TO OUR SHAREOWNERS:

Throughout fiscal 2002 the global telecommunications market continued an unprecedented down cycle—arguably the worst in history. The depth of the decline in spending by service providers around the world—and its duration—was unexpected by those of us in the industry and by those who follow it. Like many others in the industry, during fiscal 2002 we experienced substantial declines in revenues, which adversely affected our results.

The depth of the market decline was due to a number of factors: a decline in the global economy; to a large extent, a result of the excess capacity that was built in the late 1990s during the telecom boom; and regulatory uncertainty. We believe that the excess capacity will work its way out, and when it does the market for telecommunications equipment will start to recover.

In the meantime, the market we are addressing is still large at well over $100 billion a year. And the underlying demand for communications services continues to grow. Communications is fundamental to the global economy, and we are confident that over time the market for communications equipment will stabilize, recover and eventually resume growth at single-digit levels.

At Lucent Technologies, every action we take is designed to get us through the downturn and to position us to grow profitability when the market rebounds. And we are focused on the necessary actions to profitably win more of what our customers are spending today.

We differentiate ourselves with a deep understanding of how networks work, coupled with an industry-leading product portfolio in mobility, optical, circuit and packet switching and network operations software. And we have the most extensive services capability in the industry powered by Bell Labs' systems expertise and software tools.

We continue to drive down costs and expenses, improve our systems and processes, and improve our performance in serving customers.

While we still have much work to do, we did make significant progress in a number of important areas under extremely difficult market conditions. During fiscal year 2002, we:

- Lowered SG&A and R&D expenses by about $4.6 billion.
- Reduced cash used in operating activities and for capital expenditures by $3.6 billion to $1.2 billion.
- Reduced vendor financing commitments from $5.3 billion to $1.3 billion.
- Ended fiscal 2002 with $4.4 billion in cash and short-term investments, giving us the liquidity we need to fund our operations and our restructuring plan.

These results were achieved in the face of an uncertain market and the continuing challenges to our top line. Our progress is a clear indication of our employees' incredible resolve and continued dedication to the business and to supporting our customers during this prolonged industry downturn.



HENRY B. SCHACHT
Chairman

PATRICIA F. RUSSO
President and Chief Executive Officer

FINANCIAL SUMMARY

For the year ended Sept. 30, 2002, revenues declined about 42 percent compared with the prior year, from $21.3 billion to $12.3 billion, and the loss from continuing operations was $3.51 per share, compared with a loss of $4.18 per share for fiscal 2001.

On a segment basis, revenues for the year in Integrated Network Solutions decreased 48 percent, to $6.4 billion, compared with fiscal 2001, and Mobility Solutions' revenues declined 13 percent to $5.4 billion, compared with the previous year.

On June 1, 2002, we completed the spinoff of our microelectronics business as a separate company known as Agere Systems. In addition, in the first fiscal quarter of 2002 we completed the sale of our Optical Fiber Solutions business to Furukawa Electric Co., Ltd.

LOOKING AHEAD

Increasingly, it has become more difficult to predict how the spending patterns of service providers will unfold in the coming quarters.

However, it is clear that service providers need to deploy profitable new services, reduce the complexity of their operations, and optimize and evolve their current networks. Like us, our service provider customers also must reduce costs and drive down expenses to maximize the use of available capital.

So we have developed detailed plans that respond to these new market realities.

Lucent intends to be the premier global supplier of networking solutions for service providers. With our industry-leading offerings in mobility, optical, circuit and packet switching and network operations software, designed by Bell Labs, combined with our unparalleled network know-how, we have what our customers need to evolve their existing network investments and offer next-generation services.

In April 2002, Verizon Communications named Lucent its

exclusive provider for future developments of Dense Wavelength Division Multiplexing (DWDM) technology. Verizon is using our Metropolis® Enhanced Optical Networking (EON) equipment to expand the bandwidth of its existing network and cost-effectively deliver new revenue-generating, high-speed services such as Gigabit Ethernet and interoperable storage solutions to its customers. Our Metropolis optical products are in more than 45 trials and deployments.

The LambdaUnite™ MultiService Switch introduced in January 2002 was an immediate hit with customers, including Deutsche Telekom in Germany, Sichuan Telecom and Shanghai Telecom in China, and Edison Carrier Solutions through LightRiver Technologies in the United States.

We have an industry-leading long-haul optical transport system, LambdaXtreme,™ that made its debut in March, and it's now in trial with about a half dozen customers.

OPPORTUNITIES FOR INTEGRATED NETWORK SOLUTIONS

We also have opportunities with our service provider customers who have massive investments in their installed base of circuit switches, and these customers tell us they plan to leverage that investment.

We are working closely on a customer-by-customer basis to help them evolve their 5ESS® platforms to increase capacity, reduce footprint, lower cost of operations and accelerate new feature introductions. For instance:

- In May 2002, we announced a multiyear agreement with SBC Communications Inc. to provide SBC with an Internet protocol (IP) Centrex solution. SBC is using the Lucent IP Centrex platform for its SBC Centrex IP service, which helps business customers take advantage of new cutting-edge central office-based services.
- A new large capacity switch is now in its first-office application with a large regional carrier, boosting capacity from 90,000 to 260,000 ports on the same switch.
- A new high-density optical interface unit, which increases capacity tenfold, is being tested in another regional carrier's lab.

In the network core, we are committed to a MultiProtocol Label Switching (MPLS) migration. Given our customers' stated intent to focus on leveraging their embedded networks, we will enhance our GX 550™ MultiService Core Switch feature set with MPLS and other features, as requested by and committed to by our customers. At the network edge we will continue to invest in products such as the CBX 500® Multiservice WAN Switch and the PacketStar® PSAX Multiservice Media Gateway, which has found new success and new market opportunities supporting wireless networks.

One area where we will be increasing our investment is network management software, which directly addresses our customers' need to reduce operational complexity and optimize their networks. Because we have a deep understanding of how networks work and a portfolio of software to help operate and evolve networks, this is very definitely a near and clear opportunity.

For example, our new Navis™ iOperations software portfolio is focused on simplifying network management for our customers, reducing costs, improving reliability, and helping them accelerate the time to market for voice and data services.

To date, more than a thousand service provider and enterprise customers have deployed Lucent software products.



Members of the Lucent team that deployed Sprint PCS' nationwide third-generation (3G) wireless network two months ahead of schedule. Lucent Worldwide Services was an invaluable resource for enabling the quick pace. (From left) Gary Perry, Mervin Johnson, Mike Simmons and Clarence Savage. Johnson shows the team a 3G-enabled personal digital assistant that Sprint PCS subscribers use with their PCS Vision service.

STRENGTH IN MOBILITY SOLUTIONS

We have the most experience in delivering next-generation 3G mobility solutions and we are the global leader in delivering spread spectrum solutions.

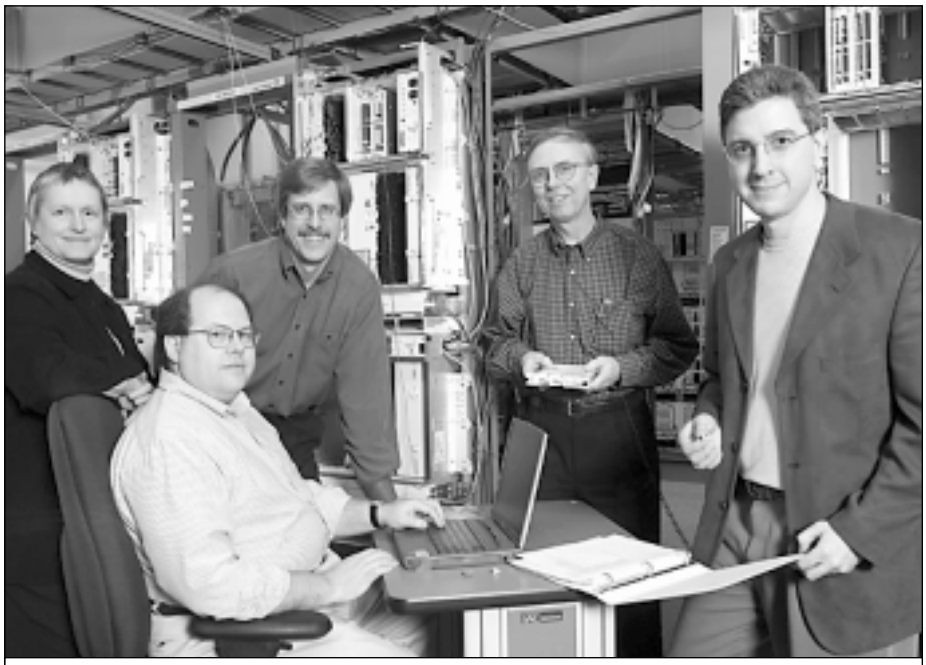
Our recent contract announcements with China Unicom for more than $400 million and with two wireless service providers in India, Reliance Infocom and Tata Teleservices, for several hundred mil-

lion dollars, are the latest in a string of recent customer announcements.

We remain the global leader in CDMA spread spectrum networks, with more than 70,000 base stations providing commercial service around the world. More than 35,000 of those base stations are providing 3G services for our customers today. We have built more CDMA networks than anyone else, and we are leveraging that expertise to establish a strong position in the early stages of UMTS deployment.

Understanding spread spectrum is key to delivering UMTS. Our knowledge and leadership in this technology will serve as a significant competitive advantage as next-generation wireless systems are deployed.

In addition, Lucent conducted a series of in-depth studies that identified substantial demand for high-speed mobile data access among businesses, particularly for e-mails with data-heavy attachments, as well as for Internet and corporate Intranet access.



Teams collaborating across Lucent—Verizon Customer Team, Metro Optical Product Teams, Supply Chain Networks, Technical Support Services and Lucent Worldwide Services—worked to provide Verizon Communications with Lucent's cost-effective, high-speed Metropolis Enhanced Optical Networking DWDM system. (From left) Mirga Girnius, Ray Higgins, Dale Seiberg, Bill Sullivan and Dick Di Pasquale.

These studies also revealed that 3G mobile operators utilizing spread spectrum systems are in the best position to provide these services to enterprise customers. We are providing these findings to our mobile operator customers to help them develop a business model that will serve their customers' needs.

SERVICES: A KEY DIFFERENTIATOR

We are putting more emphasis on our Services business.

Even with the telecom market as challenging as it is, Services remains a near and clear opportunity. Our customers spend about $30 billion a year on the types of services that Lucent can provide—services that they contract for with other outside companies.

Lucent Worldwide Services (LWS) plans to address more of the services market by expanding into new areas like network integration, multivendor networking and outsourcing.

This is a great differentiator for us. We have one of the largest skilled groups of technicians, engineers and installers serving most of Lucent's top customers on five continents. We offer services solutions such as planning, design, deployment, integration and operations of multivendor, multitechnology networks.

LWS is focused on the areas that matter most to our customers in cash-crunch times like these: revenue recovery, network optimization and inventory management.

Our Services business remains a critical component of the value we bring to customers. This is evident in that a significant number of Lucent's contracts in 2002 had a services component.

For example, in the SBC-IP Centrex announcement mentioned earlier, LWS worked closely with the customer to deploy the solution simultaneously in five U.S. locations despite a very ambitious timeline.

Also, as we announced earlier this year, LWS was selected by British Telecommunications PLC (BT) to provide general network support and services for its United Kingdom network infrastructure. LWS is providing support for several components of BT's network, including optical, IP, voice and data switching elements, as well as BT's 999 emergency services network.

In summary, we believe that we still have a robust and very competitive set of products and services in the areas where we know our customers will be investing to expand their existing networks over the near term.

We intend to emerge from these difficult times as the strongest player in the market and the partner of choice for our customers.

In short, we've reset our strategy to match new market realities, and we're putting plans in place that are designed to leverage our strengths, create additional revenue sources, and focus completely on helping our customers improve their businesses.

BELL LABS: INNOVATION CENTRAL

Bell Labs, with a world-renowned research and development (R&D) heritage that's more than three-quarters of a century in the making, continues to serve as Lucent's innovation engine.

The combined effort of thousands of employees around the world in research and development continues to yield exciting technological breakthroughs, as well as leading-edge products and services that help keep Lucent at the forefront of communications.

Today, Bell Labs has more networking expertise than can be found anywhere in the world, and is the most prolific source of innovations in the telecommunications industry. Bell Labs earns an average of more than two patents each workday, and remains No. 1 in technological strength in the telecommunications industry as ranked by MIT's *Technology Review* magazine for the second straight year.



Bell Labs researchers David Garrett (standing) and Mark Bickerstaff are members of the research team in Australia that developed Lucent's prototype BLAST chips, which have the potential to dramatically increase the capacity of wireless networks while consuming less battery power in devices such as mobile phones, laptops and personal digital assistants.

We continue to improve the alignment between our technology vision and business strategy, and Bell Labs innovations are moving from lab to market faster than ever. Especially in today's environment, having an in-house R&D brain trust like Bell Labs is an important strategic advantage for Lucent.

A NEW START IN FISCAL 2003

In early October 2002, we announced additional restructuring actions that are designed to ensure our financial viability and reshape the business so that we are positioned to meet the needs of service providers when the market recovers.

These actions will further realign and refocus Lucent and its operations as we reduce our cost and expense structure to achieve quarterly breakeven revenue at $2.5 billion by the end of fiscal 2003. And we will work to reduce it further.

Lucent will be smaller going forward—about 35,000 employees—after streamlining our product line and eliminating more jobs in the coming year. This is painful for all involved. But in order for us to return to profitability by the end of fiscal 2003, we must become a slimmer, more streamlined company.

When we've completed our restructuring plan, however, we will continue to have one of the largest work forces focused on the service provider customer. And we will continue to have the strongest customer relationships.

Throughout the past year we have met with our customers to understand their needs and to articulate the value Lucent can bring to their business. Based on these and other discussions, we are focusing our investments on the nearest and clearest market opportunities that help our customers build and enhance their existing networks to offer next-generation services.

Looking ahead, we remain confident that the market will eventually turn around as constrained spending by service providers gives way to network expansion, new service applications and enhanced revenue opportunities.

We have demonstrated our resolve and our commitment to execute the cost and expense plans we put in place. We have a tremendous set of assets, a strong foundation of customer relationships and the best people in the industry. We are respected as a leading player in our market.

We will remain focused on our customers and on new revenue opportunities. This year our resolve and resiliency were tested like never before. But we are weathering the storm and continue to concentrate on the things we can control: keeping our commitments to customers and strenuously improving our cost and expense structure.

Going forward, our No. 1 priority is to return to profitability by the end of fiscal year 2003. We have the skilled employees, the award-winning R&D resources and sufficient cash to fund our operations.

We invite you to track our progress during the coming year by logging on to www.lucent.com.



Henry B. Schacht
Chairman



Patricia F. Russo
President and Chief Executive Officer

December 2, 2002