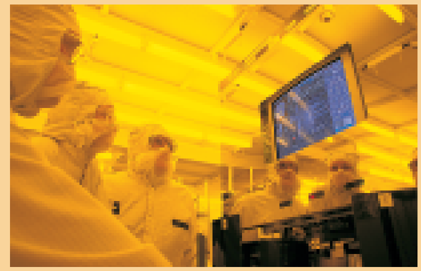
The talent and dedication of our people, combined with the power of Bell Labs' innovations, give us a unique competitive advantage that we intend to unleash in the coming year by concentrating on executing on behalf of our customers.

The market is strong, and there is solid customer acceptance of our products and services. We continue to innovate, launching new products and services to help our customers win in the marketplace. We will step up the pace of delivering these innovative technologies as we focus the new Lucent on the broadband and mobile Internet and strive to regain our momentum in the year ahead.

Henry B. Schacht
Chairman and Chief Executive Officer

December 21, 2000

Agere Systems at a Glance



Employees:
Approximately 16,500 worldwide

Location:
Central campus in Lehigh Valley, Pa., and 82 offices worldwide

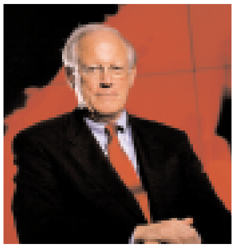
Leadership:
John Young, chairman
John Dickson, president and CEO

Revenues:
$3.7 billion, excluding sales to Lucent, in fiscal 2000

Portfolio:
Integrated circuits for wireless and wired communications; computer modems and networks; optoelectronic components for optical networking systems; wireless broadband networking solutions from the Wireless Communications and Networking Division

Acquisitions:
Ortel, an Alhambra, Calif.-based optoelectronic components supplier for cable TV networks; Agere, Inc., an Austin, Texas-based developer of programmable network processor technology; selected assets of VTC, a Bloomington, Minn.-based semiconductor components provider for PC hard-drive disk manufacturers; and Herrmann Technology, a Dallas-based optical components company

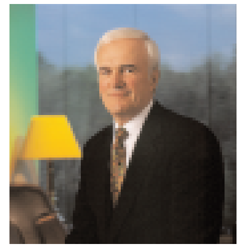
>>Lucent Leadership



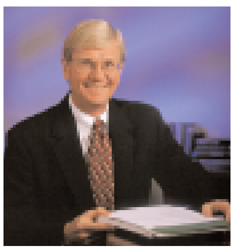
Henry B. Schacht
Chairman and
Chief Executive Officer

Ben J. M. Verwaayen
Vice Chairman

Deborah C. Hopkins
Executive Vice President and
Chief Financial Officer



Robert C. Holder
Executive Vice President

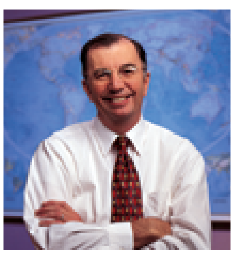


William T. O'Shea
Executive Vice President
Corporate Strategy and
Business Development

Arun N. Netravali
President, Bell Laboratories;
Chief Technology Officer and
Chief Network Architect

Richard J. Rawson
Senior Vice President and
General Counsel

Kathleen M. Fitzgerald
Senior Vice President
Public Relations and Advertising



James K. Brewington
Group President
Wireless Networks

Michael J. Butcher
President
International Sales

Janet G. Davidson
Group President
InterNetworking Systems

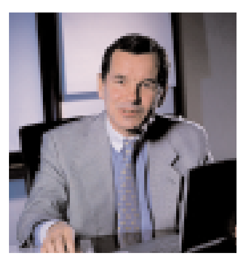
Vincent J. Molinaro
Senior Vice President
North America Sales

Carole J. Spurrier
Senior Vice President
North America Sales

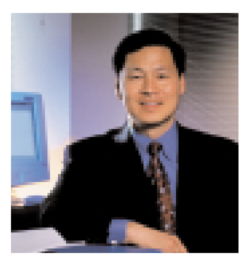
John G. Heindel
President
Lucent Worldwide Services

Jay W. Carter
Chief Operating Officer
Worldwide Sales

Frank A. D'Amelio
Group President
Switching Solutions



Denys M. Gounot
President
Optical Fiber Solutions



Jeong H. Kim
Group President
Optical Networking

James S. Lusk
President
Business Services

Martina Hund-Mejean
Senior Vice President and
Treasurer

Mark R. White
Senior Vice President and
Corporate Controller

Curtis R. Artis
Senior Vice President
Human Resources

Larry E. Kittelberger
Senior Vice President and
Chief Information Officer

Lucent Technologies

>>Financial Review

lu 2000

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

Overview

In fiscal 2000, Lucent Technologies Inc. ("Lucent" or the "Company") completed its plan to spin off its Enterprise Networks business to shareowners, forming a separate and independent company. The new company is called Avaya Inc. ("Avaya") (see DISCONTINUED OPERATIONS).

In addition, on July 20, 2000, Lucent announced its intention to spin off its microelectronics business, which includes the optoelectronics components and integrated circuits divisions, into a separate and independent company. The new company is called Agere Systems Inc. ("Agere Systems"). On December 11, 2000, a Form S-1 registration statement was filed with the SEC in anticipation of an initial public offering ("IPO") of Agere Systems. Lucent intends to distribute the remaining shares in a tax-free distribution. This report does not constitute the offering of any securities, which will be made only by a prospectus filed with the SEC. In connection with the spin-off, Lucent may be adjusting its capital structure including a possible reduction in the amount of debt outstanding. The IPO is expected to be completed in the quarter ending March 31, 2001, and completion of the spin-off is expected by the end of the 2001 fiscal year. The IPO and spin-off are subject to certain conditions, including a favorable tax ruling by the IRS.

On November 13, 2000, Lucent entered into an agreement to sell its power systems business to Tyco International Ltd., a diversified manufacturing and service company, for $2,500 million in cash. The sale, which is subject to regulatory approval and other customary closing conditions, is expected to close by December 31, 2000 and result in a one-time gain to be recorded as an extraordinary item, net of tax, in the quarter in which the sale closes.

These actions will allow Lucent to concentrate its investments, resources and management attention on optical, data and wireless solutions, along with the network design, consulting and integration services to support them. Lucent expects to take a business restructuring charge associated with the redesign of its business in the quarter ending March 31, 2001. Lucent expects to give details of the charge in late January, 2001. A review of our internal processes will continue throughout 2001 and may result in additional restructuring and associated charges (see KEY BUSINESS CHALLENGES).

On a total basis, Lucent reported net income of $1,219 million, or $0.37 per share (diluted) for the year ended September 30, 2000, as compared with year-ago net income of $4,789 million, or $1.49 per share (diluted). Fiscal 2000 net income includes a $462 million loss, or $0.14 per share (diluted), from discontinued operations, net of tax, compared with $455 million of income, or $0.14 per share (diluted), net of tax, for fiscal 1999. The fiscal 2000 net income also includes a reduction of costs and operating expenses of $252 million representing the impact of adopting Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). In addition, in fiscal 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 $0.41 per share (diluted), cumulative effect of accounting change. Lucent's income before the cumulative effect of accounting change was $3,481 million for the year ended September 30, 1999. See Note 12 to the accompanying Consolidated Financial Statements for further details of the accounting change.

Discontinued Operations

On March 1, 2000, Lucent announced plans to spin off Avaya and, on September 30, 2000, the spin-off was accomplished through a tax-free distribution of shares to Lucent's shareowners.

Avaya represented a significant segment of the Company's business. Pursuant to Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), Lucent has reclassified its Consolidated Financial Statements to reflect the spin-off of Avaya. The revenues, costs and expenses, assets and liabilities, and cash flows of Avaya have been segregated in the Consolidated Statements of Income, Consolidated Balance Sheets and Consolidated Statements of Cash Flows. The net operating results, net assets and net cash flows of this business have been reported as "Discontinued Operations" in the accompanying Consolidated Financial Statements.

Lucent recorded a $462 million loss from discontinued operations (net of a tax benefit of $78 million) for the year ended September 30, 2000. The net loss is comprised of $303 million of net income from discontinued operations for the period prior to the measurement date and a $765 million net loss on disposal of Avaya. The loss on disposal of Avaya reflects the costs directly associated with the spin-off and the net loss of Avaya between the measurement date and the spin-off date of September 30, 2000. The costs reflect those components of the Avaya reorganization plan, including a business restructuring charge and directly related asset write-downs of $545 million recorded during the year, along with transaction costs of $56 million for the spin-off. Major components of this charge include $365 million for employee separation and $101 million for real estate consolidation.

In addition, the loss from discontinued operations includes an allocation of Lucent's interest expense based on the amount of debt assumed by Avaya. Approximately $780 million of commercial paper borrowings were assumed by Avaya as part of the spin-off transaction.

Lucent's financial results for discontinued operations are different from the results reported by Avaya due to different assumptions and allocations required to be made by the two companies.

The following discussion will focus on Lucent's results from continuing operations.

Financial Highlights

Lucent reported income from continuing operations of $1,681 million, or $0.51 per share (diluted), for the year ended September 30, 2000, compared with year-ago income from continuing operations of $3,026 million, or $0.94 per share (diluted).

Income from continuing operations for 2000 includes $1,005 million ($1,001 million after-tax) of purchased in-process research and development ("IPRD") expenses related to the acquisitions of Spring Tide Networks, Chromatis Networks, Herrmann Technology, Ortel Corporation, Agere, Inc. and VTC Inc., a pre-tax gain of $189 million ($115 million after-tax) associated with the sale of an equity investment, a reduction to costs and operating expenses of $252 million related to the impact of adopting SOP 98-1 and a pre-tax charge of $61 million ($40 million after-tax) primarily associated with the mergers with International Network Services ("INS"), Excel Switching Corporation and Xedia Corporation.

Income from continuing operations in 1999 includes a $108 million ($71 million after-tax) reversal of business restructuring charges, a $110 million non-tax deductible charge for merger-related costs and a $236 million charge ($169 million after-tax) primarily associated with asset impairments and integration-related charges related to the Ascend Communications, Inc. and Nexabit Networks, Inc. mergers, a $274 million gain ($167 million after-tax) on the sale of an equity investment, and $292 million ($280 million after-tax) of IPRD expenses related to the acquisitions of Stratus Computer, Inc., XNT Systems, Inc., Quantum Telecom Solutions, Inc., InterCall Communications and Consulting, Inc., Quadritek Systems, Inc., Sybarus Technologies, WaveAccess Ltd. and the Ethernet local area network ("LAN") component business of Enable Semiconductor ("Enable").

Acquisitions

As part of Lucent's continuing efforts to provide its customers with end-to-end communications solutions, the Company completed numerous acquisitions and mergers during the three years ended September 30, 2000. For more information, see Note 4 to the accompanying Consolidated Financial Statements.

Operating Segments

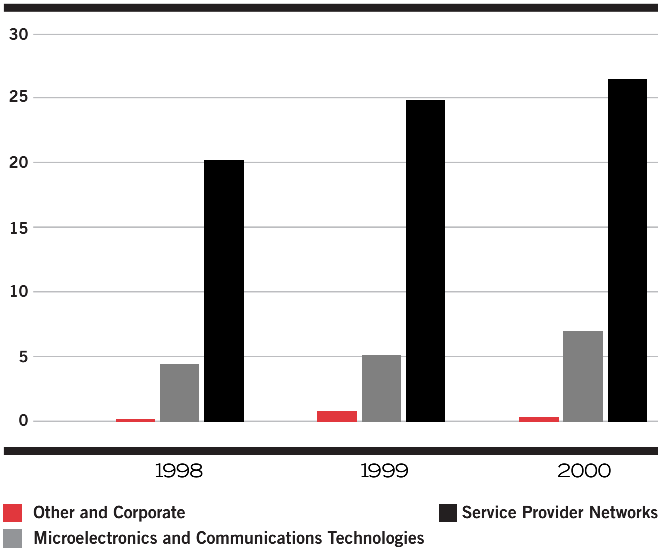
Lucent operates in the global telecommunications networking industry and has two reportable segments: Service Provider Networks ("SPN") and Microelectronics and Communications Technologies ("MCT"). SPN provides public networking systems, software and services to telecommunications service providers and public network operators around the world. MCT provides high-performance optoelectronic components and integrated circuits, power systems and optical fiber for applications in the communications and computing industries. In addition, MCT also includes Lucent's new ventures business. The results of other smaller units and corporate operations are reported in Other and Corporate.

The two 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.

As a result of reorganization initiatives (see KEY BUSINESS CHALLENGES), the Company is evaluating changes to its management model and organizational structure which will result in changes to the reportable segments in the next fiscal year.

Segment Revenues

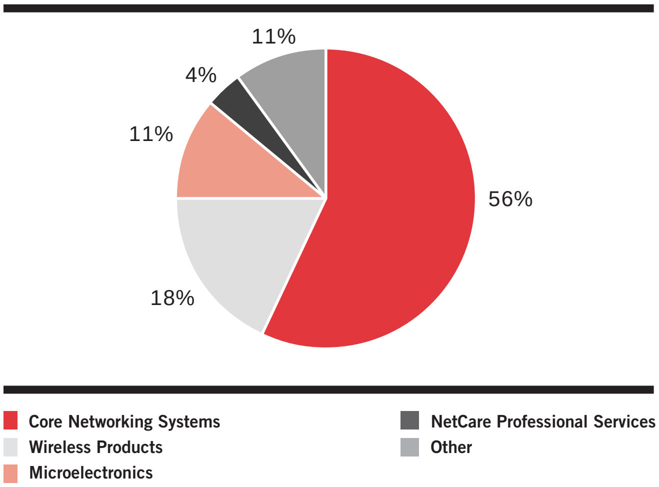
(dollars in billions) For the years ended September 30, 1998, 1999 and 2000



Lucent's Service Provider Networks segment represents about 78% of the total external sales for 2000. Lucent offers a wide range of products and services representing a full-service package for the next generation of networks.

Product and Service Revenues

For the year ended September 30, 2000



Key Business Challenges

Lucent is in the process of reorganizing its business to become more focused and better positioned to capitalize on market opportunities. This reorganization includes the recent spin-off of Avaya, the expected sale of the power systems business and the announced IPO and spin-off of Agere Systems, as well as a comprehensive review and restructuring of Lucent's internal systems and processes. Specific initiatives include performing a comprehensive product and service portfolio review aimed at aligning research and development and effective redeployment of sales and marketing teams and other investments as appropriate, consolidating corporate infrastructure and improving supply chain management. Lucent expects to take a significant business restructuring charge in the quarter ending March 31, 2001. Lucent expects to give details of the charge in late January, 2001. A review of our internal processes will continue throughout 2001 and may result in additional restructuring and associated charges. The reorganization, including the spin-off of Agere Systems, is expected to be completed by September 30, 2001.

A limited number of large customers provide a substantial portion of Lucent's revenues. These customers include Verizon, AT&T and certain incumbent and competitive local exchange carriers. The spending patterns of these customers can vary significantly during the year. An elimination or change in the spending patterns of, or a significant reduction in orders from, any one of these customers could negatively affect Lucent's operating results. Lucent's fiscal year 2000 results were negatively affected by the decline in sales to one large U.S. customer and one large non-U.S. customer. The communications industry has recently experienced a consolidation of both U.S. and non-U.S. companies. As a result, Lucent's operating results could become more dependent on a smaller number of large carriers. Lucent continually endeavors to diversify its customer base by adding new and different types of customers. Lucent, however, is often required to provide or arrange for long-term financing for customers as a condition to obtain or bid on infrastructure contracts. Thus, our ability to develop certain customer relationships may be dependent upon our ability to raise capital and extend credit.

Lucent operates in a highly competitive industry and expects the level of competition relating to pricing and product offerings will intensify. Lucent expects that new competitors will enter its markets as a result of expansion by market participants and advancements in technology. These competitors may include entrants from the telecommunications, software, data networking, cable television and semiconductor industries, and may have strong financial capabilities, technological expertise and established name recognition. Lucent attempts to direct the Company's resources to meet market needs and competitive challenges based on ongoing assessments of market conditions. However, due to misjudgment of the market demand for specific product offerings, Lucent's results for fiscal year 2000 were adversely affected by a larger than expected reduction in revenue and gross margin for its traditional circuit switching products and related software, and lower revenues and gross margins for specific optical networking products.

For the first fiscal quarter of 2001, Lucent anticipates a substantial decline in revenues compared to the year-ago quarter, and a substantial loss from continuing operations. This reflects a significant sales decline in North America due to an overall softening in the competitive local exchange carrier market, slowdown in capital spending by established service providers, lower software sales and a more focused use of vendor financing by Lucent.

On December 21, 2000, Moody's Investors Service lowered Lucent's credit rating on senior unsecured long-term debt from A2 to A3 and on commercial paper from Prime-1 to Prime-2; the A3 rating remains on review for possible further downgrade, and Moody's concluded the review of the commercial paper rating. Also on December 21, 2000, Standard & Poor's lowered Lucent's credit rating on senior unsecured long-term debt from A to BBB+ and the commercial paper rating from A-1 to A-2, both of which remain on CreditWatch with the possibility of further downgrades. Lucent believes that it will have sufficient capital resources to fulfill its own operational and capital needs, as well as to extend credit to customers when appropriate, although there can be no assurance that this will occur.

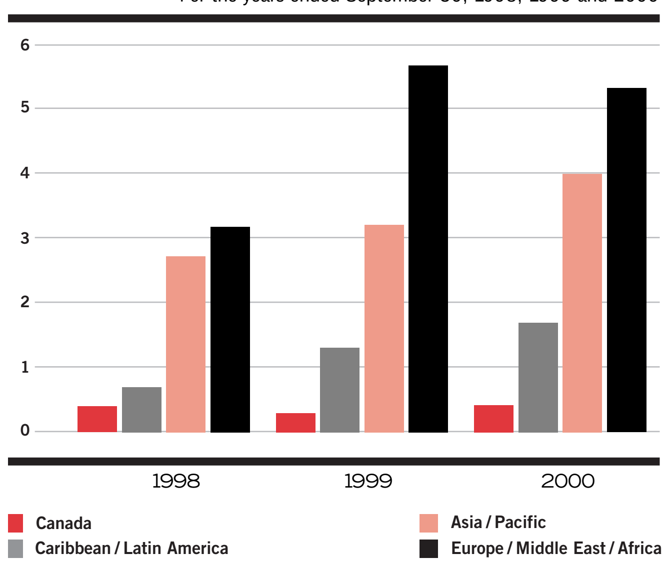
RESULTS OF OPERATIONS:

Revenues

Total revenues for 2000 increased 10.4% to $33,813 million compared with 1999, due to increases in sales from both reportable operating segments, partially offset by a decrease in Other and Corporate, predominantly from the remaining consumer products business, which was sold in the second fiscal quarter of 2000. Revenue growth was driven by sales increases globally. For 2000, sales within the United States grew 10.9% compared with 1999. Non-U.S. revenues increased 9.7% compared with 1999. These non-U.S. sales represented 33.9% of total revenues compared with 34.2% in 1999.

Revenues by Non-U.S. Regions

(dollars in billions) For the years ended September 30, 1998, 1999 and 2000



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

Total revenues for 1999 increased 25.6% to $30,617 million compared with 1998. Revenue growth was driven by sales increases globally. For 1999, U.S. sales grew 15.6% compared with 1998 and non-U.S. sales increased 50.8% compared with 1998. These non-U.S. sales represented 34.2% of total revenues compared with 28.5% in 1998.

The following table presents Lucent's revenues by segment and the percentage of total revenues for the years ended September 30, 2000, 1999, and 1998:

(dollars in millions)

	2000		1999		1998	
		% of Total		% of Total		% of Total
Service Provider Networks	$26,509	78	$24,833	81	$20,116	83
Microelectronics and Communications Technologies	6,953	21	5,026	16	4,134	17
Other and Corporate	351	1	758	3	117	–
Total Lucent	$33,813	100	$30,617	100	$24,367	100

Revenues in 2000 from the SPN segment increased by 6.8%, or $1,676 million, compared with 1999, and increased 23.4%, or $4,717 million, for 1999 compared with 1998. The 2000 increases were driven by sales of service provider Internet infrastructure, wireless systems and professional services, offset in part by a decline in optical networking products, primarily due to lower revenues in the fiscal fourth quarter and a decline in switching revenues. Lower than expected revenues in optical networking, due primarily to being late to market with the OC-192 product, which affected the entire product cycle, from engineering and manufacturing to deployment and launch, had a negative impact on the fiscal year's revenue growth. In addition, lower revenues from switching products primarily due to the shift in customer spending away from circuit switching, pricing pressures and the impact of a substantial reduction in a major long-term foreign project also negatively impacted growth. The 1999 increases resulted primarily from higher sales of switching and wireless systems products with associated software, optical networking and data networking systems and communications software.

U.S. revenues in 2000 from the SPN segment increased by 7.1% over 1999, and by 10.9% comparing 1999 with 1998. The 2000 and 1999 U.S. revenue increases included revenue gains from sales to incumbent local exchange carriers, which in certain cases provide wireless service, and competitive local exchange carriers. Revenues in 2000 increased despite a decline in revenues from AT&T, historically a significant customer. In addition, the 1999 U.S. revenue increase included long distance carriers. Non-U.S. revenues for 2000 increased 6.0% compared with 1999, reflecting gains in all regions except Europe/Middle East/Africa ("EMEA"), which was negatively impacted by the substantial reduction of revenues from a major long-term foreign project, and represented 32.6% of revenues for 2000 compared with 32.8% for 1999. Non-U.S. revenues for 1999 increased 60.7% compared with 1998 due to revenue growth in the EMEA region, primarily due to the same major long-term foreign project, Caribbean/Latin America and Asia/Pacific regions and represented 32.8% of revenues for 1999 compared with 25.2% in 1998.

Lucent expects that product transition associated with a decline in circuit switching revenue and the substantial reduction of revenues from AT&T and a major long-term foreign project will not be fully offset immediately by the ramp-up of newer products. In addition, component shortages have led to a longer than expected full-volume ramp-up in optical networking.

Revenues in 2000 from the MCT segment increased 38.3%, or $1,927 million, compared with 1999. This increase was driven by sales of optical fiber, optoelectronic components, power systems, wired and wireless LAN systems and customized chips for computing and high-speed communications systems. Revenues in 1999 increased 21.6%, or $892 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.

U.S. sales in 2000 increased 51.8% compared with 1999 and 16.2% in 1999 compared with 1998. Non-U.S. revenues increased 22.5% compared with 1999, with revenue growth in all regions. Non-U.S. revenues increased 28.6% in 1999 compared with 1998, driven by sales in the Asia/Pacific and EMEA regions. Non-U.S. revenues represented 40.7% of sales in 2000 compared with 46.0% in 1999 and 43.5% in 1998.

As previously discussed, in fiscal 2001 Lucent intends to spin off Agere Systems, which is currently part of the MCT segment.

Revenues in 2000 from sales of OTHER AND CORPORATE decreased $407 million compared with 1999, due to lower revenues from the Company's remaining consumer products business, which was sold in the second fiscal quarter of 2000. Revenues in 1999 increased $641 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 consolidated as of October 1, 1998. Revenues are included in Other and Corporate. In December 1998, Lucent sold certain assets of the wireless handset business to Motorola, Inc. and completed the sale of its remaining consumer products business in the second fiscal quarter of 2000.

COSTS AND GROSS MARGIN

(dollars in millions)

	2000	1999	1998
Costs	$19,539	$15,605	$12,938
Gross margin	$14,274	$15,012	$11,429
Gross margin percentage	42.2%	49.0%	46.9%

Total costs in 2000 increased $3,934 million, or 25.2%, compared with 1999. As a percentage of revenue, gross margin decreased to 42.2% from 49.0% in 1999. This decrease was primarily due to decreased volumes and margins in the optical networking and switching businesses, including lower software revenues, increased pricing pressures in other product lines and continued expansion into overseas markets, which generally yield lower margins. This decrease in gross margin percentage was partially offset by $400 million resulting from lower personnel costs, including lower incentive compensation awards and a higher net pension credit, and the impact of adopting SOP 98-1. In addition, Lucent anticipates a further shift from higher margin switching products to newer products with initially lower margins. Total costs in 1999 increased $2,667 million, or 20.6%, compared with 1998 due to the increase in sales volume. Gross margin percentage increased 2.1 percentage points from 1998. The increase in gross margin percentage for the year was due to a more favorable mix of products.

OPERATING EXPENSES

(dollars in millions)

	2000	1999	1998
Selling, general and administrative ("SG&A")	$6,266	$5,806	$4,424
As a percentage of revenues	18.5%	19.0%	18.2%
As a percentage of revenues excluding amortization of goodwill and other acquired intangibles	16.9%	18.0%	17.7%

SG&A expenses increased $460 million, or 7.9%, and decreased 0.5 percentage points as a percentage of revenues in 2000 as compared with 1999 and increased $1,382 million, or 31.2%, and increased 0.8 percentage points as a percentage of revenues in 1999 as compared with 1998. The dollar increases are attributable to higher sales volume and increased amortization of goodwill and other acquired intangibles. The current year expense was also negatively impacted by increased reserves for bad debt on trade receivables due to specific credit concerns primarily in the emerging service provider market. These increases were partially offset by $500 million resulting from lower personnel costs, including lower incentive compensation awards and a higher net pension credit, and the impact of adopting SOP 98-1. In addition, included in the current year expense is $61 million primarily associated with the mergers with INS, Excel and Xedia. Included in the 1999 expense is $110 million associated with the mergers with Ascend, Nexabit, RAScom and VitalSigns.

Amortization expense associated with goodwill and other acquired intangibles was $551 million, $310 million and $105 million for the years ended September 30, 2000, 1999 and 1998, respectively. As a result of the 2000 acquisition activity, Lucent expects amortization of goodwill and other acquired intangibles to significantly increase in future periods. On a pro forma basis, assuming the 2000 acquisitions occurred on October 1, 1999, the amortization of goodwill and other acquired intangibles would have increased by approximately $931 million for the year ended September 30, 2000. The 1999 increase largely relates to the $109 million write-off of Livingston goodwill and other acquired intangibles. For further details see IN-PROCESS RESEARCH AND DEVELOPMENT.

In addition, 1999 includes an $85 million reversal of 1995 business restructuring charges.

(dollars in millions)

	2000	1999	1998
Research and development ("R&D")	$4,018	$4,220	$3,667
As a percentage of revenues	11.9%	13.8%	15.0%
Purchased in-process research and development ("IPRD")	$1,005	$ 292	$1,385

R&D expenses in 2000 decreased $202 million, or 4.8%, and decreased 1.9 percentage points as a percentage of revenues compared with 1999, and increased $553 million, or 15.1%, and decreased 1.2 percentage points in 1999 as a percentage of revenues compared with 1998. The 2000 dollar decrease, as well as the percentage of revenues decrease in 2000, were largely the result of $350 million of lower personnel costs, including lower incentive compensation awards and a higher net pension credit, and the impact of adopting SOP 98-1. The 1999 dollar increase was primarily due to increased expenditures in support of substantially all product lines. The 1999 decrease in R&D as a percentage of revenues reflects more custom contract work that was recorded in costs as opposed to R&D.

IPRD expenses for 2000 were $1,005 million, reflecting the charges associated with the acquisitions of Spring Tide, Chromatis, Herrmann, Ortel, Agere and VTC in 2000, as compared with $292 million related primarily to the acquisitions of Stratus, XNT, Quantum, InterCall, Quadritek, Sybarus, WaveAccess and Enable in 1999. See further discussion under IN-PROCESS RESEARCH AND DEVELOPMENT.

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

(dollars in millions)

	2000	1999	1998
Other income-net	$ 366	$ 402	$ 110
Interest expense	$ 348	$ 318	$ 143
Provision for income taxes	$1,322	$1,752	$1,151
Effective income tax rate	44.0%	36.7%	59.9%
Adjusted income tax rate*	29.7%	32.6%	34.0%

**Excludes non-tax deductible IPRD expenses, merger-related costs, amortization of goodwill and other acquired intangibles, certain one-time gains on sales of equity investments in 2000 and 1999, and the gain on the sale of the Company's ATS business in 1998.*

During 2000, other income, net, included interest income of $125 million and net gains on sales and settlements of financial instruments of $361 million, including a $189 million gain from the sale of an equity investment. During 1999, other income, net, included interest income of $133 million and net gains on sales and settlements of financial instruments of $302 million, including a $274 million gain from the sale of an equity investment. During 1998, other income, net, included interest income of $122 million, gains from the sale of businesses of $208 million, including a gain related to the sale of the Advanced Technology Systems unit of $149 million and net equity losses from investments of $207 million primarily related to the investment in PCC.

Interest expense increased primarily due to higher debt levels in 2000 and 1999. In addition, interest expense in 2000 increased from higher weighted average interest rates on commercial paper.

The effective income tax rates exceed the U.S. federal statutory income tax rates primarily due to the write-offs of IPRD costs and merger-related expenses that are not deductible for tax purposes. The adjusted income tax rate decreased 2.9 percentage points in 2000 compared with 1999. This decrease was primarily due to increased research tax credits and the tax impact of non-U.S. activity. The adjusted 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 non-U.S. activity.

The 1998 effective income tax rate does not include a federal income tax provision for Kenan since Kenan was an S-Corporation prior to its merger with Lucent.

CASH FLOWS

(dollars in millions)

	2000	1999	1998
Net cash provided by (used in):			
Operating activities	$ 304	$ (962)	$ 1,452
Investing activities	$(2,480)	$(1,782)	$(2,697)
Financing activities	$ 2,211	$ 3,345	$ 852

Cash provided by operating activities increased $1,266 million to $304 million in 2000 compared with 1999. This improvement was primarily due to smaller increases in receivables, other operating assets and liabilities and a larger tax benefit from stock options exercised during the current year. The change in receivables resulted from smaller revenue growth in the fiscal fourth quarter of 2000 as compared with the same period in 1999, partially offset by a higher average days outstanding (see FINANCIAL CONDITION). These improvements were partially offset by increased inventories and contracts in process to meet current and anticipated sales commitments to customers and the start-up of several long-term projects, lower accounts payable due to the timing of payments and lower net income as adjusted for non-cash operating items.

Cash from operating activities decreased $2,414 million in 1999 compared with 1998. This was primarily due to larger increases in receivables and inventories as well as lower decreases in payroll and benefit-related liabilities. Cash payments of $61 million were charged against the 1995 business restructuring reserves in 1999, compared with $162 million in 1998. All projects associated with the 1995 business restructuring reserve were substantially completed as of September 30, 1999.

Cash used in investing activities increased $698 million to $2,480 million in 2000 compared with 1999. The increase was primarily due to increased capital expenditures (see below) and decreased proceeds from the sales of investments, partially offset by decreased purchases of investments and higher proceeds from the dispositions of businesses.

Cash used in investing activities decreased $915 million in 1999 compared with 1998, primarily due to increased proceeds from the sales of investments and a reduction in cash used for acquisitions and purchases of investments, partially offset by increased capital expenditures.

Capital expenditures were $2,701 million, $2,042 million and $1,615 million for 2000, 1999 and 1998, respectively. The increases in capital expenditures primarily relate to expenditures for equipment and facilities used in manufacturing and research and development, including expansion of manufacturing capacity, and expenditures for efficiency improvements and non-U.S. growth. In addition, in 2000 capital expenditures included capitalized internal use software.

Cash provided by financing activities decreased $1,134 million to $2,211 million in 2000 compared with 1999. This decrease was primarily due to lower issuances of long-term debt and increases in repayments of long-term debt, partially offset by an increase in short-term borrowings and an increase in proceeds from the issuances of common stock primarily for stock option exercises.

Cash provided by financing activities increased $2,493 million in 1999 compared with 1998. This increase was primarily due to increased issuances of debt.

FINANCIAL CONDITION

(dollars in millions)

	2000	1999
Total assets	$48,792	$35,372
Total liabilities	$22,620	$21,436
Working capital	$10,613	$10,090
Debt to total capital (debt plus equity)	20.0%	29.6%
Inventory turnover ratio	4.1x	4.4x
Average days outstanding – receivables	102 days	89 days

Total assets as of September 30, 2000, increased $13,420 million, or 37.9%, from September 30, 1999. This increase was primarily from increases of $8,985 million in goodwill and other acquired intangibles, as well as from increases in receivables, inventories, contracts in process, prepaid pension costs, and other assets of $759 million, $1,437 million, $779 million, $981 million and $994 million, respectively. These increases were partially offset by a decrease in net assets of discontinued operations of $907 million as a result of completing the Avaya spin-off on September 30, 2000. The increase in goodwill and other acquired intangibles is due to the acquisitions made in fiscal 2000 (see ACQUISITIONS). Receivables increased primarily due to higher sales volume coupled with higher average days outstanding (see below). During the fourth fiscal quarter of 2000, approximately $550 million of receivables for one large non-U.S. customer were sold. The increase in inventories resulted from the need to meet current and anticipated sales commitments to customers. Contracts in process increased as a result of the start-up of several long-term projects. Prepaid pension costs increased primarily due to higher return on plan assets and an increase in the discount rate in 2000. Other assets increased due largely to the capitalization of internal use software, increased investments and an increase in other intangible assets.

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 and amortization of prior service cost.

Total liabilities increased $1,184 million, or 5.5%, from September 30, 1999. This increase was due primarily to higher commercial paper balances.

Working capital, defined as current assets less current liabilities, increased $523 million from September 30, 1999, primarily resulting from an increase in receivables, inventories and contracts in process, partially offset by the increase in short-term debt.

Debt to total capital decreased 9.6 basis points in 2000 compared with 1999. This decrease was related to the 2000 increase in additional paid-in capital primarily associated with the issuance of common stock for business acquisitions made during the year and, to a lesser extent, the exercise of stock options and sales of stock through the employee stock purchase plan.

For the year ended September 30, 2000, Lucent's inventory turnover ratio decreased to 4.1x compared with 4.4x for the year ended September 30, 1999. The decrease is due to higher inventory in fiscal 2000. Inventory turnover ratio is calculated by dividing cost of sales for the three months ended September 30 by the fiscal fourth quarter average ending inventory balance, using a two-point average.

Average days outstanding – receivables were up 13 days to 102 days in 2000 compared with 1999 reflecting the growth in Lucent's sales outside the United States, which typically carry longer payment terms and growth in very competitive emerging markets that currently require longer payment terms. Average days outstanding is calculated by dividing the fiscal fourth quarter average ending receivables balance, using a two-point average, by total revenues for the three months ended September 30.

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, 2000, 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, 2000, approximately $4.5 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, receivable securitizations, the expected proceeds from the sale of the power systems business and the planned IPO of Agere Systems will be adequate to satisfy its future cash requirements, although there can be no assurance that this will be the case.

Lucent's customers 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, and continually monitors and reviews the creditworthiness of such arrangements. As market conditions permit, Lucent's intention is to sell or transfer 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, 2000, Lucent had made commitments or entered into agreements to extend credit to certain customers for an aggregate of approximately $6.7 billion. Excluding amounts that are not available because the customer has not yet satisfied the conditions precedent for borrowing, at September 30, 2000, approximately $3.3 billion in loan commitments was undrawn and available for borrowing and approximately $1.3 billion had been advanced and was outstanding. As part of the revenue recognition process, Lucent determines whether the notes receivable under these contracts are reasonably assured of collection based on various factors, among which is the ability of Lucent to sell these notes.

In addition, Lucent had made commitments to guarantee customer debt of about $1.4 billion at September 30, 2000. Excluding amounts not available for guarantee because conditions precedent have not been satisfied, approximately $600 million of guarantees was undrawn and available and about $770 million was outstanding on September 30, 2000.

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, credit rating and level of available credit, and its continued ability to sell or transfer 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.

For a discussion of the Company's sales of receivables and notes, see Note 16 to the accompanying Consolidated Financial Statements.

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 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.

Certain securities held in Lucent's equity and investment portfolio are subject to equity price risk. Lucent generally does not hedge its equity price risk; however, on occasion, may use equity derivative financial instruments that are subject to equity price risks to complement its investment strategies. As of September 30, 2000, Lucent had no outstanding positions.

Lucent uses foreign exchange forward and options contracts 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 exchange forward 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, 2000, Lucent's primary net foreign currency market exposures were dispersed through various countries and primarily included the Euro and its legacy currencies. As of September 30, 1999, Lucent's primary net foreign currency market exposures included Canadian dollars and Brazilian reals. Lucent has not changed its policy regarding how such exposures are managed since the year ended September 30, 1999. Management does not foresee or expect any significant changes in foreign currency exposure in the near future.

The fair value of foreign exchange forward contracts is sensitive to changes in foreign currency exchange rates. As of September 30, 2000 and 1999, a 10% appreciation in the value of foreign currencies against the U.S. dollar from the prevailing market rates would result in an incremental net unrealized loss of approximately $59 million and $31 million, respectively. Conversely, a 10% depreciation in these currencies from the prevailing market rates would result in an incremental net unrealized gain of approximately $59 million and $31 million, as of September 30, 2000 and 1999, respectively. Consistent with the nature of the economic hedge of such foreign exchange forward 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.

Lucent manages its ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this mix in a cost-effective manner, Lucent, from time to time, enters into interest rate swap agreements in which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed-upon notional amounts. Lucent had no material interest rate swap agreements in effect at September 30, 2000 or 1999. Management does not foresee or expect any significant changes in its exposure to interest rate fluctuations or in how such exposure is managed in the near future.

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, 2000 and 1999, the market value of Lucent's fixed-rate long-term debt would be reduced by approximately $317 million and $360 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, 2000 and 1999 of approximately $397 million and $456 million, respectively.

IN-PROCESS RESEARCH AND DEVELOPMENT

In connection with the acquisitions of Livingston, Yurie, Stratus, Agere, Ortel, Chromatis and Spring Tide, Lucent allocated non-tax impacting charges of $427 million, $620 million, $267 million, $94 million, $307 million, $428 million and $131 million, respectively, of the total purchase price to IPRD. 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 a number of factors including 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 IPRD for each of the above acquisitions using an income approach. This involved estimating the fair value of the IPRD using the present value of the estimated after-tax cash flows expected to be generated by the IPRD, 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 IPRD 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 IPRD project. At the date of acquisition, the IPRD 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 are not completed in a timely manner, management's anticipated 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 significant acquired IPRD projects:

Livingston

On December 15, 1997, Lucent completed the purchase of Livingston. Livingston was involved in the development of equipment used by Internet service providers to connect subscribers to the Internet. The allocation to IPRD 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 used 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 in June 1999, 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. Yurie was involved in the development of ATM access solutions. The allocation to IPRD 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 used 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. Stratus was a manufacturer of fault-tolerant computer systems. The allocation to IPRD of $267 million represented its estimated fair value using the methodology described above. The primary projects that made up the IPRD 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 used 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 development relating to the Continuum 1248 would cease by the quarter ended December 31, 1999. Consequently, Lucent did not realize the forecast revenues from these projects.

Agere, Inc.

On April 20, 2000, Lucent completed the purchase of Agere. Agere was involved in the development of programmable network processors for use in managing traffic on high-speed voice and data networks. The allocation to IPRD of $94 million represented its estimated fair value using the methodology described above. The $94 million was allocated to the development of a fully programmable, multiprotocol network processor for OC-48 (2.5 gigabits per second) wire speeds.

Revenues attributable to the OC-48 product were estimated to be $21 million in 2001 and $65 million in 2002. Revenue was expected to peak in 2007 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 205% in 2002 to 5% in 2007 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 product were expected to be $3 million.

A risk-adjusted discount rate of 30% was used to discount projected cash flows.

Ortel Corporation

On April 27, 2000, Lucent completed the purchase of Ortel. Ortel was involved in the development of semiconductor-based optoelectronic components used in fiber-optic systems for telecommunications and cable television networks. The allocation to IPRD of $307 million represented its estimated fair value using the methodology described above. The $307 million was allocated to the following projects: 10G New Products ($61 million), 10G OC-192 Receiver/Daytona ($105 million), 980 ($95 million), 1550 ($27 million) and CATV ($19 million).

Revenues attributable to the 10G New Products were estimated to be $5 million in 2001 and $30 million in 2002. Revenue was expected to peak in 2009 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 447% in 2002 to 8% in 2009, 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 product were expected to be $3 million.

Revenues attributable to the 10G OC-192 Receiver/Daytona were estimated to be $16 million in 2001 and $33 million in 2002. Revenue was expected to peak in 2009 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 166% in 2003 to 8% in 2009 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 product were expected to be $1 million.

Revenues attributable to the 980 were estimated to be $44 million in 2001 and $108 million in 2002. Revenue was expected to peak in 2008 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 143% in 2002 to 17% in 2008, 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 product were expected to be $1 million.

Revenues attributable to the 1550 were estimated to be $2 million in 2001 and $63 million in 2002. Revenue was expected to peak in 2008 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 33% in 2003 to 17% in 2008, 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 product were expected to be $2 million.

Revenues attributable to the CATV product were estimated to be $28 million in 2001 and $58 million in 2002. Revenue was expected to peak in 2004 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 107% in 2002 to 4% 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 product were expected to be $1 million.

A risk-adjusted discount rate of 25% was used to discount projected cash flows.

Chromatis Networks

On June 28, 2000, Lucent completed the purchase of Chromatis. Chromatis was involved in the development of next-generation optical transport solutions that provide telecommunications carriers with improvements in the cost, efficiency, scale and management of multiservice metropolitan networks. The allocation to IPRD of $428 million represented its estimated fair value using the methodology described above. The $428 million was allocated to the first generation of its Metropolis product, which will integrate data, voice and video services on metropolitan networks and combine this traffic onto a wave division multiplexing ("WDM") system.

Revenues attributable to the Metropolis product were estimated to be $375 million in 2001 and $1 billion in 2002. Revenue was expected to peak in 2005 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 196% in 2002 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 product were expected to be $7.8 million.

A risk-adjusted discount rate of 25% was used to discount projected cash flows.

Spring Tide Networks

On September 19, 2000, Lucent completed the purchase of Spring Tide. Spring Tide was involved in the development of carrier-class network equipment that enables service providers to offer new, value-added Internet protocol ("IP") services and virtual private networks ("VPN") with low cost and complexity. Spring Tide was involved in the development of Versions 2.0 and 2.1 of the IP Service Switch, the next generations of Spring Tide's flagship product. The allocation to IPRD of $131 million represented their estimated fair value using the methodology described above. Approximately $128 million was allocated to the next-generation IP Service Switch products, carrier-class platforms that will combine the connectivity of a remote access server, the network intelligence of a remote access server, and the switching capacity and quality of service ("QoS") capabilities of an ATM switch in one integrated solution. The remaining $3 million was allocated to projects designed to enhance the capabilities and decrease production costs associated with the IP Service Switch.

Revenues attributable to the IP Service Switch products were estimated to be $109 million in 2001 and $337 million in 2002. Revenue was expected to peak in 2006 and decline thereafter through the end of the product's life as new product technologies were expected to be introduced by Lucent. Revenue growth was expected to decrease from 209% in 2002 to 4.4% in 2006, 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 product were expected to be $0.5 million and $4.3 million in 2000 and 2001, respectively.

A risk-adjusted discount rate of 25% was used to discount projected cash flows.

Given the uncertainties of the development process, the aforementioned estimates are subject to change, and no assurance can be given that deviations from these estimates will not occur. Management expects to continue development of these efforts and believes there is a reasonable chance of successfully completing the development efforts. However, there is risk associated with the completion of the projects and there can be no assurance that the projects will realize either technological or commercial success. Failure to successfully develop and commercialize the IPRD would result in the loss of the expected economic return inherent in the fair value allocation.

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 Lucent. 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 forecast in such forward-looking statements. Lucent 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, products and services competition by U.S. and non-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 availability of manufacturing capacity, components and materials; the ability to recruit and retain talent; the achievement of lower costs and expenses; credit concerns in the emerging service provider market; customer demand for the Company's products and services; the ability to successfully integrate the operations and business of acquired companies; timely completion of the proposed IPO and spin-off of Agere Systems and the sale of the power systems business; the successful implementation of the strategic reorganization; 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 and significant suppliers; the ability to supply customer financing; technological, implementation and cost/financial risks in the use of large, multiyear contracts; the Company's credit ratings; 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 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 service providers and other 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 under KEY BUSINESS CHALLENGES.

European Monetary Union – Euro

Several member countries of the European Union have established fixed conversion rates between their existing sovereign currencies and the Euro and have adopted the Euro as their new single legal currency. The legacy currencies will remain legal tender in the participating countries for a transition period until January 1, 2002. During the transition period, cashless payments can be made in the Euro. 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 and existing contracts. 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.

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 under LIQUIDITY AND CAPITAL RESOURCES and KEY BUSINESS CHALLENGES.

Future Capital Requirements

See discussion under LIQUIDITY AND CAPITAL RESOURCES.

Non-U.S. Growth, Foreign Exchange Rates 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 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 exchange contracts, although there can be no assurances that such attempts will be successful.

Legal Proceedings and Environmental Matters

See discussion in Note 17 to the accompanying Consolidated Financial Statements.

Five-Year Summary of Selected Financial Data (Unaudited)

Lucent Technologies Inc. and Subsidiaries

(dollars in millions, except per share amounts)

	Years Ended September 30,				Nine Months Ended September 30,
RESULTS OF OPERATIONS[5]	2000	1999	1998	1997	1996[1]
Revenues	$33,813	$30,617	$24,367	$21,483	$12,432
Gross margin	14,274	15,012	11,429	9,215	4,868
Depreciation and amortization expense	2,318	1,580	1,228	1,348	822
Operating income	2,985	4,694	1,953	1,219	256
Income from continuing operations	1,681	3,026	769	453	125
Income (loss) from discontinued operations	(462)	455	296	17	263
Income before cumulative effect of accounting change	1,219	3,481	1,065	470	388
Cumulative effect of accounting change	–	1,308	–	–	–
Net income	1,219	4,789	1,065	470	388
Earnings (loss) per common share – basic[2][3]:					
Income from continuing operations	$ 0.52	$ 0.97	$ 0.25	$ 0.15	$ 0.04
Income (loss) from discontinued operations	(0.14)	0.15	0.10	0.01	0.10
Cumulative effect of accounting change	–	0.42	–	–	–
Net income	$ 0.38	$ 1.54	$ 0.35	$ 0.16	$ 0.14
Earnings (loss) per common share – diluted[2][3]:					
Income from continuing operations	$ 0.51	$ 0.94	$ 0.25	$ 0.15	$ 0.04
Income (loss) from discontinued operations	(0.14)	0.14	0.09	0.01	0.10
Cumulative effect of accounting change	–	0.41	–	–	–
Net income	$ 0.37	$ 1.49	$ 0.34	$ 0.16	$ 0.14
Earnings per common share – pro forma[3][4]	n/a	n/a	n/a	n/a	$ 0.13
Dividends per common share[3]	$ 0.08	$ 0.08	$0.0775	$0.0563	$0.0375
FINANCIAL POSITION[5]					
Total assets	$48,792	$35,372	$25,144	$21,045	$20,242
Working capital	10,613	10,090	5,355	1,494	1,963
Total debt	6,559	5,867	2,861	4,182	2,795
Shareowners' equity	26,172	13,936	7,960	4,570	3,479
OTHER INFORMATION					
Gross margin percentage	42.2%	49.0%	46.9%	42.9%	39.2%
Selling, general and administrative expenses as a percentage of revenues	18.5%	19.0%	18.2%	19.5%	22.4%
Research and development expenses as a percentage of revenues	11.9%	13.8%	15.0%	14.1%	14.7%
Ratio of total debt to total capital (debt plus equity)	20.0%	29.6%	26.4%	47.8%	44.5%
Capital expenditures	$ 2,701	$ 2,042	$ 1,615	$ 1,569	$ 981

(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 have 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 2,951,466,467 shares outstanding on April 10, 1996, were outstanding since January 1, 1996, and gives no effect to the use of proceeds from the IPO.

(5) Certain prior year amounts have been reclassified to conform to the fiscal year 2000 presentation.

n/a Not applicable.

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 accounting principles generally accepted in the United States of America and include certain amounts that are estimates based upon 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 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. Both the internal auditors and the independent accountants periodically 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 auditing standards generally accepted in the United States of America, which include consideration of the internal control structure. Their report appears on this page.

Henry B. Schacht
Chairman and
Chief Executive Officer

Deborah C. Hopkins
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, changes in shareowners' equity and cash flows present fairly, in all material respects, the financial position of Lucent Technologies Inc. and its subsidiaries at September 30, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2000, in conformity with accounting principles generally accepted in the United States of America. 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 of America, 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 our opinion.

As discussed in Note 2 to the consolidated financial statements, in 2000 the Company changed its accounting method for computer software developed or obtained for internal use. Also, as discussed in Note 12, in 1999 the Company changed its method for calculating annual net pension and postretirement benefit costs.

PricewaterhouseCoopers LLP
New York, New York
December 20, 2000

Consolidated Statements of Income

Lucent Technologies Inc. and Subsidiaries

(amounts in millions, except per share amounts)

	Years Ended September 30,		
	2000	1999	1998
REVENUES	$33,813	$30,617	$24,367
Costs	19,539	15,605	12,938
GROSS MARGIN	14,274	15,012	11,429
OPERATING EXPENSES			
Selling, general and administrative	6,266	5,806	4,424
Research and development	4,018	4,220	3,667
Purchased in-process research and development	1,005	292	1,385
Total operating expenses	**11,289**	**10,318**	**9,476**
Operating income	**2,985**	**4,694**	**1,953**
Other income – net	366	402	110
Interest expense	348	318	143
Income from continuing operations before provision for income taxes	3,003	4,778	1,920
Provision for income taxes	1,322	1,752	1,151
Income from continuing operations	1,681	3,026	769
Income (loss) from discontinued operations (net of tax (benefit) provision of ($78), $256 and $347, respectively)	(462)	455	296
Income before cumulative effect of accounting change	1,219	3,481	1,065
Cumulative effect of accounting change (net of income taxes of $842)	–	1,308	–
Net income	**$ 1,219**	**$ 4,789**	**$ 1,065**
EARNINGS (LOSS) PER COMMON SHARE – BASIC			
Income from continuing operations	$ 0.52	$ 0.97	$ 0.25
Income (loss) from discontinued operations	(0.14)	0.15	0.10
Cumulative effect of accounting change	–	0.42	–
Net income	**$ 0.38**	**$ 1.54**	**$ 0.35**
EARNINGS (LOSS) PER COMMON SHARE – DILUTED			
Income from continuing operations	$ 0.51	$ 0.94	$ 0.25
Income (loss) from discontinued operations	(0.14)	0.14	0.09
Cumulative effect of accounting change	–	0.41	–
Net income	**$ 0.37**	**$ 1.49**	**$ 0.34**
Weighted average number of common shares outstanding – basic	3,232.3	3,101.8	3,025.3
Weighted average number of common shares outstanding – diluted	3,325.9	3,218.5	3,110.6

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

Lucent Technologies Inc. and Subsidiaries

(dollars in millions, except per share amounts)

	September 30,	
ASSETS	**2000**	**1999**
Cash and cash equivalents	$ 1,467	$ 1,686
Receivables less allowances of $501 in 2000 and $318 in 1999	9,558	8,799
Inventories	5,677	4,240
Contracts in process, net of progress billings of $6,744 in 2000 and $5,565 in 1999	1,881	1,102
Deferred income taxes – net	1,165	1,472
Other current assets	1,742	1,941
Total current assets	**21,490**	**19,240**
Property, plant and equipment – net	7,084	6,219
Prepaid pension costs	6,440	5,459
Capitalized software development costs	688	436
Goodwill and other acquired intangibles, net of accumulated amortization of $1,072 in 2000 and $502 in 1999	9,945	960
Other assets	3,145	2,151
Net assets of discontinued operations	–	907
Total assets	**$48,792**	**$35,372**
LIABILITIES		
Accounts payable	$ 2,813	$ 2,537
Payroll and benefit-related liabilities	1,210	1,788
Debt maturing within one year	3,483	1,705
Other current liabilities	3,371	3,120
Total current liabilities	**10,877**	**9,150**
Postretirement and postemployment benefit liabilities	5,548	5,651
Long-term debt	3,076	4,162
Deferred income taxes – net	1,266	870
Other liabilities	1,853	1,603
Total liabilities	**22,620**	**21,436**
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: 10,000,000,000 Issued and outstanding shares: 3,384,332,104 at September 30, 2000; 3,142,537,636 at September 30, 1999	34	31
Additional paid-in capital	20,390	7,994
Guaranteed ESOP obligation	(16)	(33)
Retained earnings	6,129	6,188
Accumulated other comprehensive income (loss)	(365)	(244)
Total shareowners' equity	**26,172**	**13,936**
Total liabilities and shareowners' equity	**$48,792**	**$35,372**

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, 1997	**$ –**	**$30**	**$ 4,058**	**$(77)**	**$ 708**	**$(149)**	**$ 4,570**	
Net Income (excluding undistributed S-Corporation earnings)					980			$ 980
Reclassification of undistributed earnings of S-Corporation			85					85
Foreign currency translation adjustment						(89)		(89)
Unrealized holding losses on certain investments						(37)		(37)
Minimum pension liability adjustment						(8)		(8)
Dividends declared					(201)			
Amortization of ESOP obligation				28				
Issuance of common stock		1	654					
Tax benefit from employee stock options			287					
Issuance of common stock and conversion of stock options for acquisitions			1,525					
Conversion of common stock related to acquisitions			186					
S-Corporation distributions			(26)					
Other			5					
Total comprehensive income								**931**
Balance at September 30, 1998	**–**	**31**	**6,774**	**(49)**	**1,487**	**(283)**	**7,960**	
Net Income (excluding undistributed S-Corporation earnings)					4,781			4,781
Reclassification of undistributed earnings of S-Corporation			8					8
Foreign currency translation adjustment						(33)		(33)
Unrealized holding gains on certain investments (net of tax of $235)						307		307
Reclassification adjustment for realized holding gains on certain investments (net of tax of $178)						(246)		(246)
Minimum pension liability adjustment (net of tax of $6)						11		11
Effect of immaterial poolings			106		(26)			
Dividends declared					(222)			
Amortization of ESOP obligation				16				
Issuance of common stock			745					
Tax benefit from employee stock options			394					
Adjustment to conform pooled companies' fiscal year					170			
S-Corporation distributions			(40)					
Other			7		(2)			
Total comprehensive income								**4,828**
Balance at September 30, 1999	**–**	**31**	**7,994**	**(33)**	**6,188**	**(244)**	**13,936**	
Net Income					1,219			1,219
Foreign currency translation adjustment						(185)		(185)
Reclassification of foreign currency translation losses realized upon spin-off of Avaya						64		64
Unrealized holding gains on certain investments (net of tax of $124)						190		190
Reclassification adjustments for realized holding gains on certain investments (net of tax of $126)						(194)		(194)
Minimum pension liability adjustment (net of tax of $1)						2		2
Effect of immaterial poolings			25		(26)			
Issuance of stock by subsidiaries and investees			7					
Dividends declared					(254)			
Amortization of ESOP obligation				11				
Issuance of common stock			1,397					
Tax benefit from employee stock options			1,064					
Issuance of common stock and conversion of stock options for acquisitions		3	9,901					
Adjustment to conform pooled company's fiscal year					11			
Other			2					
Spin-off of Avaya				6	(1,009)	2		
Total comprehensive income								**$1,096**
Balance at September 30, 2000	**$ –**	**$34**	**$20,390**	**$(16)**	**$6,129**	**$(365)**	**$26,172**	

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Lucent Technologies Inc. and Subsidiaries

(dollars in millions)

	Years Ended September 30,		
OPERATING ACTIVITIES	2000	1999	1998
Net income	$ 1,219	$ 4,789	$ 1,065
Less: Income (loss) from discontinued operations, net	(462)	455	296
Less: Cumulative effect of accounting change	–	1,308	–
Income from continuing operations	1,681	3,026	769
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities:			
Business restructuring reversal	(5)	(108)	(77)
Asset impairment and other charges	–	236	–
Depreciation and amortization	2,318	1,580	1,228
Provision for uncollectibles	252	67	129
Tax benefit from employee stock options	1,064	394	287
Deferred income taxes	466	974	88
Purchased in-process research and development	1,005	19	1,385
Adjustment to conform pooled companies' fiscal years	11	170	–
Increase in receivables – net	(1,828)	(3,250)	(1,765)
Increase in inventories and contracts in process	(2,340)	(1,699)	(199)
Increase in accounts payable	266	727	88
Changes in other operating assets and liabilities	(1,192)	(2,280)	(20)
Other adjustments for non-cash items – net	(1,394)	(818)	(461)
Net cash provided by (used in) operating activities of continuing operations	**304**	**(962)**	**1,452**
INVESTING ACTIVITIES			
Capital expenditures	(2,701)	(2,042)	(1,615)
Proceeds from the sale or disposal of property, plant and equipment	29	80	44
Purchases of investments	(745)	(920)	(1,385)
Sales or maturity of investments	838	1,394	838
Dispositions of businesses	250	44	329
Acquisitions of businesses – net of cash acquired	(156)	(268)	(837)
Other investing activities – net	5	(70)	(71)
Net cash used in investing activities of continuing operations	**(2,480)**	**(1,782)**	**(2,697)**
FINANCING ACTIVITIES			
Repayments of long-term debt	(405)	(16)	(98)
Issuance of long-term debt	72	2,193	375
Proceeds from issuance of common stock	1,444	725	659
Dividends paid	(255)	(222)	(201)
S-Corporation distribution to stockholder	–	(40)	(26)
Increase in short-term borrowings – net	1,355	705	143
Net cash provided by financing activities of continuing operations	**2,211**	**3,345**	**852**
Effect of exchange rate changes on cash and cash equivalents	10	41	(67)
Net cash provided by (used in) continuing operations	**45**	**642**	**(460)**
Net cash (used in) provided by discontinued operations	(264)	(100)	84
Net (decrease) increase in cash and cash equivalents	(219)	542	(376)
Cash and cash equivalents at beginning of year	1,686	1,144	1,520
Cash and cash equivalents at end of year	**$ 1,467**	**$ 1,686**	**$ 1,144**

See Notes to Consolidated Financial Statements.

>> Notes to Consolidated Financial Statements

(dollars in millions, except per share amounts)

1. BASIS OF PRESENTATION

On September 30, 2000, Lucent Technologies Inc. (the "Company") spun off its Enterprise Networks business ("Avaya"). This transaction resulted in a distribution of Avaya common stock to each holder of Lucent common stock of record as of September 20, 2000. As a result of this transaction, the Consolidated Financial Statements and related footnotes have been restated to present the results of this business as discontinued operations (see Note 3).

In fiscal year 2000, the Company merged with Excel Switching Corporation and International Network Services ("INS"). In fiscal year 1999, the Company merged with Ascend Communications, Inc. and Kenan Systems Corporation. These mergers have been accounted for under the "pooling-of-interests" method of accounting, therefore, the Consolidated Financial Statements of Lucent were restated for all periods prior to the mergers to include the accounts and operations of Excel, INS, Ascend and Kenan (see Note 4).

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% to 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 revenues and expenses during the period reported. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, 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 Consolidated Financial Statements in the period they are determined to be necessary.

Foreign Currency Translation

For operations outside the U.S. 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 and Software 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.

Effective October 1, 1999, Lucent adopted Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). As a result, certain costs of computer software developed or obtained for internal use have been capitalized as part of other assets and are amortized over a three-year period. The impact of adopting SOP 98-1 was a reduction of costs and operating expenses of $252 for the fiscal year ended September 30, 2000.

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 stated 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 over the estimated useful lives of the various asset classes. Useful lives for buildings and building improvements, furniture and fixtures and machinery and equipment principally range from 10 to 40 years, five to 10 years and two to 10 years, respectively.

Financial Instruments

Lucent uses various financial instruments, including foreign exchange forward contracts and interest rate swap agreements to manage 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. 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 and Other Acquired Intangibles

Goodwill and other acquired intangibles are amortized on a straight-line basis over the periods benefited, principally in the range of five to 10 years. Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases.

Impairment of Goodwill and Other Long-Lived Assets

Goodwill and other long-lived assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. When such events occur, Lucent compares the carrying amount of the assets to undiscounted expected future cash flows. If this comparison indicates that there is an impairment, the amount of the impairment is typically calculated using discounted expected future cash flows. The discount rate applied to these cash flows is based on Lucent's weighted average cost of capital, which represents the blended after-tax costs of debt and equity.

Reclassifications

Certain prior year amounts have been reclassified to conform to the 2000 presentation.

3. DISCONTINUED OPERATIONS

On September 30, 2000, Lucent completed the spin-off of Avaya in a tax-free distribution to its shareowners. Each Lucent shareowner received one share of Avaya common stock for every 12 shares of Lucent common stock held on the record date of September 20, 2000. Avaya represented a significant segment of Lucent's business.

Pursuant to Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"), the Consolidated Financial Statements of Lucent have been reclassified to reflect the spin-off of Avaya. Accordingly, the revenues, costs and expenses, assets and liabilities, and cash flows of Avaya spun off have been segregated in the Consolidated Statements of Income, Consolidated Balance Sheets and Consolidated Statements of Cash Flows. The net operating results, net assets and net cash flows of this business have been reported as "Discontinued Operations." The historical carrying amount of the net assets transferred to Avaya on the spin-off date has been recorded as a stock dividend of $1,009.

Following is summarized financial information for the discontinued operations:

	Years Ended September 30,		
	2000	1999	1998
Revenues	$7,607	$8,157	$7,741
Income from discontinued operations(1) (after applicable income taxes of $160, $256, and $347, respectively)	303	455	296
Loss on disposal of business(2) (after applicable income tax benefit of $238)	(765)	–	–
Income (loss) from discontinued operations	$ (462)	$ 455	$ 296

	September 30, 1999
Current assets	$3,043
Total assets	4,955
Current liabilities	2,758
Total liabilities	4,048
Net assets of discontinued operations	907

(1) *Income from discontinued operations includes an allocation of Lucent's interest expense totaling $64, $91 and $112 for the fiscal years ended September 30, 2000, 1999 and 1998, respectively based upon the amount of debt being assumed by Avaya. Approximately $780 of commercial paper borrowings was assumed by Avaya as part of the spin-off transaction.*

(2) *The loss on disposal of Avaya recorded in the Company's results for the year ended September 30, 2000 reflects the costs directly associated with the spin-off and the net loss of Avaya between the measurement date and the spin date of September 30, 2000. The costs reflect those components of the Avaya reorganization plan, including a business restructuring charge and directly-related asset write-downs of $545 recorded during the year, along with transaction costs of $56 for the spin-off. Major components of this charge include $365 for employee separation and $101 for real estate consolidation.*

Included in the net assets transferred to Avaya at September 30, 2000 were reserves of $499 associated with remaining actions under the reorganization plan, principally for employee separation and real estate consolidation. Avaya is responsible for completing the plan.

(dollars in millions, except per share amounts)

4. BUSINESS COMBINATIONS

Acquisitions

The following table presents information about acquisitions by Lucent in the fiscal years ended September 30, 2000, 1999 and 1998. All of these acquisitions were accounted for under the purchase method of accounting, and the acquired technology valuation included existing technology, purchased in-process research and development ("IPRD") and other intangibles. All IPRD charges were recorded in the quarter in which the transaction was completed. On a pro forma basis, if the following fiscal 2000 acquisitions had occurred on October 1, 1999, the amortization of goodwill and other acquired intangibles would have increased by approximately $931 for the fiscal year ended September 30, 2000.

							Amortization Period (in years)		
2000	Acquisition Date	Purchase Price	Goodwill	Existing Technology	Other Intangibles	Purchased IPRD (after-tax)	Goodwill	Existing Technology	Other Intangibles
Spring Tide[1]	9/00	$1,315 Stock & options	$1,075	$143	$ 14	$131	7	7	7
Chromatis[2]	6/00	4,756 Stock & options	4,223	n/a	186	428	7	n/a	2-7
Herrmann[3]	6/00	432 Stock & options	384	52	16	34	8	7	7
Ortel[4]	4/00	2,998 Stock & options	2,554	171	24	307	9	7.5	4-9
Agere[5]	4/00	377 Stock & options	303	n/a	n/a	94	7	n/a	n/a
DeltaKabel[6]	4/00	52 Cash	56	n/a	n/a	n/a	6	n/a	n/a
VTC Inc.[7]	3/00	104 Cash	46	31	7	7	7	5	7
1999									
Stratus[8]	10/98	$ 917 Stock & options	$ 0	$130	$ 4	$267*	n/a	10	3
Other[9]	various	217 Cash & notes	146	22	12	37	4-10	4-7	4-8
1998									
Yurie[10]	5/98	$1,056 Cash & options	$292	$ 40	n/a	$620	7	5	n/a
Livingston[11]	12/97	610 Stock & options	114	69	n/a	427	5	8	n/a
Other[12]	various	131 Cash	39	36	7	59	5-10	5-10	10

(1) Spring Tide Networks was a provider of network switching equipment.

(2) Chromatis Networks Inc. was a supplier of metropolitan optical networking systems.

(3) Herrmann Technology, Inc. was a supplier of devices for next-generation dense wavelength division multiplexing (DWDM) optical networks.

(4) Ortel Corporation was a developer of optoelectronic components for cable TV networks.

(5) Agere, Inc. was a developer of programmable network processor technology.

(6) DeltaKabel Telecom cv was a developer of cable modem and Internet protocol (IP) telephony solutions for the European market.

(7) VTC Inc. was a supplier of semiconductor components to computer hard disk drive manufacturers.

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

(9) Other acquisitions include the Ethernet LAN business of Enable Semiconductor ("Enable Ethernet"); Sybarus Technologies; WaveAccess Ltd.; Quadritek Systems, Inc.; XNT Systems, Inc.; Quantum Telecom Solutions, Inc.; and InterCall Communications and Consulting, Inc.

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

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

(12) Other acquisitions include JNA Telecommunications Limited, MassMedia Communications, Inc. and Optimay GmbH.

n/a Not applicable.

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

In connection with the acquisitions of Spring Tide and Chromatis, certain key employees are entitled to receive additional Lucent common stock based on the achievement of specified milestones. The value of such stock, if distributed, will be recorded as compensation expense.

In connection with the acquisition of Herrmann, certain stockholders are entitled to receive additional Lucent common stock based on the achievement of specified milestones. If distributed, a portion will be recorded as compensation expense and a portion will be recorded as additional goodwill.

Included in the purchase price for the acquisitions was IPRD, 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 other acquired intangibles, less liabilities assumed.

The value allocated to IPRD was determined using 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 IPRD 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.

TeraBeam Corporation

On April 9, 2000, Lucent and TeraBeam Corporation entered into an agreement to develop TeraBeam's fiberless optical networking system that provides high-speed data networking between local and wide area networks. Under the agreement, Lucent paid cash and contributed research and development assets, intellectual property, and free-space optical products, valued in the aggregate at $450. Lucent owns 30 percent of the venture that will develop the fiberless optical networking system, which is accounted for under the equity method of accounting. Lucent will also be a preferred supplier of optical components, networking equipment and professional services to TeraBeam. In addition, under certain conditions, Lucent will have the right to purchase TeraBeam's equity interest in the venture. A total of $189 was allocated to goodwill and other acquired intangibles to be amortized over five years.

Ignitus Communications LLC

On April 4, 2000, Lucent acquired the remaining 44 percent of Ignitus Communications LLC, a start-up company that focuses on high-speed optical communications at the network edge, for approximately $33. Lucent previously owned 56 percent of the company.

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 percent interest in SpecTran. The acquisition was accounted for under the purchase method of accounting. On February 4, 2000, Lucent acquired the remaining shares of SpecTran, resulting in a total purchase price of approximately $68.

Pooling-of-Interests Mergers

The following table presents information about certain mergers by Lucent accounted for under the pooling-of-interests method of accounting in the fiscal years ended September 30, 2000 and 1999. As a result, Lucent's financial statements have been restated for all periods prior to the mergers to include the accounts and operations of those companies.

Acquisition	Merger Date	Total Shares of Common Stock Issued	Description of Business
2000			
Excel	11/99	22 million	Developer of programmable switches
INS(1)	10/99	49 million	Provider of network consulting, design and integration services
1999			
Ascend(2)	6/99	371 million	Developer, manufacturer and seller of wide area networking solutions
Kenan	2/99	26 million	Developer of third-party billing and customer care software

(1) INS previously had a June 30 fiscal year-end. In order to conform the fiscal year-ends for INS and Lucent, INS's results of operations and cash flows for the three months ended September 30, 1999, were not reflected in Lucent's financial statements for the first fiscal quarter of 2000. INS's revenue and net income for the three months ended September 30, 1999 were $100 and $11, respectively. The Consolidated Balance Sheet of Lucent at September 30, 2000, includes an adjustment to retained earnings to reflect the income recognized by INS for the three months ended September 30, 1999.

(2) Lucent assumed Ascend stock options equivalent to approximately 65 million shares of Lucent common stock. In connection with the merger, Lucent recorded a third fiscal quarter 1999 charge to operating expenses of approximately $79 (non-tax deductible) for merger-related costs, primarily fees for investment bankers, attorneys, accountants and financial printing. Ascend's historical revenue and net loss for the fiscal year ended September 30, 1998 were $1,478 and $20, respectively. For the nine months ended June 30, 1999, Ascend's historical revenue and net income of $1,610 and $66, respectively, are included in Lucent's historical revenues and income from continuing operations, respectively, for the year ended September 30, 1999. Intercompany transactions between Lucent and Ascend for the nine months ended June 30, 1999 of $138 and $86 have been eliminated from revenues and income from continuing operations, respectively, for the year ended September 30, 1999.

(dollars in millions, except per share amounts)

Lucent has also completed other pooling transactions. The historical operations of these entities were not material to Lucent's consolidated results of operations either on an individual or aggregate basis; therefore, prior periods have not been restated for these mergers.

5. RECENT PRONOUNCEMENTS

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 provides guidance on the recognition, presentation and disclosure of revenues in financial statements and requires adoption no later than the fourth quarter of fiscal 2001. The Company is currently evaluating the impact of SAB 101 and its related interpretations to determine the effect it will have on the Company's consolidated financial position and results of operations.

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 requires the recognition of the fair value of all derivative instruments on the balance sheet. Subsequent to the issuance of SFAS 133, the FASB received many requests to clarify certain issues causing difficulties in implementation. In June 2000, the FASB issued SFAS 138, which responds to those requests by amending certain provisions of SFAS 133. These amendments include allowing foreign-currency denominated assets and liabilities to qualify for hedge accounting, permitting the offsetting of certain interentity foreign currency exposures that reduce the need for third-party derivatives and redefining the nature of interest rate risk to avoid sources of ineffectiveness. Lucent is adopting SFAS 133 and the corresponding amendments under SFAS 138 effective as of October 1, 2000. The impact of adopting SFAS 133, as amended by SFAS 138, is not significant.

6. SUPPLEMENTARY FINANCIAL INFORMATION

Supplementary Income Statement Information

	Years Ended September 30,		
INCLUDED IN COSTS AND OPERATING EXPENSES	2000	1999	1998
Amortization of software development costs	$ 396	$ 235	$ 210
Depreciation of property, plant and equipment	$1,370	$1,169	$ 882
INCLUDED IN SELLING, GENERAL AND ADMINISTRATIVE EXPENSES			
Amortization of goodwill and other acquired intangibles	$ 551	$ 310	$ 105
OTHER INCOME – NET			
Interest income	$ 125	$ 133	$ 122
Minority interests in earnings of subsidiaries	(50)	(27)	(24)
Net equity losses from investments	(27)	(23)	(207)
(Loss) gain on foreign currency transactions	(12)	1	(51)
Net gain on sales and settlements of financial instruments	361	302	38
Gain on businesses sold	54	16	208
Miscellaneous – net	(85)	–	24
Other income – net	**$ 366**	**$ 402**	**$ 110**
DEDUCTED FROM INTEREST EXPENSE			
Capitalized interest	$ 20	$ 20	$ 17

Supplementary Balance Sheet Information

	September 30,	
INVENTORIES	2000	1999
Completed goods	$ 2,976	$ 2,374
Work in process and raw materials	2,701	1,866
Inventories	**$ 5,677**	**$ 4,240**

PROPERTY, PLANT AND EQUIPMENT – NET		
Land and improvements	$ 367	$ 328
Buildings and improvements	3,773	3,601
Machinery, electronic and other equipment	10,085	9,060
Total property, plant and equipment	14,225	12,989
Less: Accumulated depreciation	7,141	6,770
Property, plant and equipment – net	**$ 7,084**	**$ 6,219**

INCLUDED IN OTHER CURRENT LIABILITIES		
Advance billings, progress payments and customer deposits	$ 855	$ 719

Supplementary Cash Flow Information

	Years Ended September 30,		
	2000	1999	1998
Interest payments, net of amounts capitalized	$364	$316	$ 159
Income tax payments, net	$ 72	$774	$ 406
Acquisitions of businesses:			
Fair value of assets acquired, net of cash acquired	$165	$398	$1,748
Less: Fair value of liabilities assumed	9	130	911
Acquisitions of businesses, net of cash acquired	**$156**	**$268**	**$ 837**

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 percent 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, 1999 and 1998, 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 related to the Ascend and Nexabit mergers.

7. EARNINGS PER COMMON SHARE

Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is 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 used in the earnings per share calculations:

	Years Ended September 30,		
(Number of shares in millions)	2000	1999	1998
Common shares – basic	3,232.3	3,101.8	3,025.3
Effect of dilutive securities:			
Stock options	88.5	109.5	78.4
Other	5.1	7.2	6.9
Common shares – diluted	3,325.9	3,218.5	3,110.6
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	41.0	5.5	14.0

8. COMPREHENSIVE INCOME

Comprehensive income, which is displayed in the Consolidated Statements of Changes in Shareowners' Equity, represents net income plus the results of certain shareowners' equity changes not reflected in the Consolidated Statements of Income.

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, 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)	$(244)
Current-period change	(185)	(4)	2	(187)
Amounts transferred to Avaya	64	–	2	66
Ending balance, September 30, 2000	**$(434)**	**$ 75**	**$ (6)**	**$(365)**

Foreign currency translation adjustments are not currently adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

(dollars in millions, except per share amounts)

9. BUSINESS RESTRUCTURING AND OTHER CHARGES

In the fourth quarter of calendar year 1995, a pre-tax charge of $2,655 was recorded to cover restructuring costs of $2,467 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 $16 and $184 for the years ended September 30, 2000 and 1999, respectively. Included in these deductions were cash payments of $11 and $61 for the years ended September 30, 2000 and 1999, respectively, and non-cash related charges of $15 for the year ended September 30, 1999. 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. In addition, during 1999 Lucent reversed $108 of business restructuring reserves primarily related to favorable experience in employee separations, as well as to other projects being completed at a cost lower than originally estimated for the year ended September 30, 1999. As of September 30, 1999, all restructuring plans were substantially completed.

10. INCOME TAXES

The following table presents the principal reasons for the difference between the effective tax rate on continuing operations and the U.S. federal statutory income tax rate:

	Years Ended September 30,		
	2000	1999	1998
U.S. federal statutory income tax rate	35.0 %	35.0 %	35.0 %
State and local income taxes, net of federal income tax effect	1.7 %	2.3 %	3.1 %
Foreign earnings and dividends taxed at different rates	(1.1)%	(0.1)%	1.0 %
Research credits	(3.5)%	(2.5)%	(3.2)%
Acquisition-related costs(1)	14.2 %	3.9 %	25.9 %
Other differences – net	(2.3)%	(1.9)%	(1.9)%
Effective income tax rate	**44.0 %**	**36.7 %**	**59.9 %**
Effective income tax rate excluding acquisition-related costs(1)	29.8 %	32.8 %	34.0 %

(1) Includes non-tax deductible purchased in-process research and development, goodwill amortization and merger-related costs.

The following table presents the U.S. and non-U.S. components of income before income taxes and the provision for income taxes:

	Years Ended September 30,		
INCOME BEFORE INCOME TAXES	2000	1999	1998
U.S.	$2,349	$4,169	$1,689
Non-U.S.	654	609	231
Income before income taxes	**$3,003**	**$4,778**	**$1,920**

PROVISION FOR INCOME TAXES	2000	1999	1998
CURRENT			
Federal	$ 460	$ 476	$ 766
State and local	40	8	127
Non-U.S.	356	294	170
Sub-total	856	778	1,063
DEFERRED			
Federal	399	858	36
State and local	78	185	42
Non-U.S.	(11)	(69)	10
Sub-total	466	974	88
Provision for income taxes	**$1,322**	**$1,752**	**$1,151**

As of September 30, 2000, Lucent had tax credit carryforwards of $112 and federal, state and local, and non-U.S. net operating loss carryforwards of $138, all of which expire primarily after the year 2004. As of September 30, 2000, Lucent has recorded valuation allowances totaling $198 against these carryforwards primarily in certain foreign jurisdictions where recovery of these carryforwards is uncertain.

The components of deferred tax assets and liabilities are as follows:

	September 30,	
DEFERRED INCOME TAX ASSETS	2000	1999
Employee benefit obligations	$2,788	$2,572
Reserves and allowances	847	855
Net operating loss/credit carryforwards	250	198
Valuation allowance	(198)	(148)
Other	231	348
Total deferred tax assets	**$3,918**	**$3,825**

DEFERRED INCOME TAX LIABILITIES	2000	1999
Employee benefit obligations	$2,698	$2,176
Property, plant and equipment	497	408
Other	824	639
Total deferred tax liabilities	**$4,019**	**$3,223**

Lucent has not provided for U.S. deferred income taxes or foreign withholding taxes on $3,802 of undistributed earnings of its non-U.S. subsidiaries as of September 30, 2000, since these earnings are intended to be reinvested indefinitely.

11. DEBT OBLIGATIONS

DEBT MATURING WITHIN ONE YEAR	September 30, 2000	1999
Commercial paper	$2,475	$ 667
Long-term debt	765	41
Secured borrowings and other	243	997
Total debt maturing within one year	**$3,483**	**$1,705**
Weighted Average Interest Rates		
Commercial paper	6.3%	5.0%
Long-term debt, secured borrowings and other	7.4%	9.6%

Lucent had revolving credit facilities at September 30, 2000 aggregating $4,731 (a portion of which is used to support Lucent's commercial paper program), $4,000 with domestic lenders and $731 with foreign lenders. The total credit facilities available at September 30, 2000 with domestic and foreign lenders were $4,000 and $455, respectively.

LONG-TERM DEBT	September 30, 2000	1999
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	500
6.50% debentures due January 15, 2028	300	300
6.45% debentures due March 15, 2029	1,360	1,360
7.70% notes due May 19, 2010	20	–
8.00% notes due May 18, 2015	25	–
Long-term lease obligations	62	79
Secured borrowings and other (6.9% and 8.4% weighted average interest rates, respectively)	116	509
Less: Unamortized discount	42	45
Total long-term debt	3,841	4,203
Less: Amounts maturing within one year	765	41
Long-term debt	**$3,076**	**$4,162**

Lucent has an effective shelf registration statement for the issuance of debt securities up to $1,800, of which $1,755 remains available at September 30, 2000.

The following table shows the aggregate maturities, by year, of the $3,841 in total long-term debt obligations:

September 30,

2001	2002	2003	2004	2005	Later Years
$765	$22	$38	$28	$21	$2,967

In 1999, Lucent sold trade accounts receivable and notes receivable to unaffiliated financial institutions with and without recourse. Certain sales with recourse were 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 in the year ended September 30, 1999. These arrangements were terminated in the year ended September 30, 2000. In 2000, there were no sales of receivables accounted for as secured borrowings. See Note 16 for further discussion of sales of receivables.

(dollars in millions, except per share amounts)

12. 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. The following information summarizes activity in the pension and postretirement benefit plans for the entire Company, including discontinued operations:

	Pension Benefits September 30,		Postretirement Benefits September 30,	
CHANGE IN BENEFIT OBLIGATION	2000	1999	2000	1999
Benefit obligation at October 1	$ 27,401	$27,846	$ 8,604	$ 9,193
Service cost	478	509	67	80
Interest cost	1,915	1,671	601	537
Actuarial losses (gains)	370	(2,182)	33	(240)
Amendments	(1)	1,534	–	(359)
Benefits paid	(2,294)	(1,977)	(651)	(607)
Benefit obligation assumed by Avaya	(1,756)	–	(412)	–
Benefit obligation at September 30	**$ 26,113**	**$27,401**	**$ 8,242**	**$ 8,604**
CHANGE IN PLAN ASSETS				
Fair value of plan assets at October 1	$ 41,067	$36,191	$ 4,467	$ 3,959
Actual return on plan assets	9,791	7,114	654	776
Company contributions	19	14	8	29
Benefits paid	(2,294)	(1,977)	(651)	(607)
Assets transferred to Avaya	(2,984)	–	(255)	–
Other (including transfer of assets from pension to postretirement plans)	(337)	(275)	334	310
Fair value of plan assets at September 30	**$ 45,262**	**$41,067**	**$4,557**	**$ 4,467**
Funded (unfunded) status of the plan	$ 19,149	$13,666	$(3,685)	$(4,137)
Unrecognized prior service cost	2,086	2,583	49	121
Unrecognized transition asset	(322)	(645)	–	–
Unrecognized net gain	(14,499)	(9,466)	(1,208)	(1,014)
Net amount recognized	**$ 6,414**	**$ 6,138**	**$(4,844)**	**$(5,030)**
Amounts recognized in the Consolidated Balance Sheets consist of:				
Prepaid pension costs	$ 6,440	$ 5,459	$ –	$ –
Prepaid pension costs allocated to discontinued operations	–	716	–	–
Accrued benefit liability	(37)	(63)	(4,844)	(4,730)
Accrued benefit liability allocated to discontinued operations	–	–	–	(300)
Intangible asset	5	9	–	–
Accumulated other comprehensive income	6	17	–	–
Net amount recognized	**$ 6,414**	**$ 6,138**	**$(4,844)**	**$(5,030)**

Pension plan assets include $102 and $287 of Lucent common stock at September 30, 2000 and 1999, respectively. Postretirement plan assets include $3 and $20 of Lucent common stock at September 30, 2000 and 1999, respectively.

The asset and pension obligation amounts that were transferred to Avaya are subject to final adjustment. The final amounts to be transferred to Avaya are not expected to be materially different from the estimated amounts.

Components of Net Periodic Benefit Cost

	Years Ended September 30,		
PENSION COST	2000	1999	1998
Service cost	$ 478	$ 509	$ 331
Interest cost on projected benefit obligation	1,915	1,671	1,631
Expected return on plan assets	(3,229)	(2,957)	(2,384)
Amortization of unrecognized prior service costs	362	461	164
Amortization of transition asset	(300)	(300)	(300)
Amortization of net (gain) loss	(197)	2	–
Net pension credit	**$ (971)**	**$ (614)**	**$ (558)**
DISTRIBUTION OF NET PENSION CREDIT			
Continuing operations	$(1,085)	$ (740)	$ (647)
Discontinued operations	114	126	89
Net pension credit	**$ (971)**	**$ (614)**	**$ (558)**
POSTRETIREMENT COST			
Service cost	$ 67	$ 80	$ 63
Interest cost on accumulated benefit obligation	601	537	540
Expected return on plan assets	(338)	(308)	(263)
Amortization of unrecognized prior service costs	37	53	53
Amortization of net (gain) loss	(12)	6	3
Net postretirement benefit cost	**$ 355**	**$ 368**	**$ 396**
DISTRIBUTION OF NET POSTRETIREMENT BENEFIT COST			
Continuing operations	$ 306	$ 315	$ 351
Discontinued operations	49	53	45
Net postretirement benefit cost	**$ 355**	**$ 368**	**$ 396**
PENSION AND POSTRETIREMENT BENEFITS			
Weighted-average assumptions as of September 30			
Discount rate	7.5%	7.25%	6.0%
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-plan 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 SFAS No. 87, "Employers' Accounting for Pensions," 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 $0.42 and $0.41 earnings 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 $0.08 earnings per basic and diluted share) as compared with the previous accounting method. If the accounting change were applied retroactively for the year ended September 30, 1998, pro forma net income would be $1,306, earnings per share-basic would be $0.43 and earnings per share-diluted would be $0.42.

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 receive a different pension benefit, known as an account balance program, effective January 1, 2000. Expenses related to the account balance program are included in the previous pension cost table.

Lucent has several non-pension postretirement benefit plans. For postretirement health care benefit plans, Lucent assumed a 7.6% annual health care cost trend rate for 2001 through 2004, after which the trend rate would decline to 3.9%. 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	$ 26	$ 24
Effect on postretirement benefit obligation	$353	$329

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 $228, $318 and $317 for the years ended September 30, 2000, 1999 and 1998, respectively. Lucent savings plan expense charged to continuing operations was $185, $250 and $254 for the years ended September 30, 2000, 1999 and 1998, 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 a reduction in shareowners' equity. As of September 30, 2000, the ESOP contained 12.8 million shares of Lucent's common stock. Of the 12.8 million shares, 11.0 million shares have been allocated under the ESOP and 1.8 million shares were unallocated. As of September 30, 2000, the unallocated shares had a fair value of $54.

13. 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 two-to-10-year terms and vest within four years from the date of grant. Subject to customary antidilution adjustments and certain exceptions, the total number of shares of common stock authorized for option grants under the plans was 446 million shares at September 30, 2000.

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 generally included as part of the purchase price. As of July 1, 2000, Lucent began recording deferred compensation related to unvested options held by employees of companies acquired in a purchase acquisition, in accordance with FASB Interpretation No. 44. Unamortized deferred compensation expense was $34 at September 30, 2000. The deferred expense calculation and future amortization is based on the graded vesting schedule of the awards.

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 2000, 1999 and 1998, 7.8 million, 7.5 million and 9.4 million shares, respectively, were purchased under the ESPP and the employee stock purchase plans of acquired companies, at a weighted average price of $46.75, $43.60 and $23.23, respectively.

Lucent has adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and, as permitted under SFAS 123, applies Accounting Principles Board Opinion No. 25 ("APB 25") and related interpretations in accounting for its plans. Compensation expense recorded under APB 25 was $49, $50 and $79 for the years ended September 30, 2000, 1999 and 1998, respectively. If Lucent had elected to adopt the optional recognition provisions of SFAS 123 for its stock option plans and the ESPP, net income and earnings per share would have been changed to the pro forma amounts indicated below:

	Years Ended September 30,		
NET INCOME	2000	1999	1998
As reported	$1,219	$4,789	$1,065
Pro forma	$ 452	$4,239	$ 770
EARNINGS PER SHARE – BASIC			
As reported	$ 0.38	$ 1.54	$ 0.35
Pro forma	$ 0.14	$ 1.37	$ 0.25
EARNINGS PER SHARE – DILUTED			
As reported	$ 0.37	$ 1.49	$ 0.34
Pro forma	$ 0.13	$ 1.27	$ 0.24

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	2000	1999	1998
Dividend yield	0.23%	0.10%	0.17%
Expected volatility – Lucent	39.2%	33.8%	28.2%
– Acquisitions(1)	55.3%	58.2%	60.3%
Risk-free interest rate	6.5%	5.2%	5.3%
Expected holding period (in years)	2.9	3.7	4.2

(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, 2000, 1999 and 1998:

	Shares (in thousands)	Weighted Average Exercise Price Per Share
Options outstanding at October 1, 1997	**194,066**	**$11.85**
Granted/assumed(1) (2)	130,730	$27.46
Exercised	(41,722)	$ 9.33
Forfeited/expired	(15,941)	$19.85
Options outstanding at September 30, 1998	**267,133**	**$19.40**
Granted/assumed(1)	61,944	$47.68
Exercised	(30,951)	$12.20
Forfeited/expired	(11,834)	$23.16
Options outstanding at September 30, 1999	**286,292**	**$26.15**
Granted/assumed(1)	285,798	$47.95
Exercised	(74,963)	$15.38
Forfeited/expired	(38,815)	$41.56
Options outstanding at September 30, 2000	**458,312**	**$40.20**
Options outstanding reflecting spin-off adjustments(3)	**431,509**	**$39.34**

(1) Includes options converted in acquisitions.

(2) 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.

(3) Effective with the spin-off of Avaya on September 30, 2000, unvested Lucent stock options held by Avaya employees were converted into Avaya stock options. For remaining unexercised Lucent stock options, the number of Lucent stock options and the exercise price were adjusted to preserve the intrinsic value of the stock options that existed prior to the spin-off.

The weighted average fair value of Lucent stock options, calculated using the Black-Scholes option-pricing model, granted during the years ended September 30, 2000, 1999 and 1998 is $16.15, $16.65 and $11.87 per share, respectively.

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2000 after considering the spin-off adjustments:

	Stock Options Outstanding			Stock Options Exercisable	
Range of Exercise Prices Per Share	Shares (in thousands)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price Per Share	Shares (in thousands)	Weighted Average Exercise Price Per Share
$ 0.02 to $ 11.14	65,014	5.8	$ 7.61	49,393	$ 9.16
$11.15 to $ 23.07	47,558	6.6	17.19	39,825	16.68
$23.08 to $ 41.70	61,080	7.9	34.52	11,904	31.00
$41.71 to $ 42.47	101,011	2.2	42.17	60	42.15
$42.48 to $ 58.60	49,474	9.0	52.57	3,513	51.73
$58.61 to $ 59.13	52,202	9.6	58.61	99	58.78
$59.14 to $101.73	55,170	9.2	65.89	2,987	64.59
Total	**431,509**		**$39.34**	**107,781**	**$17.34**

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, 2000, 1999 and 1998:

	Years Ended September 30,		
	2000	1999	1998
Other stock unit awards granted (in millions)	858	532	1,730
Weighted average market value of shares granted during the period	$59.23	$31.82	$22.23

14. OPERATING SEGMENTS

As described in Note 3, Lucent has reclassified the results of operations of Avaya as discontinued operations. This business was previously disclosed as a separate operating segment. The segment data included below has been restated to exclude amounts related to the spin-off of Avaya.

Lucent operates in the global telecommunications networking industry and has two reportable operating segments: Service Provider Networks ("SPN") and Microelectronics and Communications Technologies ("MCT"). SPN provides public networking systems, software and services to telecommunications service providers and public network operators around the world. MCT provides high-performance optoelectronic components and integrated circuits, power systems and optical fiber for applications in the communications and computing industries. MCT also includes Lucent's new ventures business.

The two 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 was 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 other acquired intangibles amortization, and IPRD 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 on other factors according to 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).

(dollars in millions, except per share amounts)

Reportable Segments

Year Ended September 30, 2000	SPN	MCT	Other and Corporate[1]	Consolidated Totals
External revenues	$26,509	$6,953	$ 351	$33,813
Intersegment revenues	328	1,440	(1,768)	–
Total revenues	**26,837**	**8,393**	**(1,417)**	**33,813**
Depreciation and amortization	959	553	806	2,318
Operating income (loss)	3,041	1,582	(1,638)	2,985
Assets	26,919	8,497	13,376	48,792
Capital expenditures	981	1,003	717	2,701

Year Ended September 30, 1999	SPN	MCT	Other and Corporate[1]	Consolidated Totals
External revenues	$24,833	$5,026	$ 758	$30,617
Intersegment revenues	230	1,297	(1,527)	–
Total revenues	**25,063**	**6,323**	**(769)**	**30,617**
Depreciation and amortization	677	499	404	1,580
Operating income (loss)	4,730	786	(822)	4,694
Assets	17,627	4,146	13,599	35,372
Capital expenditures	713	828	501	2,042

Year Ended September 30, 1998	SPN	MCT	Other and Corporate[1]	Consolidated Totals
External revenues	$20,116	$4,134	$ 117	$24,367
Intersegment revenues	215	1,044	(1,259)	–
Total revenues	**20,331**	**5,178**	**(1,142)**	**24,367**
Depreciation and amortization	631	371	226	1,228
Operating income (loss)	3,008	406	(1,461)	1,953
Assets	13,154	3,140	8,851	25,145
Capital expenditures	584	712	319	1,615

(1) 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, prepaid pension costs and other assets.

Reconciling Items

A reconciliation of the totals reported for the operating segments to income from continuing operations before provision for income taxes in the Consolidated Financial Statements is as follows:

	Years ended September 30,		
OPERATING INCOME	2000	1999	1998
Total reportable segments	$ 4,623	$ 5,516	$ 3,414
Acquisition/integration-related costs	(1,066)	(530)	(1,385)
Goodwill and other acquired intangibles amortization	(551)	(310)	(105)
Other and corporate	(21)	18	29
Operating income	**2,985**	**4,694**	**1,953**
Other income-net	366	402	110
Interest expense	(348)	(318)	(143)
Income from continuing operations before provision for income taxes	**$ 3,003**	**$ 4,778**	**$ 1,920**

Products and Services Revenues

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

	Years ended September 30, 2000	1999	1998
Wireless Products	$ 6,223	$ 5,511	$ 4,456
Core Networking Systems	19,018	18,309	14,962
NetCare Professional Services	1,247	1,107	656
Microelectronics	3,726	2,805	2,396
Other [1]	3,599	2,885	1,897
Totals	**$33,813**	**$30,617**	**$24,367**

(1) "Other" principally includes optical fiber, power systems and consumer products.

Geographic Information

	External Revenues[1] Years Ended September 30,			Long-Lived Assets[2] September 30,		
	2000	1999	1998	2000	1999	1998
United States	$22,337	$20,151	$17,428	$15,367	$5,575	$4,719
Non-U.S. countries	11,476	10,466	6,939	1,662	1,604	1,317
Totals	$33,813	$30,617	$24,367	$17,029	$7,179	$6,036

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

(2) Represents property, plant and equipment (net), and goodwill and other acquired intangibles.

Concentrations

Historically, Lucent has relied on a limited number of customers for a substantial portion of its total revenues. Revenues from Verizon accounted for approximately 13% of consolidated revenues in fiscal year 2000, principally in the SPN segment. Revenues from AT&T accounted for approximately 10%, 14% and 15% of consolidated revenues in the years 2000, 1999 and 1998, respectively, principally in the SPN segment. Lucent expects a significant portion of its future revenues to 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.

15. FINANCIAL INSTRUMENTS

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

	September 30, 2000		September 30, 1999	
ASSETS	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Derivative and off-balance-sheet instruments:				
Foreign exchange forward contracts/options	$ 31	$ 32	$ 17	$ 16
Letters of credit	–	2	–	2
LIABILITIES				
Long-term debt[1]	$3,029	$2,731	$4,083	$3,956
Derivative and off-balance-sheet instruments:				
Foreign exchange forward contracts/options	13	19	35	26

(1) Excluding long-term lease obligations of $47 at September 30, 2000 and $79 at September 30, 1999.

(dollars in millions, except per share amounts)

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 exchange forward 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 continuous monitoring procedures and reserves for losses are established when deemed necessary. 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 the foreign exchange rates. The notional amounts for foreign exchange forward and option contracts represent the U.S. dollar equivalent of amounts exchanged. Generally, foreign exchange forward contracts are designated for firmly committed or forecast 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, 2000 and 1999. All other gains and losses on foreign exchange forward 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 to, 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 2000, these notional amounts principally represent contracts in Canadian dollars, Brazilian reals, Australian dollars, British pounds, Japanese yen and Euros. 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,	
	2000	1999
Foreign exchange forward contracts	$1,850	$1,778
Foreign exchange option contracts	$ 124	$ 251

Lucent may enter into certain interest rate swap agreements to manage its risk between fixed and variable interest rates and long-term and short-term maturity debt instruments. There were no material interest rate swap agreements in effect during 2000 and 1999.

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.

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 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,	
	2000	1999	2000	1999
Commitments to extend credit	$5,391	$5,543	$1,263	$1,565
Guarantees of debt	$ 677	$ 108	$ 771	$ 324

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. In certain situations, credit may not be available for draw down until certain conditions precedent are met.

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 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 $917 and $910 as of September 30, 2000 and 1999, respectively.

16. SECURITIZATIONS

In September 2000, Lucent and a third-party financial institution arranged for the creation of a non-consolidated Special Purpose Trust (the "Trust") for the purpose of allowing Lucent from time to time to sell on a limited-recourse basis up to a maximum of $970 of customer finance loans and receivables (the "Loans") at any given point in time through a wholly owned bankruptcy-remote subsidiary, which in turn will sell the Loans to the Trust. Lucent has also agreed, in the case of foreign currency denominated Loans and Loans with a fixed interest rate, to indemnify the Trust for foreign exchange losses and losses due to movements in interest rates (if any) if hedging instruments have not been entered into for such Loans. Lucent will receive a fee from the Trust for either arranging hedging instruments or providing the indemnity. Lucent will continue to service, administer and collect the Loans on behalf of the Trust and receive a fee for performance of these services. Lucent will also receive a fee for referring Loans to the Trust that the Trust purchases from Lucent. At September 30, 2000, Lucent had sold $579 of Loans to the Trust. The impact of this transaction increased cash flows from operating activities by $575.

In September 1999, a subsidiary of Lucent sold approximately $625 of accounts receivable from one large non-U.S. customer 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 as of September 30, 1999. The impact of the above transaction on the 1999 financial statements reduced receivables and increased cash flows from operating activities in the Consolidated Statements of Cash Flows by $600. During December 1999, Lucent repurchased $408 of the $625 of accounts receivable, and the previously reported arrangement was terminated. In addition, Lucent established a new arrangement whereby its subsidiary sold $750 of accounts receivable (including the repurchased receivables described) to a consortium of banks with limited recourse. As a result of these transactions, receivables at September 30, 2000 were reduced by $342 and cash flows from operating activities were increased by $312 during fiscal 2000.

During the fourth fiscal quarter of 2000, approximately $550 of additional receivables from this customer were sold.

From time to time, Lucent may sell trade and note receivables with or without recourse and/or discounts in the normal course of business.

17. 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, 2000, 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, from matters other than those described in the next paragraph, beyond that provided for at September 30, 2000 would not be material to the annual Consolidated Financial Statements.

In addition, Lucent and certain of its former officers are defendants in several purported shareholder class action lawsuits for alleged violations of federal securities laws. Specifically, the complaints allege, among other things, that beginning in late October 1999, Lucent and certain of its officers misrepresented Lucent's financial condition and failed to disclose material facts that would have an adverse impact on Lucent's future earnings and prospects for growth. These actions seek compensatory and other damages, and costs and expenses associated with the litigation. These actions are in the early stages and the Company is unable to determine their potential impact on the Consolidated Financial Statements. Lucent intends to defend these actions vigorously.

In connection with the formation of Lucent from certain units of AT&T Corp. and the associated assets and liabilities of those units and AT&T's distribution of its remaining interest in Lucent to its shareowners, Lucent, AT&T and NCR Corporation executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996, as amended and restated, 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.

(dollars in millions, except per share amounts)

In connection with the spin-off of Avaya, Lucent and Avaya executed and delivered a Contribution and Distribution Agreement which provides for indemnification by each company with respect to contingent liabilities primarily relating to their respective businesses or otherwise assigned to each, subject to certain sharing provisions. In the event the aggregate value of all amounts paid by each company, in respect of any single contingent liability or any set or group of related contingent liabilities, is in excess of $50 each company will share portions in excess of the threshold amount based on agreed-upon percentages. The Contribution and Distribution Agreement also provides for the sharing of certain contingent liabilities, specifically: (1) any contingent liabilities that are not primarily contingent liabilities of Lucent or contingent liabilities associated with the businesses attributed to Avaya; (2) certain specifically identified liabilities, including liabilities relating to terminated, divested or discontinued businesses or operations; and (3) shared contingent liabilities within the meaning of the Separation and Distribution Agreement with AT&T Corp.

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 five 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 amounts 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, 2000 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 $522, $406 and $336 for the years ended September 30, 2000, 1999 and 1998, respectively. The table below shows the future minimum lease payments due under non-cancelable leases at September 30, 2000. Such payments total $1,463 for operating leases. The net present value of such payments on capital leases was $62 after deducting imputed interest of $10.

	Years Ended September 30,					
	2001	2002	2003	2004	2005	Later Years
Operating leases	$298	$255	$202	$150	$109	$449
Capital leases	16	21	21	13	1	–
Minimum lease payments	314	276	223	163	110	449

18. SUBSEQUENT EVENTS

On November 13, 2000, Lucent entered into an agreement to sell its power systems business to Tyco International Ltd., a diversified manufacturing and service company, for $2,500 in cash. The sale, which is subject to regulatory approval and other customary closing conditions, is expected to close by December 31, 2000.

19. QUARTERLY INFORMATION (UNAUDITED)

	Fiscal Year Quarters				
YEAR ENDED SEPTEMBER 30, 2000	First	Second	Third	Fourth	Total
Revenues	$8,065	$8,355	$8,713	$8,680	**$ 33,813**
Gross margin	3,758	3,482	3,790	3,244	**14,274**
Income (loss) from continuing operations	1,124(1)	622(2)	(14)(3)	(51)(4)	**1,681**
Income (loss) from discontinued operations	125	133	(287)	(433)	**(462)**
Net income (loss)	$1,249	$ 755	$ (301)	$ (484)	**$ 1,219**
Earnings (loss) per common share – basic:					
Income (loss) from continuing operations	$ 0.36(1)	$ 0.20(2)	$ (0.00)(3)	$ (0.01)(4)	**$ 0.52**
Income (loss) from discontinued operations	0.04	0.04	(0.09)	(0.13)	**(0.14)**
Net income (loss)	$ 0.40	$ 0.24	$ (0.09)	$ (0.14)	**$ 0.38**
Earnings (loss) per common share – diluted:					
Income (loss) from continuing operations	$ 0.34(1)	$ 0.19(2)	$ (0.00)(3)(5)	$ (0.01)(4)(5)	**$ 0.51**
Income (loss) from discontinued operations	0.04	0.04	(0.09)(5)	(0.13)(5)	**(0.14)**
Net income (loss)	$ 0.38	$ 0.23	$ (0.09)(5)	$ (0.14)(5)	**$ 0.37**
Dividends per share	$ 0.04	$ 0.00	$ 0.02	$ 0.02	**$ 0.08**
Stock price:(10)					
High	84 3/16	77 1/2	65 15/16	67 3/16	**84 3/16**
Low	55 1/16	49 13/16	51 1/16	28 1/16	**28 1/16**
Quarter-end close	75	62	58 3/4	30 1/2	**30 1/2**

YEAR ENDED SEPTEMBER 30, 1999	First	Second	Third	Fourth	Total
Revenues	$8,036	$6,831	$7,403	$8,347	$30,617
Gross margin	4,378	3,347	3,573	3,714	15,012
Income from continuing operations	1,194(6)	511(7)	622(8)	699(9)	3,026
Income from discontinued operations	42	24	141	248	455
Income before cumulative effect of accounting change	1,236	535	763	947	3,481
Cumulative effect of accounting change	1,308	–	–	–	1,308
Net income	$2,544	$ 535	$ 763	$ 947	$ 4,789
Earnings per common share – basic:					
Income from continuing operations	$ 0.39(6)	$ 0.16(7)	$ 0.20(8)	$ 0.22(9)	$ 0.97
Income from discontinued operations	0.01	0.01	0.05	0.08	0.15
Cumulative effect of accounting change	0.43	–	–	–	0.42
Net income	$ 0.83	$ 0.17	$ 0.25	$ 0.30	$ 1.54
Earnings per common share – diluted:					
Income from continuing operations	$ 0.38(6)	$ 0.16(7)	$ 0.19(8)	$ 0.21(9)	$ 0.94
Income from discontinued operations	0.01	0.01	0.05	0.08	0.14
Cumulative effect of accounting change	0.41	–	–	–	0.41
Net income	$ 0.80	$ 0.17	$ 0.24	$ 0.29	$ 1.49
Dividends per share	$ 0.04	$ 0.00	$ 0.02	$ 0.02	$ 0.08
Stock price:(10)					
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

(1) Includes an after-tax gain of $115 ($189 pre-tax) associated with the sale of an equity investment and an after-tax charge of $40 ($61 pre-tax) primarily associated with the mergers with INS, Excel and Xedia.

(2) Includes an after-tax charge of $7 ($11 pre-tax) of IPRD related to the acquisition of VTC.

(3) Includes an after-tax charge of $863 (non-tax impacting) of IPRD related to the acquisitions of Chromatis, Herrmann, Ortel and Agere.

(4) Includes an after-tax charge of $131 (non-tax impacting) of IPRD related to the acquisition of Spring Tide.

(5) As a result of the loss reported from continuing operations, potentially dilutive securities have been excluded from the calculation of diluted earnings (loss) per share because their effect would be anti-dilutive.

(6) Includes an after-tax charge of $287 ($295 pre-tax) of IPRD related to the acquisitions of Quadritek, Stratus, XNT and Quantum.

(7) Includes an after-tax charge of $15 ($18 pre-tax) of IPRD related to the acquisitions of WaveAccess, Enable Ethernet and Sybarus. In addition, $24 of Stratus IPRD was reversed. As a result of the merger with Vital Signs, Lucent recorded a charge to operating expenses of $7 (non-tax impacting) for direct merger related costs.

(8) Includes an after-tax charge of $81 (non-tax impacting) primarily associated with the mergers with Ascend and RASCom.

(9) Includes pre-tax costs of $258 ($191 after-tax) primarily associated with asset impairments, integration-related charges and merger expenses related to the mergers with Ascend and Nexabit. These costs principally include the write-off of Livingston goodwill and other acquired intangibles and certain product and system integration and direct merger expenses related to Nexabit. Additionally, as a result of the 1999 acquisition of InterCall, Lucent recorded an after-tax charge of $2 ($3 pre-tax) for IPRD and an after-tax gain of $167 ($274 pre-tax) associated with the sale of an equity investment.

(10) 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.

>>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 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 2001 annual meeting of shareowners will be held Wednesday, Feb. 21, 2001, at 9 a.m. EST in the Linda W. Chapin Auditorium, Orange County Convention Center, 9800 International Drive, Orlando, FL 32819.

Internet/Telephone Voting

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. Instructions are in the proxy statement and attached to the proxy card for the annual meeting. 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. Registered shareowners also may sign up to access annual reports and proxy statements over the Internet in the future. Beneficial owners may contact the brokers or banks that hold their stock to see if electronic access is available.

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. For a plan brochure and enrollment form, call The Bank of New York directly at 1 888 LUCENT6 (1 888 582-3686), or write to the address shown in the Shareowner Hotline paragraph. Also, you can visit The Bank of New York's stock transfer 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 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, 2000: 3,384,332,104. Shareowners of record as of Oct. 1, 2000: 1,617,052.

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, visit our Investor Relations Web site at:
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Other Information

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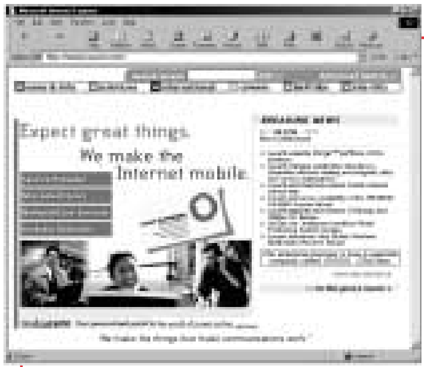
600 Mountain Ave.
Murray Hill, NJ 07974-0636

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



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On the cover:
An instructor at ionex telecommunications' customer Sylvan Rocks Climbing School & Guide Service in South Dakota catches up on work details. ionex, a Dallas-based competitive local exchange carrier, signed a $195 million contract with Lucent to bring high-speed voice, data and Internet access to business customers in 14 states.

>>Board of Directors

Behind Henry B. Schacht are (from left): Betsy S. Atkins, Paul H. O'Neill, Paul A. Allaire, John A. Young, Franklin A. Thomas and Carla A. Hills.

Henry B. Schacht
66, chairman and chief executive officer of Lucent since October 2000. Chairman (1996-1998) and chief executive officer (1996-1997) of Lucent. Chairman (1977-1995) and chief executive officer (1973-1994) of Cummins Engine Company, Inc. (diesel engines). Director and senior advisor, Warburg Pincus & Co., LLC. Director, Alcoa Inc.; Avaya Inc.; The Chase Manhattan Corporation and The Chase Manhattan Bank, N.A.; Johnson & Johnson; Knoll, Inc.; The New York Times Co. Lucent director since 1996.

Betsy S. Atkins
45, independent venture capitalist focusing on investments in early stage, high-tech companies. Director, Advanced Switching Communications, Inc.; Polycom, Inc.; Selectica Inc. Lucent director since April 2000.

Paul H. O'Neill
65, retired chairman (1987-December 2000) and chief executive officer (1987-1999) of Alcoa Inc. (aluminum production). Chairman, RAND and Manpower Demonstration Research Corporation. Director, Eastman Kodak Co.; Gerald R. Ford Foundation; the National Association of Securities Dealers, Inc. Lucent director since 1996.

Paul A. Allaire
62, chairman of Xerox Corporation (document processing services and products) since 1991. Chief executive officer of Xerox 1990-1999 and May 2000 to present. Director, J.P. Morgan & Co.; priceline.com Incorporated; Sara Lee Corp.; SmithKline Beecham p.l.c. Lucent director since 1996.

John A. Young
68, vice chairman of SmithKline Beecham p.l.c. (pharmaceuticals) since January 1999. Vice chairman of Novell, Inc. (network software and directory-enabled network solutions) since 1997. Retired president and chief executive officer of Hewlett-Packard Co. (1978-1992). Director, Affymetrix Inc.; Chevron Corp.; Ciphergen Biosystems, Inc.; Novell, Inc.; SmithKline Beecham p.l.c. Lucent director since 1996.

Franklin A. Thomas
66, consultant to the TFF Study Group (non-profit initiative assisting development in southern Africa) since 1996. Retired president of The Ford Foundation (1979-1996). Director, Alcoa Inc.; Avaya Inc.; Citigroup N.A.; Conoco Inc.; Cummins Engine Company, Inc.; PepsiCo, Inc. Lucent director since 1996.

Carla A. Hills
66, 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.

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