

Henry B. Schacht Chairman and Chief Executive Officer

>> 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-

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 1/2	$ 64 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.

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.



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.

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 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.

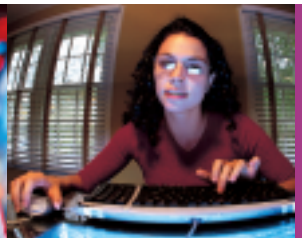
Lucent was first to market with a dense wavelength division multiplexing (DWDM) system in 1995 and has since shipped more DWDM systems than any other vendor. We signed a three-year, multimillion-dollar contract with Germany's Deutsche Telekom for our DWDM solution to build a high-speed optical network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





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.

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.



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.

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.

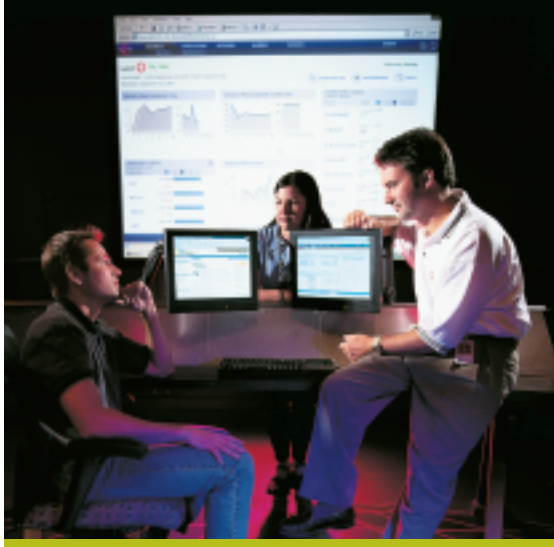
Our next-generation 7R/E™ packet switching solution helps service providers transition from circuit to packet switching. It puts voice on packets, yet captures everything voice networks do best, including delivering any of 3,000 networking and calling features.

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.



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.

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.

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.



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.

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.



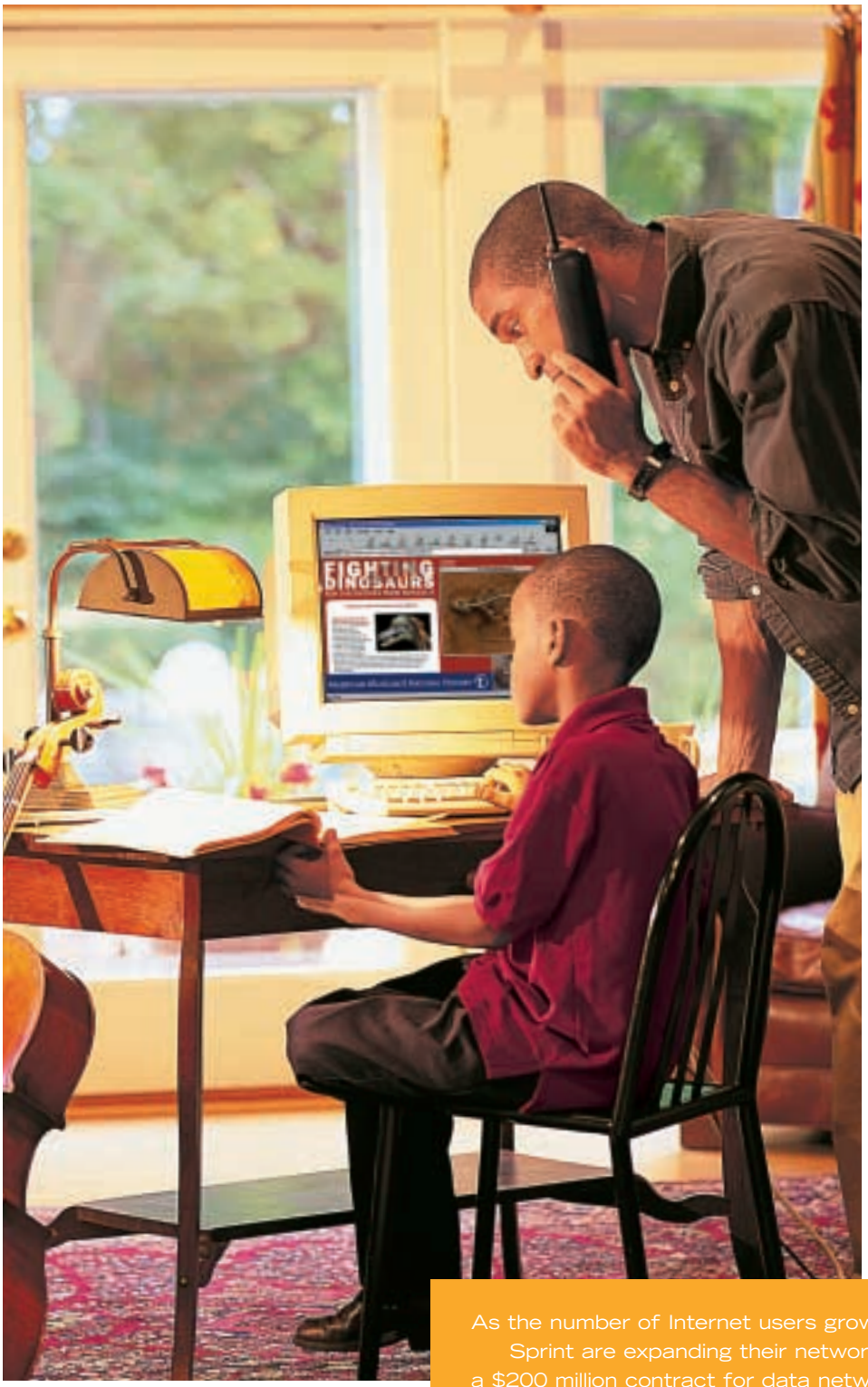
With nearly 6,000 network engineers and consultants in almost 70 countries, Lucent Worldwide Services handles virtually all the tasks needed to keep complex networks humming.

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.

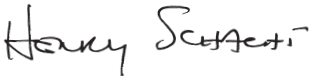
Bell Labs celebrated its 75th anniversary as a global technology powerhouse in 2000. Two-thirds of its researchers are developing next-generation software and applications.

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.

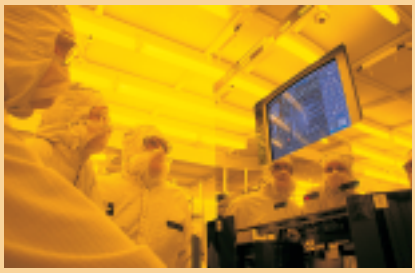


Henry B. Schacht
Chairman and Chief Executive Officer

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