LUCENT TECHNOLOGIES

FINANCIAL REVIEW 2002

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FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about us, our future performance, the industries in which we operate, our beliefs and our management's assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by or on behalf of us. Words such as "expects,""anticipates,""targets,""goals,""projects,""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 that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. These risks and uncertainties include: the failure of the telecommunications market to improve or improve at the pace we anticipate; continued net losses may reduce or impair our legally available surplus; our ability to realize the benefits we expect from our strategic direction and restructuring program; our ability to secure additional sources of funds on reasonable terms; our credit ratings; our ability to compete effectively; our reliance on a limited number of key customers; our exposure to the credit risk of our customers as a result of our vendor financing arrangements and accounts receivable; our reliance on third parties to manufacture most of our products; the cost and other risks inherent in our long-term sales agreements; our product portfolio and ability to keep pace with technological advances in our industry; the complexity of our products; our ability to retain and recruit key personnel; existing and future litigation; our ability to protect our intellectual property rights and the expenses we may incur in defending such rights; changes in environmental health and safety law; changes to existing regulations or technical standards; the social, political and economic risks of our foreign operations; the impact if our common stock is de-listed from the New York Stock Exchange; and the costs and risks associated with our pension and postretirement benefit obligations. For a further list and description of such risks and uncertainties, see the reports filed by us with the Securities and Exchange Commission. Except as required under the federal securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update publicly any forward-looking statements after the distribution of this MD&A, whether as a result of new information, future events, changes in assumptions, or otherwise.

OVERVIEW

We design and deliver networks for the world's largest communications service providers. Backed by Bell Labs research and development, we rely on our strengths in mobility, optical, data and voice networking technologies, as well as software and services, to develop next-generation networks. Our systems, services and software are designed to help customers quickly deploy and better manage their networks and create new, revenue-generating services that help businesses and consumers.

Beginning in fiscal 2001, the global telecommunications market deteriorated, reflecting a significant decrease in the competitive local exchange carrier market and a significant reduction in capital spending by established service providers. This trend intensified during fiscal 2002. We believe that large service providers, primarily in the wireline market, have reduced their capital spending by more than 25% since the end of 2001. The U.S. wireline service provider capital spending declined by about 40%. Additional capital spending reductions may occur during 2003. Reasons for this reduction include the general economic slowdown, network overcapacity, customer bankruptcies, network build-out delays and limited capital availability. As a result, our sales and results of operations have been and may continue to be adversely affected. The significant slowdown in capital spending has created uncertainty as to the level of demand in our target markets. In addition, the level of demand can change quickly and can vary over short periods of time, including from month to month. As a result of the uncertainty and variations in our markets, accurately forecasting future results, earnings and cash flow is increasingly difficult.

As discussed in more detail throughout our MD&A:

- our results of operations during the past two years were adversely affected by the rapid and sustained deterioration of the telecommunications market. After several years of significant growth, our revenues declined during fiscal 2002 and 2001 by 42% and 26%, respectively, as compared to the respective prior year. The significant reduction in capital spending by service providers, among other factors, contributed to this decline;
- our gross margin rates, which historically had been at least 40%, declined to 12.6% and 9.7% during fiscal 2002 and 2001, respectively. The significant and rapid decline in revenue from decreased market demand and product line discontinuances led to significant inventory charges and high-unabsorbed fixed costs, which, among other factors, adversely affected our gross margin rates;
- we were able to reduce our operating expenses as a result of cost reductions under our restructuring actions; however, these actions resulted in net business restructuring and asset impairment charges of $2.3 billion and $10.2 billion during fiscal 2002 and 2001, respectively;
- we recorded significant provisions for bad debts and customer financings of $1.3 billion and $2.2 billion during fiscal 2002 and 2001, respectively, as a result of the significant deterioration of the financial health of certain customers. Most of these provisions were related to commitments made and loans drawn under our customer-financing program during prior years; and
- we recorded a full valuation allowance on our net deferred tax assets during fiscal 2002, which resulted in a tax provision of $4.8 billion despite a pre-tax loss from continuing operations of $7.1 billion.

All of these factors contributed significantly to our loss from continuing operations of $11.8 billion and $14.2 billion during fiscal 2002 and 2001, respectively. The fiscal 2001 results were also adversely affected by $3.2 billion of net losses from discontinued operations, which primarily related to our share of Agere's estimated losses through the June 1, 2002 spinoff date. We also completed several dispositions during the past two years, the most significant being the sale of our optical fiber business ("OFS"), resulting in a $664 million gain during fiscal 2002. Our dispositions did not have a significant effect on our results from continuing operations, except for the sale of OFS, which had revenues of $2.0 billion and pretax income of $541 million during fiscal 2001.

In fiscal 2002, we restructured our operations into distinct wireline and wireless units, and targeted the large service providers in each segment. We believe structuring our business along customer lines – wireline and wireless – enables us to better serve the needs of our large service provider customers.

Our wireline segment, Integrated Network Solutions ("INS"), focuses on global wireline service providers, including long distance carriers, traditional local telephone companies and Internet service providers. INS primarily sells and services core switching and access and optical networking products. Our wireless segment, Mobility Solutions ("Mobility"), offers products to support the needs of its customers for radio access and core networks and primarily sells and services wireless products to wireless service providers. Both segments offer network management and application and service delivery products. We support these two new segments through a number of central organizations, including our services organization and corporate headquarters. Manufacturing and supply chain functions are part of a single global supply chain network organization that manages the materials and activities necessary to produce and deliver products to our customers.

During this prolonged market downturn, we have worked closely with our customers to position the full breadth of our products and services, significantly reducing our cost structure and reducing our quarterly earnings per share ("EPS") breakeven revenue figure. If capital investment levels continue to decline, or if the telecommunications market does not improve or improves at a slower pace than we anticipate, our revenues and profitability will continue to be adversely affected. We are financially planning for our revenues to decline by about 20% during fiscal 2003. However, our results are expected to improve by realizing higher gross margin rates and lower operating expenses resulting from improved product mix, cost reductions related to our restructuring actions, lower inventory-related charges, and lower provisions for bad debts and customer financings.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. We believe that the following are some of the more critical judgment areas in the application of our accounting policies that affect our financial condition and results of operations.

The impact of changes in the estimates and judgments pertaining to revenue recognition, receivables and inventories is directly reflected in our segments' operating loss. Although any charges related to our net deferred tax assets and goodwill and other acquired intangibles are not reflected in the segment results, the long-term forecasts supporting the realization of those assets and changes in them are significantly affected by the actual and expected results of each segment. Generally, the changes in estimates related to pension and postretirement benefits, our restructuring program and litigation will not affect our segment results, although execution of the restructuring plans by each segment may cause related changes in the estimates.

We have discussed the application of these critical accounting policies with our board of directors and Audit and Finance Committee. There was no initial adoption of any accounting policies during fiscal 2002. See Note 18 to the consolidated financial statements for recent accounting pronouncements.

Revenue recognition

Most of our sales are generated from complex contractual arrangements, which require significant revenue recognition judgments, particularly in the areas of multiple element arrangements and collectibility. Revenues from contracts with multiple element arrangements, such as those including installation and integration services, are recognized as each element is earned based on objective evidence of the relative fair value of each element and when there are no undelivered elements that are essential to the functionality of the delivered elements. We have determined that the customer or a third party can install most of our equipment, and as a result, revenue may be recognized upon delivery of the equipment, provided all other revenue recognition criteria are met. The assessment of collectibility is particularly critical in determining whether revenues should be recognized in the current market environment. As part of the revenue recognition process, we determine whether trade and notes receivable are reasonably assured of collection based on various factors, including our ability to sell those receivables and whether there has been deterioration in the credit quality of our customers that could result in our being unable to collect or sell the receivables. In situations where we have the ability to sell the receivable, revenue is recognized to the extent of the value we could reasonably expect to realize from the sale. We will defer revenue and related costs if we are uncertain as to whether we will be able to sell or collect the receivable. We will defer revenue but recognize costs when we determine that the collection or sale of the receivable is unlikely. For sales generated from long-term contracts, primarily those related to customized network solutions and network build-outs, we generally use the percentage of completion method of accounting. In doing so, we make important judgments in estimating revenue and cost and in measuring progress towards completion. These judgments underlie our determinations regarding overall contract value, contract profitability and timing of revenue recognition. Revenue and cost estimates are revised periodically based on changes in circumstances; any losses on contracts are recognized immediately. We also sell products through multiple distribution channels, including resellers and distributors. For products sold through these channels, revenue is generally recognized when the reseller or distributor sells the product to the end user. The total amount of deferred revenue, including deferrals relating to collectibility concerns, undelivered elements and multiple distribution channels was approximately $228 million and $550 million at September 30, 2002 and 2001, respectively.

Receivables and customer financing

We are required to estimate the collectibility of our trade receivables and notes receivable. A considerable amount of judgment is required in assessing the realization of these receivables, including the current creditworthiness of each customer and related aging of the past due balances. Our provisions for bad debts and customer financings during fiscal 2002, 2001, and 2000 amounted to approximately $1.3 billion, $2.2 billion, and $500 million, respectively. At September 30, 2002 and 2001, our receivables of $1.6 billion and $4.6 billion, respectively, included reserves of $325 million and $634 million, respectively. Under our customer financing program, there were approximately $950 million and $2.1 billion of reserves on the $1.1 billion and $3.0 billion of drawn commitments at September 30, 2002 and 2001, respectively. We evaluate specific accounts when we become aware of a situation where a customer may not be able to meet its financial obligations due to a deterioration of its financial condition, credit ratings or bankruptcy. The reserve requirements are based on the best facts available to us and re-evaluated and adjusted as additional information is received. Our reserves also are determined by using percentages applied to certain aged receivable categories. Significant increases in reserves have been recorded during fiscal 2002 and 2001, and may occur in the future due to the market environment. In addition, at September 30, 2002, we had approximately $500 million of net assets from long-term projects that have been winding down in Saudi Arabia (primarily long-term receivables included in other assets). We have concluded that these net assets are realizable based on our contractual rights and past collection history.

Inventories

We are required to state our inventories at the lower of cost or market. In assessing the ultimate realization of inventories, we are required to make judgments as to future demand requirements and compare these with the current or committed inventory levels. Our reserve requirements generally increase as our projected demand requirements decrease due to market conditions, technological and product life cycle changes, and longer than previously expected usage periods. We have experienced significant changes in required reserves in recent periods due to changes in strategic direction, such as discontinuances of product lines, as well as declining market conditions. As a result, we incurred net inventory charges of approximately $620 million, $2.4 billion and $360 million during fiscal 2002, 2001 and 2000, respectively. At September 30, 2002 and 2001, inventories of $1.4 billion and $3.6 billion respectively, are net of reserves of approximately $1.4 billion and $1.1 billion, respectively. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a further decline in market conditions and if additional restructuring actions are taken.

Income taxes

We currently have significant deferred tax assets resulting from tax credit carryforwards, net operating loss carryforwards and deductible temporary differences, which will reduce taxable income in future periods. At September 30, 2001 and continuing through March 31, 2002 we provided valuation allowances on future tax benefits with relatively short carryforward periods such as foreign tax credits, foreign net operating losses, capital losses and most state net operating losses. At that time, we believed it was more likely than not that the remaining net deferred tax assets of $5.2 billion at both September 30, 2001 and March 31, 2002 would be realized principally based upon forecasted taxable income, generally within the twenty-year research and development ("R&D") credit and net operating loss carryforward periods, giving consideration to substantial benefits realized to date through our restructuring program. A valuation allowance is required when it is more likely than not that all or a portion of a deferred tax asset will not be realized. Forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years. Cumulative losses weigh heavily in the overall assessment. During the fiscal 2002 third quarter-end review, several significant developments were considered in determining the need for a full valuation allowance, including the continuing and recently more severe market decline, uncertainty and lack of visibility in the telecommunications market as a whole, a significant decrease in sequential quarterly revenue levels, a decrease in sequential earnings after several quarters of sequential improvement and the necessity for further restructuring and cost reduction actions to attain profitability. As a result of our assessment, we established a full valuation allowance for our remaining net deferred tax assets at June 30, 2002. During the fourth quarter of fiscal 2002, we maintained a full valuation allowance on our net deferred tax assets. Until we reach an appropriate level of profitability we do not expect to recognize any significant tax benefits in our future results of operations. Our income tax provision (benefit) included charges related to changes in valuation allowances of approximately $7.9 billion, $540 million and $40 million during fiscal 2002, 2001, and 2000, respectively. As of September 30, 2002 and 2001, our total valuation allowance on net deferred tax assets was approximately $10.0 billion and $740 million, respectively.

Intangible assets

We currently have intangible assets, including goodwill and other acquired intangibles of $224 million and capitalized software development costs of $570 million. The determination of related estimated useful lives and whether these assets are impaired involves significant judgments based upon short and long-term projections of future performance. Certain of these forecasts reflect assumptions regarding our ability to successfully develop and ultimately commercialize acquired technology. Changes in strategy and/or market conditions may result in adjustments to recorded asset balances. For example, we had taken significant impairment charges, including $4.1 billion related to goodwill and other acquired intangibles and $362 million related to capitalized software under our restructuring program during fiscal 2001. During fiscal 2002, the continued and recently sharper decline in the telecommunications market prompted a re-assessment of all key assumptions underlying our goodwill valuation judgments, including those relating to short and longer-term growth rates. As a result of our analysis, during fiscal 2002 we determined that impairment charges of $975 million were required because the forecasted undiscounted cash flows were less than the book values of certain businesses. The charges were measured on the basis of comparison of estimated fair values with corresponding book values and relate primarily to goodwill recorded in connection with our September 2000 acquisition of Spring Tide Networks. Fair values were determined on the basis of discounted cash flows. In addition, in the fourth quarter of fiscal 2002, we recorded

approximately $200 million of capitalized software impairments and $50 million in property, plant and equipment impairments, primarily as a result of delays and increasing uncertainties in the development of the universal mobile telecommunications systems ("UMTS") market. Goodwill and other acquired intangibles at September 30, 2002, is primarily related to our acquisition of Yurie Systems, Inc., which provides asynchronous transfer mode access equipment. We have concluded that this amount is realizable based upon projected undiscounted cash flows through 2006. Due to uncertain market conditions and potential changes in our strategy and product portfolio, it is possible that forecasts used to support our intangible assets may change in the future, which could result in additional non-cash charges that would adversely affect our results of operations and financial condition.

Pension and postretirement benefits

We have significant pension and postretirement benefit costs and credits, which are developed from actuarial valuations. Inherent in these valuations are key assumptions, including discount rates and expected return on plan assets, which are usually updated on an annual basis at the beginning of each fiscal year. We are required to consider current market conditions, including changes in interest rates, in making these assumptions. Changes in the related pension and postretirement benefit costs or credits may occur in the future due to changes in the assumptions. The key assumptions used in developing our fiscal 2002 net pension and postretirement benefit credit were a 7% discount rate, a 9% expected return on plan assets and a 4.5% rate of compensation increase. These were consistent with the prior year assumptions except that the discount rate was reduced by one-half of a percent due to current market conditions. Compared with the prior year, our net pension and postretirement benefit credit in fiscal 2002 was reduced by $111 million to $972 million, excluding the impact of restructuring actions. Our net pension and postretirement benefit credit is expected to be reduced to approximately $500 million during fiscal 2003, primarily as a result of lower plan assets, a reduction in the discount rate from 7% to 6.5%, a reduction in the expected return on plan assets from 9% to 8.5% for pensions and from 9% to 7.93% for postretirement benefits. Holding all other assumptions constant, a one-half percent increase or decrease in the discount rate would have increased or decreased annual fiscal 2002 pre-tax loss by approximately $125 million. Likewise, a one-half percent increase or decrease in the expected return on plan assets would have increased or decreased annual fiscal 2002 pre-tax loss by $200 million.

In addition, the estimated accumulated benefit obligation ("ABO") related to the U.S. management employees pension plan, as well as several other smaller pension plans, exceeded the fair value of the plan assets at September 30, 2002. This was due primarily to negative returns on the pension funds as a result of the overall decline in the equity markets and a decline in the discount rate used to estimate the pension liability as a result of declining interest rates in the U.S. Therefore, we were required to establish a minimum liability and record a $2.9 billion direct charge to equity for the difference to the extent the minimum liability exceeded the unrecognized prior service cost. Market conditions and interest rates significantly impact future assets and liabilities of our pension plans, and similar charges might be required in the future upon measurement of plan obligations which are usually completed by us at the end of a fiscal year.

We expect to have minimal, if any, cash requirements related to our pension and postretirement benefit plans during fiscal 2003. However during fiscal 2004, it is likely that we will be required to fund some portion of retiree health benefits and, depending on market conditions, we may be required to make a contribution to the pension plan of our U.S. management employees. Although it is difficult to estimate these potential fiscal 2004 cash requirements due to uncertain market conditions, we currently expect that the cash requirements for the retiree health benefits would be approximately $350 million. For more information, see the detailed risk factor included in our Form 10-K for the year ended September 30, 2002.

Business restructuring

During fiscal 2002 and 2001, we recorded significant charges in connection with our restructuring program. The related reserves reflect many estimates, including those pertaining to separation costs, inventory, settlements of contractual obligations and proceeds from asset sales. We reassess the reserve requirements to complete each individual plan under our restructuring program at the end of each reporting period. Actual experience has been and may continue to be different from these estimates. For example, we revised our estimates for certain fiscal 2001 restructuring plans during fiscal 2002 which resulted in a net credit of $333 million. As of September 30, 2002 and 2001, liabilities associated with our restructuring program were $1.1 billion and $1.6 billion, respectively. For more information, see Note 2 to the consolidated financial statements.

Legal contingencies

We are subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to securities, environmental, labor, product and other matters. We are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is based on a careful analysis of each individual issue with the assistance of outside legal counsel. The required reserves may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters. For more information, see Note 17 to the consolidated financial statements.

RESULTS OF OPERATIONS

Revenues

The following table presents our U.S. and non-U.S. revenues and the approximate percentage of total revenues (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
U.S. revenues	$ 8,148	$13,776	$19,829
Non-U.S. revenues	4,173	7,518	9,075
Total revenues	**$12,321**	**$21,294**	**$28,904**
	As a percentage of total revenues		
U.S. revenues	66.1%	64.7%	68.6%
Non-U.S. revenues	33.9%	35.3%	31.4%
Total revenues	**100.0%**	**100.0%**	**100.0%**

Fiscal 2002 vs. 2001

Continued reductions in capital spending in fiscal 2002 by service providers, primarily affecting our INS segment, and business dispositions were the primary reasons for the lower revenues in fiscal 2002 than in fiscal 2001. The revenue decline resulting from business dispositions was $2.3 billion for fiscal 2002, of which approximately 84% was a result of the sale of the OFS business in the first quarter of fiscal 2002. The impact of product rationalizations and discontinuances under our restructuring program has not had a significant effect on our overall trend of revenues.

Fiscal 2001 vs. 2000

A significant decrease in the competitive local exchange carrier ("CLEC") market and a significant reduction in capital spending by service providers were the primary reasons for the decline in revenues. In addition, we implemented a more selective customer-financing program, which also had a negative impact on revenues. 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. The adoption of SAB 101 in fiscal 2001 did not have a significant impact on revenues or the comparability of results of operations for the periods presented (see Note 16 to the consolidated financial statements).

Gross Margin

The following table presents our gross margin and the percentage to total revenues (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
Gross margin	$1,552	$2,058	$11,714
Gross margin rate	12.6%	9.7%	40.5%

Inventory and other charges negatively affected the gross margin rate in fiscal 2002 and 2001 by approximately 13 percentage points and 11 percentage points, respectively. The total dollar amount of charges was lower in fiscal 2002, primarily due to lower inventory levels resulting from our strategy of focusing on large service providers, our restructuring program and improved inventory management. However, due to the significant revenue decline in fiscal 2002, the charges had a greater impact on the gross margin rate. These charges were primarily related to items or events associated with customers experiencing financial difficulties and in some cases declaring bankruptcy or becoming insolvent, costs associated with supplier and customer contract settlements, higher provisions for slow-moving and obsolete inventory, adjustments to certain long-term projects and higher than expected costs due to certain customer obligations and product performance issues.

During fiscal 2002 and 2001, we recorded $64 million and $1.2 billion, respectively, of inventory charges associated with product line rationalizations and product line discontinuances under our restructuring program. These inventory charges negatively affected the gross margin rate for fiscal 2002 and 2001 by 1 percentage point and 6 percentage points, respectively. Our product mix in fiscal 2002 was adversely affected by the sale of OFS.

Also, significant reductions in capital spending by service providers reduced sales volumes across all product lines and services more quickly than the reduction in our fixed costs, which resulted in less absorption of fixed costs. The net change in unabsorbed fixed costs as well as all other factors affecting gross margin, including changes in geographic and product mix, negatively affected the gross margin rate for fiscal 2002 and 2001.

Operating Expenses

The following table presents our operating expenses (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
Selling, general and administrative ("SG&A") expenses, excluding the following two items	$2,466	$ 4,240	$4,743
Provision for bad debts and customer financings	1,253	2,249	505
Amortization of goodwill and other acquired intangibles	250	921	362
Total SG&A	3,969	7,410	5,610
Research and development ("R&D")	2,310	3,520	3,179
Purchased in-process research and development ("IPRD")	–	–	559
Business restructuring charges and asset impairments, net	2,252	10,157	–
Operating expenses	**$8,531**	**$21,087**	**$9,348**

SG&A expenses

Excluding provisions for bad debts and customer financings and amortization of goodwill and other acquired intangibles, SG&A expenses decreased by 41.8% during fiscal 2002 as compared with fiscal 2001 and decreased by 10.6% in fiscal 2001 as compared with fiscal 2000. The decreases in fiscal 2002 and 2001 were primarily a result of headcount reductions under our restructuring program and other cost savings initiatives that limited discretionary spending. Approximately 80% of the fiscal 2002 reductions were in the INS segment due to the greater degree of product rationalization efforts in INS as well as the required cost reductions due to the significant INS revenue decline.

Provision for bad debts and customer financings

Many of our customers have been negatively affected by the continued decline in telecommunications market conditions. As a result, the creditworthiness of certain customers has declined, resulting in some having to file for bankruptcy protection or having been declared insolvent. As a result, we have provided reserves for certain trade and notes receivable and sold others at significant discounts in the periods presented. We may have to record additional reserves or write-offs in the future.

Fiscal 2002 vs. 2001

During fiscal 2002, $765 million of provisions related to customer financings with the balance relating to trade receivables. Approximately one-third of the provision for customer financings was related to one customer that defaulted under the terms and conditions of its customer financing agreement. Approximately 55% of the total provisions

were related to INS customers and 39% were related to Mobility customers. The remaining provisions were not related to reportable segments.

Fiscal 2001 vs. 2000

The deterioration of the creditworthiness of certain customers resulted in higher provisions for bad debts and customer financings in fiscal 2001 as compared with fiscal 2000. Provisions for three customer financings, including provisions for amounts due from One.Tel and Winstar, accounted for approximately 60% of fiscal 2001 expense. On April 18, 2001, Winstar filed for Chapter 11 bankruptcy protection, and in late May 2001, One.Tel filed for voluntary administration (bankruptcy). Approximately 63% of the total provisions were related to INS customers and 34% were related to Mobility customers. The remaining provisions were not related to reportable segments.

Amortization of goodwill and other acquired intangibles

Fiscal 2002 vs. 2001

Amortization of goodwill and other acquired intangibles was significantly lower in fiscal 2002 as compared with fiscal 2001 as a result of restructuring actions committed to in fiscal 2001 that reduced total goodwill and other acquired intangibles by $4.1 billion, primarily related to the discontinuance of the Chromatis Networks, Inc. product portfolio. In addition, as a result of the continued downturn in the telecommunications market during fiscal 2002, impairment charges of $975 million were recognized in fiscal 2002, primarily related to goodwill associated with Spring Tide.

Fiscal 2001 vs. 2000

The full-year effect of the acquisitions of Chromatis in June 2000 and Spring Tide in September 2000 were the primary reasons for the increase in the amortization of goodwill and other acquired intangibles in fiscal 2001 as compared with fiscal 2000.

R&D

Fiscal 2002 vs. 2001

The decrease in R&D expenses in fiscal 2002 as compared with fiscal 2001 was primarily due to headcount reductions and product rationalizations under our restructuring program. Approximately 75% of the fiscal 2002 reductions were in the INS segment due to the greater degree of product rationalizations in INS.

During fiscal 2002, 53% of our R&D was attributable to our INS segment, and most of the remaining amounts were attributable to our Mobility segment. The INS spending was primarily related to next-generation products, including optical products for both long haul and metro networks, multi-service switches that can handle both Internet protocol services and multiple network traffic protocols, network operations software solutions, and digital subscriber line products. The Mobility spending was primarily related to code division multiple access ("CDMA") and UMTS next-generation technologies.

Fiscal 2001 vs. 2000

The increase in R&D expenses for fiscal 2001 as compared with fiscal 2000 was primarily due to acquisitions made late in fiscal 2000 and new product development, particularly in next-generation optical networking and wireless products, partially offset by headcount reductions and product rationalizations under our restructuring program.

During fiscal 2001, 60% of our R&D was attributable to our INS segment and most of the remaining amounts were attributable to our Mobility segment.

IPRD

In connection with the acquisitions in fiscal 2000 of Chromatis and Spring Tide, we allocated non-tax impacting charges of $428 million and $131 million, respectively, of the total purchase price to IPRD. As part of the process of analyzing each of these acquisitions, we made a decision to buy technology that had not yet been commercialized rather than develop the technology internally. We based this decision on a number of factors, including the amount of time it would take to bring the technology to market. We also considered Bell Labs' resource allocation and its progress on comparable technology, if any. We expect to use the same decision process in the future.

On June 28, 2000, we 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 multi-service metropolitan networks. 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. As part of our restructuring program in fiscal 2001, the Chromatis product portfolio was discontinued and all of the remaining assets, primarily goodwill and other acquired intangibles, were written off (see Note 2 to the consolidated financial statements).

On September 19, 2000, we 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 with low cost and complexity. 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 fiscal 2000 and 2001, respectively. A risk-adjusted discount rate of 25% was used to discount projected cash flows. In fiscal 2002, our remaining goodwill from the acquisition of Spring Tide was written off.

We 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 our weighted average cost of capital, as well as other factors, including the expected useful life of each technology, estimated profitability levels of each technology, the uncertainty of technology advances that were known at the time, and the stage of completion of each technology. We believe that the estimated IPRD amounts so determined represented fair value and did not exceed the amount a third party would pay for the projects.

Where appropriate, we 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.

Business restructuring charges and asset impairments, net

Since beginning our restructuring program during the second quarter of fiscal 2001, we have realigned our resources to focus on the opportunities that we currently believe to be the most profitable for us – the large service provider market. We evaluated our manufacturing operations and decided to sell or otherwise lease certain of our manufacturing facilities and make greater use of contract manufacturers. We assessed our product portfolio and associated R&D, made decisions based on the needs of our largest service provider customers, deployed our resources to meet those needs and then streamlined the rest of our operations to support those reassessments. We eliminated some marginally profitable or non-strategic product lines, merged certain technology platforms, consolidated development activities, eliminated management positions and eliminated many duplications in marketing functions and programs, and centralized our sales support functions, which resulted in reduced associated product development costs. We sold the assets relating to a number of product lines whose products did not support our large service provider customers or our strategy. We closed facilities and reduced the workforces in many of the countries that we operated in at the end of fiscal 2000. As a result we incurred net business restructuring charges and asset impairments in fiscal 2001 of $11.4 billion. Due to continuing market declines in fiscal 2002, we committed to additional restructuring actions that resulted in net business restructuring charges and asset impairments of $1.3 billion. These actions are designed to enable us to achieve a cost structure that will result in EPS breakeven at a quarterly revenue level in late fiscal 2003 of $2.5 billion with a targeted gross margin rate of 35%. We generally expect to complete each restructuring plan within 12 months of committing to it.

During fiscal 2002, we recorded in operating expenses net business restructuring charges and related asset impairments of $1.3 billion and other impairment charges of $975 million, primarily related to Spring Tide's goodwill. This compares to $10.2 billion of net business restructuring charges and asset impairments recorded during fiscal 2001. We believe the restructuring actions committed to in fiscal 2001 will yield annual cost savings of approximately $5.0 billion, $4.0 billion of which will be reflected in operating expenses. We began to realize the full effect of these cost savings during the second quarter of fiscal 2002. In fiscal 2002, we committed to additional restructuring actions, primarily in the third and fourth quarters. These actions are expected to yield additional cost savings of approximately $2.0 billion, $1.4 billion of which is expected from reduced operating expenses. See Note 2 to the consolidated financial statements for more information.

Other Income (Expense), Net

Other income (expense), net consisted of the following items (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
Interest income	$ 114	$ 255	$118
Minority interests in earnings of consolidated subsidiaries	(12)	(81)	(50)
Net income (loss) from equity method investments	14	(60)	(31)
Other-than-temporary write-downs of investments	(209)	(266)	(14)
Loss on foreign currency transactions	(46)	(58)	(18)
Net gains on sales of businesses	725	56	30
Legal settlements	(212)	–	–
Net gains (losses) on sales and settlements of financial instruments	(22)	18	347
Write-off of embedded derivative assets	–	(42)	–
Miscellaneous, net	(60)	(179)	(49)
Other income (expense), net	**$ 292**	**$(357)**	**$333**

Fiscal 2002

Other income (expense), net included $725 million of gains from business dispositions, $664 million of which was from the sale of the OFS business and China joint ventures, and interest income of $114 million related to our cash and cash equivalents. This was partially offset by a legal settlement of $162 million related to our former consumer products telephone leasing business and a $50 million purchase price adjustment to settle a claim with VTech Holdings Limited and VTech Electronics Netherlands B.V., and other-than-temporary investment write-downs of $209 million, primarily related to our investment in Commscope.

Fiscal 2001

Other income (expense), net primarily included other-than-temporary write-downs on several of our investments due to adverse market conditions and net losses from minority interests and equity method investments, offset in part by interest income. The write-off of the embedded derivative assets was primarily related to One.Tel.

Fiscal 2000

In fiscal 2000, other income (expense), net primarily included interest income and net gains on sales and settlements of financial instruments, including equity investments.

Interest Expense

Fiscal 2002 vs. 2001

Interest expense for fiscal 2002 decreased to $382 million as compared with $518 million for fiscal 2001. The decrease resulted from a significant reduction in short-term debt, partially offset by interest expense related to our trust preferred securities, which were issued in March 2002.

Fiscal 2001 vs. 2000

Despite lowering debt levels by approximately $2.1 billion in the latter half of fiscal 2001, interest expense increased to $518 million as compared with $342 million for fiscal 2000. The increase in interest expense was due to higher weighted average short-term debt levels, primarily related to borrowings under our credit facilities. In addition, interest expense in fiscal 2001 included the amortization of fees associated with entering into our credit facility arrangements.

Provision (Benefit) for Income Taxes

The following table presents our provision (benefit) for income taxes and the related effective tax (benefit) rates (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
Provision (benefit) for income taxes	$ 4,757	$ (5,734)	$ 924
Effective tax (benefit) rate	67.3%	(28.8)%	39.2%

As discussed in more detail under "APPLICATION OF CRITICAL ACCOUNTING POLICIES," the effective tax rate for fiscal 2002 was significantly more than the U.S. statutory rate primarily due to providing for a full valuation allowance on our net deferred tax assets and not reflecting any significant tax benefits for the current fiscal year's losses.

The effective tax benefit rate for fiscal 2001 was lower than the U.S. statutory rate, primarily from the impact of non-tax deductible goodwill amortization, certain non-tax deductible business restructuring charges and asset impairments, as well as an increase in our deferred tax valuation allowances, all of which decreased the effective tax benefit rate. Such decrease was offset in part by research and development tax credits, which increased the effective tax benefit rate on the pre-tax loss.

The effective tax rate exceeded the U.S. statutory rate for fiscal 2000, primarily due to the write-offs of IPRD costs that were not deductible for tax purposes.

Income (Loss) from Continuing Operations

As a result of the above, income (loss) from continuing operations and related per share amounts are as follows (amounts in millions, except per share amounts):

	Years ended September 30,		
	2002	**2001**	**2000**
Income (loss) from continuing operations	$(11,826)	$(14,170)	$ 1,433
Basic earnings (loss) per share from continuing operations	$ (3.51)	$ (4.18)	$ 0.44
Diluted earnings (loss) per share from continuing operations	$ (3.51)	$ (4.18)	$ 0.43
Weighted average number of common shares outstanding – basic	3,426.7	3,400.7	3,232.3
Weighted average number of common shares outstanding – diluted	3,426.7	3,400.7	3,325.9

Income (Loss) from Discontinued Operations, Net

Income (loss) from discontinued operations, net for fiscal 2002, 2001 and 2000 was $73 million or $0.02 per basic and diluted share, ($3.2) billion or ($0.93) per basic and diluted share and ($214) million or ($0.06) per basic and diluted share, respectively (see Note 3 to the consolidated financial statements).

Extraordinary Gain, Net

During fiscal 2001, we recorded a gain of $1.2 billion, net of a $780 million tax provision, or $0.35 per basic and diluted share, from the sale of our power systems business.

Cumulative Effect of Accounting Changes, Net

Effective October 1, 2000, we recorded a net $38 million charge for the cumulative effect of certain accounting changes. This was comprised of a $30 million earnings credit ($0.01 per basic and diluted share) from the adoption of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," and a $68 million charge to earnings ($0.02 per basic and diluted share) from the adoption of SAB 101.

Results of Operations by Segment

INS

The following table presents external revenues, U.S. and non-U.S., and operating income (loss) (dollars in millions):

	Years ended September 30,		
	2002	**2001**	**2000**
U.S. revenues	$ 3,490	$ 7,065	$12,548
Non-U.S. revenues	2,925	5,198	6,106
Total revenues	$ 6,415	$ 12,263	$18,654
Operating income (loss)	$ (2,769)	$ (4,724)	$ 1,685
Return on sales	(43.2%)	(38.5%)	9.0%

Fiscal 2002 vs. 2001

During fiscal 2002, INS revenues declined by 47.7% as a result of continuing reductions and delays in capital spending by service providers. The decline was reflected in all product lines and geographic regions, except for China. The deterioration of creditworthiness or financial condition of certain service providers also adversely affected revenues, although to a much lesser degree. Approximately, 60% of the decline was in the United States, and about 40% was non-U.S., primarily in EMEA (Europe, Middle East, and Africa). The five largest INS customers represented about 40% of INS revenues during fiscal 2002, and accounted for about 45% of the revenue decline as compared with fiscal 2001.

During fiscal 2002, the operating loss declined by $2.0 billion to an operating loss of approximately $2.8 billion. The $2.8 billion operating loss was driven by a 2.2% gross margin rate and $2.9 billion of operating expenses, which included $683 million of provisions for bad debts. The INS gross margin rate continues to be under significant pressure

and declined from 10.3% in fiscal 2001 to 2.2% in fiscal 2002. The low gross margin rates were primarily a result of unabsorbed fixed costs as a result of significantly lower revenue levels, as well as significant inventory charges. The decline from fiscal 2001 was primarily due to the continued decrease in sales volume, partially offset by lower inventory charges and cost reductions. Operating expenses declined $3.1 billion, of which $2.3 billion resulted from headcount reductions and less discretionary spending. The remaining decrease was from a decrease in provisions for bad debts and customer financings of $742 million, primarily due to the significant charges incurred for amounts due from Winstar in the prior year.

Fiscal 2001 vs. 2000

During fiscal 2001, INS revenues declined by 34%. The decline primarily resulted from reductions and delays in capital spending by large service providers and was reflected in all product lines. The most significant declines were in the U.S., especially associated with large service providers. Our five largest customers represented about 45% of INS revenues during fiscal 2001, and about 40% of the revenue decline as compared with revenues realized from those customers in fiscal 2000. The deterioration of creditworthiness or financial condition of certain service providers and CLECs also adversely affected revenues, although to a lesser degree. The decrease in non-U.S. revenues for fiscal 2001 was also attributable to the continued wind-down of a project with Saudi Telecommunications Company ("STC").

During fiscal 2001, the operating income (loss) declined by approximately $6.4 billion to a loss of $4.7 billion. Lower gross margin of $6.0 billion and higher operating expenses of $412 million drove this decline. The gross margin decrease resulted from a significant decline in the gross margin rate from 38.9% to 10.3%, primarily due to lower sales volume and significant inventory-related charges. The $412 million increase in operating expenses resulted from $993 million of higher provisions for bad debts and customer financings, partially offset by $581 million of lower expenses, primarily due to headcount reductions and less discretionary spending. The higher provisions for bad debts and customer financings primarily related to significant charges incurred for amounts due from Winstar.

Mobility

The following table presents external revenues, U.S. and non-U.S., and operating income (loss) (dollars in millions):

Years ended September 30,

	2002	2001	2000
U.S. revenues	$ 4,315	$ 4,929	$4,913
Non-U.S. revenues	1,065	1,225	1,924
Total revenues	$ 5,380	$ 6,154	$6,837
Operating income (loss)	$ (655)	$ (1,517)	$ 939
Return on sales	(12.2%)	(24.7%)	13.7%

Fiscal 2002 vs. 2001

During fiscal 2002, Mobility revenues decreased by 12.6%. The decrease in the U.S. resulted primarily from reductions in capital spending by certain service providers. The decrease in non-U.S. revenues for fiscal 2002 resulted from reductions in the CALA (Caribbean and Latin America) and Asia Pacific regions primarily due to a loss of fiscal 2002 revenues from One.Tel, which went into receivership during 2001, partially offset by higher revenues in the China and EMEA regions. The five largest customers represented approximately 75% of Mobility revenues during fiscal 2002, and approximately 35% of the revenue decline compared with fiscal 2001. In addition, approximately 20% of the decline was related to lower revenues from a U.S. customer that defaulted on its customer financing commitment.

During fiscal 2002, the operating loss declined by $862 million to $655 million. Increases in gross margin of $188 million and decreases in operating expenses of $674 million drove the improvement. The gross margin rate increased from 21.0% to 27.5% due to lower inventory and warranty-related charges and cost reductions. However, the gross margin rate in fiscal 2002 was still affected by these charges. The reduction in operating expenses resulted from a reduction in provisions for bad debts and customer financings of $278 million, as well as a reduction in other operating expenses of $396 million, primarily related to headcount reductions and less discretionary spending. In fiscal 2002, approximately 50% of Mobility's provisions for bad debts and customer financings was due to the one customer that defaulted on its customer financing commitment. In fiscal 2001, Mobility incurred significant provisions for bad debts and customer financings for amounts due from One.Tel and another customer that experienced financial difficulties.

Fiscal 2001 vs. 2000

During fiscal 2001, Mobility revenues decreased by 10%. The decrease primarily resulted from lower non-U.S. revenues due to the wind-down of various projects and certain customers that experienced financial difficulties, including a loss of revenues from One.Tel, which went into receivership during the third fiscal quarter of 2001. Revenues from our five largest customers represented about 70% of Mobility revenues during fiscal 2001 and were slightly higher as compared with the revenues realized from those customers in fiscal 2000.

During fiscal 2001, operating income (loss) declined by $2.5 billion to a loss of $1.5 billion. Lower gross margin of $1.5 billion and higher operating expenses of $960 million drove this decline. The gross margin rate decreased from 40.7% to 21.0% primarily due to lower sales volume and higher inventory and warranty-related charges. The $960 million increase in operating expenses primarily resulted from higher provisions for bad debts and customer financings of $696 million. Substantially all of the increase in provisions for bad debts and customer financings was related to One.Tel and one other customer with specific credit concerns for which financing was provided. Most of the remaining increases in operating expenses were primarily related to higher R&D expenses for next-generation CDMA and UMTS technology.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow for the Years Ended September 30, 2002, 2001 and 2000

Operating activities

Net cash used in operating activities was $756 million for fiscal 2002. This primarily resulted from the loss from continuing operations of $2.9 billion (adjusted for non-cash items) and changes in other operating assets and liabilities of $2.4 billion, offset in part by a reduction in working capital requirements (accounts receivable, inventories and contracts in process and accounts payable) of $4.5 billion. The reduction in working capital primarily resulted from the significant decrease in sales volume during fiscal 2002 as compared with fiscal 2001. Consistent with the decrease in receivables of $2.5 billion, the average receivable days sales outstanding decreased from 80 days at September 30, 2001 to 77 days at September 30, 2002. In addition to reduced sales volume, the decline in inventory and contracts in process was also a result of our continued efforts to streamline inventory supply chain operations and higher billings for our long-term contracts. The changes in other operating assets and liabilities include cash outlays under our restructuring program of $1.0 billion and a reduction in other operating assets and liabilities due to the decrease in sales volume and lower headcount. Federal and state income tax refunds in fiscal 2002 amounted to approximately $1.0 billion including $616 million received in connection with changes to tax legislation.

Net cash used in operating activities was $3.4 billion for fiscal 2001. This primarily resulted from the loss from continuing operations (adjusted for non-cash items) of $6.6 billion, a decrease in accounts payable of $759 million and changes in other operating assets and liabilities of $602 million. Changes in other operating assets and liabilities primarily include a net increase in notes receivable and higher software development assets, offset in part by business restructuring liabilities. The increases in net cash used in operating activities were partially offset by decreases in receivables of $3.6 billion and in inventories and contracts in process of $881 million. Receivable improvement was largely due to improved collections and lower sales volumes in fiscal 2001 as compared with fiscal 2000. Average receivable days outstanding improved by 34 days from 114 days at September 30, 2000 to 80 days at September 30, 2001. Improvements in inventory and contracts in process resulted from streamlining inventory supply chain operations, as well as lower amounts in net contracts in process due to the wind-down of the STC project in Saudi Arabia.

Net cash used in operating activities was $703 million for fiscal 2000. This primarily resulted from increases in receivables of $1.6 billion and inventories and contracts in process of $2.2 billion and changes in other operating assets and liabilities of $1.8 billion. Changes in other operating assets and liabilities primarily include higher software development assets and decreases in accrued income tax and payroll- and benefit-related liabilities. Net cash used in operating activities was partially offset by income from continuing operations (adjusted for non-cash items) of $3.6 billion and tax benefits from stock options of $1.1 billion and an increase in accounts payable of $263 million. The receivable deterioration in fiscal 2000 resulted from slower collections, partially offset by smaller revenue growth in the fourth fiscal quarter of 2000 as compared with the same period in fiscal 1999. Average receivable days outstanding increased by 19 days to 114 days at September 30, 2000. The increase in inventories and contracts in process resulted from our increased production to meet current and anticipated sales commitments to customers and the start-up of several long-term projects.

Investing activities

The net cash provided by investing activities of $757 million for fiscal 2002 was primarily from the $2.6 billion of net cash proceeds received from the disposition of businesses and the sale of certain manufacturing operations, partially offset by $1.5 billion of purchases of short-term investments and capital expenditures of $449 million. Cash proceeds from dispositions primarily included the $2.1 billion received from the sale of our OFS businesses, $60 million from the sale of our voice enhancement and echo cancellation business, $93 million from the sale of New Venture Partners II LP, approximately $250 million from the sale of our billing and customer care business and $96 million from the sale of certain manufacturing operations to Solectron. The short-term investments primarily consisted of U.S. treasury bills and government agency notes, bank instruments and top tier corporate debt securities.

Net cash provided by investing activities was $2.0 billion for fiscal 2001 and was primarily from $2.5 billion in proceeds from the sale of the power systems business, $572 million from the sale of two of our manufacturing operations to Celestica and sales or disposals of property, plant and equipment of $177 million. These proceeds were partially offset by capital expenditures of $1.4 billion.

Net cash used in investing activities was $1.6 billion for fiscal 2000, primarily from capital expenditures of $1.9 billion and purchases of investments of $680 million, offset in part by proceeds from the sales or maturity of investments of $820 million and from the disposition of businesses of $250 million, largely related to the sale of the remaining consumer products business.

We currently expect about $400 million of capital expenditures during fiscal 2003, $100 million of which relates to the repurchase of certain real estate, under synthetic lease agreements we had in place as of September 30, 2002, which were designed to fund certain real estate construction costs. We expect to sell the property that we repurchased under the synthetic lease agreements during fiscal 2003, which may result in additional charges. We do not expect significant proceeds from business or asset dispositions.

Financing activities

Net cash provided by financing activities of $468 million for fiscal 2002 included $1.75 billion of proceeds from the sale of 7.75% convertible trust preferred securities in March 2002. Fees paid in connection with this transaction were approximately $46 million. Partially offsetting these proceeds were repayments under our credit facilities and other short-term borrowings of $1.1 billion and preferred stock dividend payments related to our 8% convertible redeemable preferred stock of $149 million.

During September 2002, we repurchased approximately 175 thousand shares of 8% redeemable convertible preferred stock for approximately 58 million shares of our common stock. Since September 30, 2002, we have repurchased an additional 380 thousand shares of preferred stock for approximately 143 million shares of common stock. No gain or loss was recognized on these exchanges. The total carrying value of the preferred stock repurchased was approximately $555 million ($175 million was reflected as of September 30, 2002) and resulted in a corresponding increase to our common stock and additional paid-in capital. The fair value of the additional common shares issued to the preferred shareowners to prompt the exchange over the shares obligated for exchange pursuant to the original conversion terms amounted to $125 million ($29 million of which was recognized in fiscal 2002 and was included in the net loss applicable to the common shareowners). We may issue more common stock for similiar transactions in the future.

Net cash provided by financing activities for fiscal 2001 was $2.6 billion and was primarily due to net proceeds received from the issuance of 8% redeemable convertible preferred stock in August 2001 of $1.8 billion (a portion of the proceeds received were used to reduce borrowings under our credit facilities), net borrowings under our credit facilities of $3.5 billion ($2.5 billion of the debt associated with borrowings was assumed by Agere), and proceeds from a real estate debt financing of $302 million under which certain real estate was transferred to a separate, consolidated wholly-owned subsidiary. Borrowings under our credit facilities were used to fund our operations and to pay down $2.1 billion of short-term borrowings, which primarily represented commercial paper. We had no commercial paper outstanding as of September 30, 2001. In addition, we repaid the current portion of long-term debt that matured in July 2001 of $750 million. Dividends paid on our common stock in fiscal 2001 were $204 million.

Net cash provided by financing activities for fiscal 2000 of $2.2 billion resulted primarily from issuances of common stock related to the exercise of stock options of $1.4 billion and a net increase in short-term borrowings of $1.4 billion, partially offset by repayments of long-term debt of $387 million and common stock dividend payments of $255 million.

Cash Requirements

Our cash requirements over the next 12 months are primarily to fund operations, including spending on R&D, our restructuring program, capital expenditures, capital requirements in connection with our existing customer financing commitments, and debt service and preferred stock dividend requirements. We expect to use cash to fund our operations in fiscal 2003. Although we believe we will realize additional cash savings upon completion of our restructuring actions, including a full year impact of those actions completed during fiscal 2002, these savings will be offset by less working capital reductions and income tax refunds that were realized in fiscal 2002. We expect to have minimal, if any, cash requirements related to our pension and postretirement benefit plans during fiscal 2003. For more information on these obligations, see the detailed risk factor included in our Form 10-K for the year ended September 30, 2002.

Restructuring

Total cash requirements under the restructuring program since its inception are expected to be approximately $2.6 billion. Approximately $530 million was paid during fiscal 2001 and $1.0 billion was paid during fiscal 2002. The majority of the remaining $1.1 billion is expected to be paid in fiscal 2003, except for lease obligations of approximately $300 million, of which approximately $200 million would be paid in fiscal 2004 and 2005. Upon completion of the actions during fiscal 2003, we expect to realize annual cash savings of approximately $1.8 billion. These anticipated savings result primarily from reduced headcount. Our restructuring program may not achieve all of the cost and expense reductions and other benefits we anticipate and may not be completed on the timetable contemplated.

If we do not complete our restructuring program and achieve our anticipated expense reductions in the time frame we contemplate, our cash requirements to fund our operations are likely to be significantly higher than we currently anticipate. In addition, because market demand continues to be uncertain and because we are currently implementing our restructuring program and business strategy, it is difficult to estimate our ongoing cash requirements. Our restructuring program may also have other unanticipated adverse effects on our business.

Customer financing commitments

The following table presents our customer financing commitments at September 30, 2002 and September 30, 2001 (dollars in billions):

	September 30, 2002		
	Total loans and guarantees	*Loans*	*Guarantees*
Drawn commitments	$1.1	$0.9	$0.2
Available but not drawn	0.1	0.1	–
Not available	0.1	0.1	–
Total commitments	$1.3	$1.1	$0.2
Reserves	$1.0		

	September 30, 2001		
	Total loans and guarantees	*Loans*	*Guarantees*
Drawn commitments	$3.0	$2.6	$0.4
Available but not drawn	1.4	1.4	–
Not available	0.9	0.6	0.3
Total commitments	$5.3	$4.6	$0.7
Reserves	$2.1		

We have provided substantial long-term financing to some of our customers worldwide as a condition of obtaining or bidding on infrastructure projects, in the form of both commitments to extend credit and providing third party financial guarantees. These commitments were extended to established companies as well as start up companies and ranged from modest amounts to more than a billion dollars. As a result, customer financing commitments increased to $8.1 billion at September 30, 2000. Our overall customer financing exposure, coupled with the rapid and sustained decline in telecommunications market conditions, negatively affected our results of operations and cash flows in fiscal 2001 and 2002. These market conditions led to the deteriora-

tion of certain customer's creditworthiness or bankruptcy filings and corresponding defaults. We were also unable to sell or transfer significant amounts of the drawn and undrawn commitments to financial institutions or other investors on reasonable terms or at all. These adverse conditions resulted in significant charges for customer financings of approximately $1.8 billion and $765 million during fiscal 2001 and 2002, respectively, and additional charges may be required in the future.

We expect to continue to provide or commit to financing on a much more limited basis. We are focusing on the largest service providers who typically have less demand for such financing. We currently have the ability to offer limited customer financing due to our capital structure, credit rating, level of available credit and liquidity. As a result of significant customer defaults that led to significant charges and the cancellation or restructuring of several financing arrangements, our customer financing commitments were reduced to $1.3 billion at September 30, 2002. We expect that approximately $50 million of the undrawn commitments will be drawn during the next twelve months and the rest will likely expire undrawn.

Although on a very limited basis, we consider requests for customer financing on a case-by-case basis and may consider offering financing only after a careful review that considers the credit quality of the individual borrowers, their respective business plans and market conditions. We also consider the likelihood of our ability to sell or transfer the undrawn commitments and drawn borrowings to unrelated third parties. We continue to monitor the drawn borrowings and undrawn commitments by assessing, among other things, the customer's short-term and long-term liquidity position, current operating performance versus plan, execution challenges facing the company, changes in the competitive landscape, and management experience and depth. We undertake certain mitigating actions, including cancellation of commitments if corrective measures are not taken, depending upon the extent of any deterioration of a customer's credit profile or non-compliance with our loan conditions. Although these actions can limit the extent of our losses, substantial exposure remains to the extent of drawn amounts, which may not be recoverable.

Debt service and preferred dividend requirements

Debt service primarily represents interest payments on our short- and long-term debt and trust preferred securities. Preferred dividend requirements represent payments on our 8% redeemable convertible preferred stock. We expect debt service and preferred dividend requirements for fiscal 2003 to be approximately $500 million.

Sources of Cash

We expect to fund our cash requirements during fiscal 2003 through a combination of cash and cash equivalents of $2.9 billion and short-term investments of $1.5 billion, both as of September 30, 2002.

Credit facility and accounts receivable securitization facility

On October 17, 2002, we cancelled our $1.5 billion credit facility and our $500 million accounts receivable securitization facility to avoid an anticipated default on the financial covenants contained in these agreements. We had no outstanding balance on the credit facility, which was scheduled to expire in February 2003, and nothing drawn against the accounts receivable securitization facility. We are currently in negotiations with our bankers concerning a new and smaller credit facility, however we can not provide assurance that one will be obtained.

Although the credit facility was cancelled, substantially all of our domestic U.S. assets remained collateralized as a result of extending through December 18, 2002, the Guarantee and Collateral Agreement with our banks. This agreement provides security for commercial bankers in extending, among other things, credit facilities to non-U.S. subsidiaries, letters of credit and foreign exchange hedging. If this agreement is not renewed or replaced with a similar agreement, we may be required to collateralize certain new or existing obligations or financial instruments, such as letters of credit with cash. Any cash collateral requirements would be expected to occur over time.

Future capital requirements

We believe our cash and cash equivalents and short-term investments are currently sufficient to meet our requirements in fiscal 2003. However, we cannot assure that these sources will be available when needed or that our actual cash requirements will not be greater than we currently expect. If our sources of liquidity are not available or if we cannot generate sufficient cash flow from operations, we might be required to obtain additional sources of funds through additional operating improvements, asset sales and financing from third parties, or a combination thereof. We cannot provide assurance that these additional sources of funds will be available, or if available, would have reasonable terms.

Credit ratings

Our credit ratings as of November 30, 2002, are as follows:

	Long-term debt	*Convertible preferred stock*	*Trust preferred securities*	*Last update*
Rating Agency				
Standard & Poor's	B–[(a)]	CCC–	CCC–	October 11, 2002
Moody's	Caa1[(a)]	Ca	Caa3	November 1, 2002

(a) Ratings outlook is negative.

Our credit ratings are below investment grade. As a result of past downgrades, we no longer have the ability to participate in the commercial paper market and are unable to sell trade and notes receivables to the Trust (see "Customer financing commitments"). In addition, a credit downgrade affects our ability to enter into and maintain certain contracts on favorable terms, and increases our cost of borrowing.

Special Purpose Entities

We have used special purpose entities for the sales and securitizations of receivables and in real estate financing arrangements. The Financial Accounting Standards Board is currently proposing amendments to existing accounting standards that will require the consolidation of certain special purpose entities. If these proposed amendments are approved in their existing form, we may be required to consolidate the Trust described below, that we have used to sell certain customer financing loans and receivables to, and this will result in the addition

of approximately $350 million of long-term notes receivable and debt obligations to our balance sheet. We are currently analyzing these proposed amendments to existing accounting standards; we believe that if they are adopted in their existing form, we will be required to consolidate the aforementioned special purpose entity beginning July 1, 2003.

In September 2000, we and a third party created a non-consolidated Special Purpose Trust ("Trust") for the purpose of allowing us from time to time to sell on a limited-recourse basis customer finance loans and receivables ("Loans") at any given point in time to the Trust. Due to our credit downgrade in February 2001, we are unable to sell additional Loans to the Trust. As of September 30, 2002, the Trust held approximately $350 million in Loans relating to five obligors, all of which are in default. Because we and the Trust collectively hold significant portions of the total outstanding debt of each of the five obligors, we and the Trust currently are reviewing alternatives related to recovery of defaulted Loans currently held in the Trust. Our wholly-owned captive insurance company assumed the credit risk of the loans that are held in the Trust. It also reinsured the exposure to an unaffiliated insurer for amounts in excess of an initial loss of $90 million. The self-insured loss reserve related to these loans (including accrued interest) was $379 million and the corresponding receivable due from the unaffiliated insurer was $298 million. We also indemnify the Trust for any actions that we may take that impairs the Trust's ability to obtain payment.

Contractual Cash Obligations and Other Commercial Commitments and Contingencies

The following tables quantify our future contractual obligations and commercial commitments as of September 30, 2002 (dollars in millions):

Contractual Obligations

	Payments due in fiscal						
	Total	*2003*	*2004*	*2005*	*2006*	*2007*	*Thereafter*
Long-term debt (including company-obligated trust preferred securities)	$5,025	$ 31	$ 37	$ 42	$ 948	$ 2	$3,965
8% redeemable convertible preferred stock[a]	1,680	–	–	–	–	–	1,680
Operating leases[b]	1,590	253	208	169	129	106	725
Unconditional purchase obligations	775	350	425	–	–	–	–
Total	**$9,070**	**$634**	**$670**	**$211**	**$1,077**	**$108**	**$6,370**

(a) Subsequent to September 30, 2002, $380 of convertible preferred stock was exchanged for our common stock (see "Financing activities"). The convertible preferred stock is redeemable, at our option after August 15, 2006 and at the option of the holders on August 2 of 2004, 2007, 2010 and 2016.

(b) The contractual obligations under operating leases exclude approximately $250 of potential lease obligations that were assigned to Avaya, Agere and other dispositions for which Lucent remained secondarily liable.

Other Commercial Commitments[a]

	Amounts expiring in fiscal						
	Total	*2003*	*2004*	*2005*	*2006*	*2007*	*Thereafter*
Standby letters of credit	$ 668	$374	$ 98	$ 22	$ 130	$ 4	$ 40
Undrawn customer commitments	244	209	33	–	–	2	–
Total	**$ 912**	**$583**	**$131**	**$ 22**	**$ 130**	**$ 6**	**$ 40**

(a) At September 30, 2002, we had $90 of surety bonds that remain outstanding until specific events or projects are completed and claims are settled.

RISK MANAGEMENT

We are exposed to market risk from changes in foreign currency exchange rates, interest rates and equity prices. We manage our exposure to these market risks through the use of derivative financial instruments coupled with other strategies. Our risk management objective is to minimize the effects of volatility on our cash flows by identifying the assets, liabilities or forecasted transactions exposed to these risks and hedging them with either forward or option contracts or swap derivatives or by embedding terms into certain contracts that affect the ultimate amount of cash flows under the contract. Since there is a high correlation between the hedging instruments and the underlying exposures, the gains and losses on these exposures are generally offset by reciprocal changes in value of the hedging instruments when used. We use derivative financial instruments as risk management tools and not for trading or speculative purposes.

Foreign Currency Risk

As a multinational company, we conduct our business in a wide variety of currencies and are therefore subject to market risk for changes in foreign exchange rates. We use foreign exchange forward and option contracts to minimize exposure to the risk to the eventual net cash inflows and outflows resulting from foreign currency denominated transactions with customers, suppliers and non-U.S. subsidiaries. Our objective is to hedge all types of foreign currency risk to preserve our economic cash flows, but we generally do not expect to designate these derivative instruments as hedges under current accounting standards unless the benefits of doing so are material. Cash inflows and outflows denominated in the same foreign currency are netted on a legal entity basis, and the corresponding net cash flow exposure is appropriately hedged. To the extent that the forecasted cash flow exposures are overstated or understated or if there is a shift in the timing of the anticipated cash flows during periods of currency volatility, we may experience unanticipated currency gains or losses. We do not hedge our net investment in non-U.S. entities because we view those investments as long-term in nature.

Our primary net foreign currency exposures as of September 30, 2002 include the euro, the Chinese renminbi and the Indian rupee and at September 30, 2001, include the euro, Brazilian real, Australian dollar and Danish kroner. We use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of the foreign currency forwards and options and results of operations. To perform the sensitivity analysis, we assess the risk of loss in fair values from the effect of a hypothetical 10% change in the value of foreign

currencies, assuming no change in interest rates. For contracts outstanding as of September 30, 2002 and 2001, a 10% adverse movement in the value of foreign currencies against the U.S. dollar from the prevailing market rates, including the primary foreign currency exposures noted above, would result in an incremental pretax net unrealized loss of $21 million and $63 million, respectively. Consistent with the nature of the economic hedge, any unrealized gains or losses on these forwards and options would be offset by corresponding decreases or increases, respectively, of the underlying instrument or transaction being hedged. The model to determine sensitivity assumes a parallel shift in all foreign currency exchange spot rates, although exchange rates rarely move in the same direction. We have not changed our foreign exchange risk management strategy from the prior year.

Interest Rate Risk

The fair values of our fixed-rate long-term debt, interest rate swaps, company-obligated 7.75% mandatorily redeemable convertible preferred securities of subsidiary trust and short-term investments are sensitive to changes in interest rates. Our portfolio of customer finance notes receivable is predominantly comprised of variable-rate notes at LIBOR plus a stated percentage and subjects us to variability in cash flows and earnings due to the effect of changes in LIBOR. Prior to May 2002, our debt obligations primarily consisted of fixed-rate debt instruments while our interest rate sensitive assets were primarily variable-rate instruments. In the latter half of fiscal 2002, we began to mitigate this interest rate sensitivity by adding short-term fixed-rate assets to our investment portfolio and simultaneously entering into interest rate swaps on a portion of our debt obligations to make them variable-rate debt instruments. Under these swaps, we receive a fixed interest rate of 7.25% and pay an average floating rate of LIBOR plus 2.91% on the notional amounts of the swaps. As of September 30, 2002, LIBOR was approximately 1.79%. The objective of maintaining the mix of fixed and floating-rate debt and investments is to mitigate the variability of cash inflows and outflows resulting from interest rate fluctuations, as well as reduce the overall cost of borrowing. We do not enter into derivative transactions on our cash equivalents since their relatively short maturities do not create significant risk. We do not foresee any significant changes in our risk management strategy or in our exposure to interest rate fluctuations.

The impacts of a sensitivity analysis we performed under a model that assumes a hypothetical 150 basis point parallel shift in interest rates is as follows (dollars in millions):

	Fair value as of September 30, 2002	*Hypothetical increase or decrease in fair value as of September 30, 2002*	*Fair value as of September 30, 2001*	*Hypothetical increase or decrease in fair value as of September 30, 2001*
Assets:				
Short-term invesments	$1,515	$14	$ –	$ –
Interest rate swaps	28	27	–	–
Liabilities:				
Long-term debt obligations	998	60	2,009	210
Company-obligated 7.75% mandatorily redeemable convertible preferred securities of subsidiary trust	400	19	–	–

The changes in fair values of our fixed-rate liabilities are not necessarily indicative of actual changes that may occur as a result of changes in interest rates alone when also considered with the result of potential future changes in our credit ratings. Our sensitivity analysis on debt obligations excludes variable-rate debt instruments, secured borrowings and bank loans because the changes in interest rates would not significantly affect the fair value of such instruments. In addition, our variable-rate customer finance notes have been excluded since a significant portion of the principle balances and related receivables for accrued interest are fully reserved.

Equity Price Risk

Our investment portfolio includes equity investments in publicly held companies that are classified as available-for-sale and other strategic equity holdings in privately held companies. These securities are exposed to price fluctuations and are generally concentrated in the high-technology and telecommunications industries. At September 30, 2002, the fair value of two available-for-sale securities (Commscope and Corning) that were obtained in connection with the sale of our optical fiber businesses totaled $101 million out of a total available-for-sale portfolio valued at $117 million. The process of determining the fair values of our privately held equity investments inherently requires subjective judgments. These valuation assumptions and judgments include consideration of the investee's earnings and cash flow position, cash flow projections and rate of cash consumption, recent rounds of equity infusions by us and other investors, strength of investee's management and valuation data provided by the investee that may be compared with peers. Due to a sustained weakness in the economic environment in both public and private equity markets, we have and may continue to record impairment losses and write down the carrying value of certain equity investments when the declines in fair value are other-than-temporary. Impairment charges recorded in 2002 and 2001 were $209 million and $266 million, respectively.

We generally do not hedge our equity price risk due to hedging restrictions imposed by the issuers, illiquid capital markets or inability to hedge non-marketable equity securities in privately held companies. As of September 30, 2002 and 2001, a 20% adverse change in equity prices would result in an approximate $23 million and $12 million decrease, respectively, in the fair value of our available-for-sale equity securities. The model to determine sensitivity assumes a corresponding shift in all equity prices. This analysis excludes stock purchase warrants as we do not believe that the value of such warrants is significant. An adverse movement in the equity prices of our holdings in privately held companies can not be easily quantified as our ability to realize returns on investments depends on the investees' ability to raise additional capital or derive sales from continuing operations or through liquidity events such as initial public offerings, mergers or private sales. As of September 30, 2002 and 2001, we had no outstanding hedging instruments for our equity price risk. However, during December 2002, we entered into a prepaid forward sales agreement for 50% of the Corning stock we own, under which we received approximately $60 million and locked in approximately $35 million of unrealized appreciation.

FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

(Amounts in Millions, Except Per Share Amounts)	*Years ended September 30,*				
RESULTS OF OPERATIONS	**2002**	**2001**	**2000**	**1999**	**1998**
Revenues	$ 12,321	$ 21,294	$28,904	$26,993	$21,307
Gross margin[a]	1,552	2,058	11,714	12,969	9,817
Operating income (loss)[a]	(6,979)	(19,029)	2,366	3,786	1,384
Income (loss) from continuing operations[a]	(11,826)[b]	(14,170)	1,433	2,369	360
Earnings (loss) per common share from continuing operations[c] [d]:					
Basic	(3.51)	(4.18)	0.44	0.76	0.12
Diluted	(3.51)	(4.18)	0.43	0.74	0.12
Dividends per common share[c]	0.00	0.06	0.08	0.08	0.0775
FINANCIAL POSITION					
Cash, cash equivalents and short-term investments	$ 4,420	$ 2,390	$ 1,467	$ 1,686	$ 1,144
Total assets	17,791	33,664	47,512	34,246	24,289
Total debt	5,106[e]	4,409	6,498	5,788	2,861
8.00% redeemable convertible preferred stock	1,680	1,834	–	–	–
Shareowners' (deficit) equity	(4,734)[f]	11,023	26,172	13,936	7,960

(a) Operating income (loss) and Income (loss) from continuing operations includes net business restructuring charges and asset impairments of $2,316 and $11,416 in fiscal 2002 and 2001, respectively, of which $64 and $1,259 of inventory write-downs affected gross margin, in fiscal 2002 and 2001, respectively.

(b) Includes a full valuation allowance on the net deferred tax assets as of September 30, 2002.

(c) All per share data have been restated to reflect the two-for-one splits of our common stock that became effective on April 1, 1998 and April 1, 1999.

(d) Includes the impact of preferred dividends and accretion of $167 and $28 in fiscal 2002 and 2001, respectively. In addition, fiscal 2002 includes the effect of conversion cost of $29 associated with the exchange of 8% redeemable convertible preferred stock for Lucent common stock.

(e) Includes company-obligated 7.75% mandatorily redeemable convertible preferred securities of subsidiary trust of $1,750.

(f) Includes a non-cash charge of $2,927 related to the minimum liability adjustment for the management pension plan.

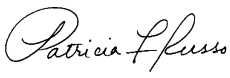
REPORT OF MANAGEMENT

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 independent directors, 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.



Patricia F. Russo
President and
Chief Executive Officer



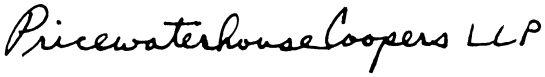
Frank A. D'Amelio
Chief Financial Officer

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 operations, changes in shareowners' (deficit) equity and cash flows present fairly, in all material respects, the financial position of Lucent Technologies Inc. and its subsidiaries at September 30, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2002, 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 16 to the consolidated financial statements, in 2001 the Company changed its accounting methods for revenue recognition and for derivative financial instruments.



PRICEWATERHOUSECOOPERS LLP
New York, New York
October 23, 2002,
except for the second paragraph of Note 4, the third paragraph of Note 10 and the first paragraph of Note 12, as to which the date is December 4, 2002

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in Millions, Except Per Share Amounts) *Years ended September 30,*

	2002	2001	2000
Revenues:			
Products	$ 9,632	$ 17,132	$23,978
Services	2,689	4,162	4,926
Total revenues	12,321	21,294	28,904
Costs:			
Products	8,452	15,596	13,265
Services	2,317	3,640	3,925
Total costs	10,769	19,236	17,190
Gross margin	1,552	2,058	11,714
Operating expenses:			
Selling, general and administrative	3,969	7,410	5,610
Research and development	2,310	3,520	3,179
Purchased in-process research and development	–	–	559
Business restructuring charges and asset impairments, net	2,252	10,157	–
Total operating expenses	8,531	21,087	9,348
Operating income (loss)	(6,979)	(19,029)	2,366
Other income (expense), net	292	(357)	333
Interest expense	382	518	342
Income (loss) from continuing operations before income taxes	(7,069)	(19,904)	2,357
Provision (benefit) for income taxes	4,757	(5,734)	924
Income (loss) from continuing operations	**(11,826)**	**(14,170)**	**1,433**
Income (loss) from discontinued operations, net	73	(3,172)	(214)
Income (loss) before extraordinary item and cumulative effect of accounting changes	(11,753)	(17,342)	1,219
Extraordinary gain, net	–	1,182	–
Cumulative effect of accounting changes, net	–	(38)	–
Net income (loss)	(11,753)	(16,198)	1,219
Conversion cost – 8% redeemable convertible preferred stock	(29)	–	–
Preferred stock dividends and accretion	(167)	(28)	–
Net income (loss) applicable to common shareowners	**$(11,949)**	**$(16,226)**	**$ 1,219**
EARNINGS (LOSS) PER COMMON SHARE – BASIC			
Income (loss) from continuing operations	$ (3.51)	$ (4.18)	$ 0.44
Net income (loss) applicable to common shareowners	$ (3.49)	$ (4.77)	$ 0.38
EARNINGS (LOSS) PER COMMON SHARE – DILUTED			
Income (loss) from continuing operations	$ (3.51)	$ (4.18)	$ 0.43
Net income (loss) applicable to common shareowners	$ (3.49)	$ (4.77)	$ 0.37
Weighted average number of common shares outstanding – basic	3,426.7	3,400.7	3,232.3
Weighted average number of common shares outstanding – diluted	3,426.7	3,400.7	3,325.9

See Notes to Consolidated Financial Statements.

LUCENT TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Millions, Except Per Share Amounts)	*September 30,* 2002	2001
ASSETS		
Cash and cash equivalents	$ 2,894	$ 2,390
Short-term investments	1,526	–
Receivables, less allowance of $325 in 2002 and $634 in 2001	1,647	4,594
Inventories	1,363	3,646
Contracts in process, net	10	1,027
Deferred income taxes, net	–	2,658
Other current assets	1,715	1,788
Total current assets	9,155	16,103
Property, plant and equipment, net	1,977	4,416
Prepaid pension costs	4,355	4,958
Deferred income taxes, net	–	2,695
Goodwill and other acquired intangibles, net of accumulated amortization of $910 in 2002 and $832 in 2001	224	1,466
Other assets	2,080	2,724
Net long-term assets of discontinued operations	–	1,302
Total assets	**$17,791**	**$33,664**
LIABILITIES		
Accounts payable	$ 1,298	$ 1,844
Payroll and benefit-related liabilities	1,094	1,500
Debt maturing within one year	120	1,135
Other current liabilities	3,814	5,285
Net current liabilities of discontinued operations	–	405
Total current liabilities	**6,326**	**10,169**
Postretirement and postemployment benefit liabilities	5,230	5,481
Pension liability	2,752	80
Long-term debt	3,236	3,274
Company-obligated 7.75% mandatorily redeemable convertible preferred securities of subsidiary trust	1,750	–
Deferred income taxes, net	–	152
Other liabilities	1,551	1,651
Total liabilities	**20,845**	**20,807**
Commitments and contingencies		
8.00% redeemable convertible preferred stock	**1,680**	**1,834**
SHAREOWNERS' (DEFICIT) EQUITY		
Preferred Stock – par value $1.00 per share; authorized shares: 250,000,000; issued and outstanding none	–	–
Common stock – par value $.01 per share; Authorized shares: 10,000,000,000; 3,491,585,126 issued and 3,490,310,034 outstanding shares at September 30, 2002 and 3,414,815,908 issued and 3,414,167,155 outstanding shares at September 30, 2001	35	34
Additional paid-in capital	20,606	21,702
Accumulated deficit	(22,025)	(10,272)
Accumulated other comprehensive loss	(3,350)	(441)
Total shareowners' (deficit) equity	**(4,734)**	**11,023**
Total liabilities, redeemable convertible preferred stock and shareowners' (deficit) equity	**$17,791**	**$33,664**

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' (DEFICIT) EQUITY

(Dollars in Millions)	*Common Stock*	*Additional Paid-In Capital*	*Retained Earnings (Accumulated Deficit)*	*Accumulated Other Comprehensive Loss*	*Total Shareowners' (Deficit) Equity*	*Total Comprehensive Income (Loss)*
Balance at September 30, 1999	**$31**	**$7,961**	**$6,188**	**$(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 adjustment for realized holding gains on certain investments (net of tax benefit of $126)				(194)		(194)
Common stock dividends declared			(255)			
Issuance of common stock		1,397				
Tax benefit from employee stock options		1,064				
Issuance of common stock and conversion of stock options for acquisitions	3	9,901				
Other		45	(14)	2		2
Spin off of Avaya		6	(1,009)	2		
Total comprehensive income						**$ 1,096**
Balance at September 30, 2000	**34**	**20,374**	**6,129**	**(365)**	**26,172**	
Net loss			(16,198)			$(16,198)
Foreign currency translation adjustment (net of tax benefit of $16)				(30)		(30)
Reclassification of foreign currency translation losses realized upon the sale of foreign entities (net of tax of $2)				(3)		(3)
Unrealized holding losses on certain investments (net of tax benefit of $72)				(95)		(95)
Reclassification adjustment for realized holding gains and impairment losses on certain investments (net of tax of $32)				50		50
Common stock dividends declared			(204)			
Issuance of common stock		234				
Tax benefit from employee stock options		18				
Preferred stock dividends and accretion		(28)				
Cumulative effect of accounting change (SFAS 133)				11		11
Agere initial public offering		922				
Compensation on equity-based awards		87				
Other		95	1	(9)		(9)
Total comprehensive loss						**$(16,274)**
Balance at September 30, 2001	**34**	**21,702**	**(10,272)**	**(441)**	**11,023**	
Net loss			(11,753)			$(11,753)
Minimum pension liability adjustment				(2,927)		(2,927)
Foreign currency translation adjustment				40		40
Reclassification of foreign currency translation gain realized upon the sale of foreign entities				20		20
Unrealized holding losses on certain investments				(27)		(27)
Reclassification adjustment for realized holding losses and impairment losses on certain investments				(8)		(8)
Issuance of common stock in connection with exchange of 8% convertible redeemable preferred stock	1	174				
Other issuance of common stock		55				
Preferred stock dividends and accretion		(167)				
Spin off of Agere		(1,191)		(6)		(6)
Other		33		(1)		(1)
Total comprehensive loss						**$(14,662)**
Balance at September 30, 2002	**$ 35**	**$20,606**	**$(22,025)**	**$ (3,350)**	**$ (4,734)**	

See Notes to Consolidated Financial Statements.

LUCENT TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Millions)	*Years ended September 30,*		
	2002	**2001**	**2000**
OPERATING ACTIVITIES			
Net income (loss)	$(11,753)	$(16,198)	$1,219
Less: Income (loss) from discontinued operations	73	(3,172)	(214)
Extraordinary gain	–	1,182	–
Cumulative effect of accounting changes	–	(38)	–
Income (loss) from continuing operations	(11,826)	(14,170)	1,433
Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities, net of effects of acquisitions and dispositions of businesses and manufacturing operations:			
Non-cash portion of business restructuring charges, net	827	9,322	–
Asset impairment charges	975	–	–
Depreciation and amortization	1,470	2,536	1,667
Provision for bad debts and customer financings	1,253	2,249	505
Tax benefit from employee stock options	–	18	1,064
Deferred income taxes	5,268	(5,935)	491
Purchased in-process research and development	–	–	559
Net pension and postretirement benefit credit	(972)	(1,083)	(802)
Gains on sales of businesses	(725)	(56)	(30)
Other adjustments for non-cash items	843	551	(222)
Changes in operating assets and liabilities:			
Decrease (increase) in receivables	2,493	3,627	(1,626)
Decrease (increase) in inventories and contracts in process	2,552	881	(2,242)
(Decrease) increase in accounts payable	(539)	(759)	263
Changes in other operating assets and liabilities	(2,375)	(602)	(1,763)
Net cash used in operating activities from continuing operations	**(756)**	**(3,421)**	**(703)**
INVESTING ACTIVITIES			
Capital expenditures	(449)	(1,390)	(1,915)
Dispositions of businesses and manufacturing operations, net of cash disposed	2,576	3,187	250
Sales or maturity of investments	31	57	820
Purchases of non-consolidated investments	(30)	(101)	(680)
Purchases of short-term investments	(1,518)	–	–
Proceeds from the sale or disposal of property, plant and equipment	194	177	26
Other investing activities	(47)	21	(60)
Net cash provided by (used in) investing activities from continuing operations	**757**	**1,951**	**(1,559)**
FINANCING ACTIVITIES			
Issuance of company-obligated 7.75% mandatorily redeemable convertible preferred securities of subsidiary trust	1,750	–	–
(Repayments of)proceeds from credit facilities	(1,000)	3,500	–
Net (repayments of) proceeds from other short-term borrowings	(104)	(2,147)	1,355
Issuance of long-term debt	–	302	72
Repayments of long-term debt	(47)	(754)	(387)
Issuance of 8% redeemable convertible preferred stock	–	1,831	–
Issuance of common stock	64	222	1,444
Dividends paid on preferred and common stock	(149)	(204)	(255)
Other financing activities	(46)	(125)	–
Net cash provided by financing activities from continuing operations	**468**	**2,625**	**2,229**
Effect of exchange rate changes on cash and cash equivalents	35	4	10
Net cash provided by (used in) continuing operations	504	1,159	(23)
Net cash used in discontinued operations	–	(236)	(196)
Net increase (decrease) in cash and cash equivalents	504	923	(219)
Cash and cash equivalents at beginning of year	2,390	1,467	1,686
Cash and cash equivalents at end of year	**$ 2,894**	**$ 2,390**	**$1,467**

See Notes to Consolidated Financial Statements.