TO OUR SHAREOWNERS:

Fiscal 2004 was a pivotal year for our company. For the first time since 2000, we posted a profitable year and achieved annual revenue growth. We also generated cash from operations. Further, we developed a clear vision for the next generation of communications and put in place capabilities to be our customers' partner of choice. We achieved this through our relentless focus on growth opportunities in the marketplace, solid execution and controlling our costs and expenses.

We believed our efforts would pay off when the market stabilized and started to grow. And that's what happened this past year. As a result, we achieved profitability as the benefits of our cost-reduction work materialized at the same time we were able to grow our top line.



PATRICIA F. RUSSO
Chairman and Chief Executive Officer

FINANCIAL SUMMARY

In accordance with U.S. generally accepted accounting principles (GAAP) for the year ended September 30, 2004:

- Revenues increased 7 percent to $9.05 billion from $8.47 billion in the prior year.
- Net income was $2.0 billion, or 42 cents per diluted share, compared with a net loss of $770 million, or 29 cents per diluted share, in the prior year. (Net income for fiscal 2004 includes $861 million, or 17 cents per diluted share, related to an expected tax refund we announced in November 2004.)
- Gross margin rate improved by 11 percentage points to 42 percent.
- Operating expenses decreased to $2.6 billion from $2.9 billion in fiscal 2003.
- Operating income improved by $1.4 billion.
- Operating activities generated $634 million of cash, compared with a use of $948 million in fiscal 2003 — a swing of almost $1.6 billion.

On a segment basis, revenues in Mobility Solutions increased 30 percent compared with the prior year to $4.01 billion as customers enhanced their networks to deliver next-generation mobile high-speed data services. Revenues in Integrated Network Solutions decreased 10 percent compared with the prior year to $2.98 billion as the market for wireline technology remains in transition. Revenues in Lucent Worldwide Services increased 5 percent compared with the prior year to $1.93 billion as our renewed focus on services has begun to yield results.

OUR PEOPLE MADE THE DIFFERENCE

Our results and achievements reflect the tireless dedication of thousands of Lucent employees across the company who have worked over the past few years to reshape the business, reduce our cost structure and streamline our supply chain, all while continuing to meet the needs of our customers. Our employees are as determined as they are diverse, as creative as they are hard working and as resilient as they are committed to excellence. They have faced the most difficult period our industry has ever seen and have done everything that was asked of them to see our company through some challenging times.

Now that we have weathered the storm, we have recommitted ourselves to leveraging — and further developing — the strengths of our talent base. By attracting and developing world-class talent at every level of the business and by standing by our commitment to diversity and an open exchange of ideas, we continue to create an environment where every Lucent employee can become a creative force behind new solutions for our customers. This creative force already has led to improved customer satisfaction. Based on feedback from recently conducted surveys,

we improved our customer loyalty index by about 5 percent in fiscal 2004 compared with the prior year. This represents the highest score in Lucent's history and is above the competitive average in the industry.

TRANSFORMING OUR COMPANY

Lucent is a vastly different company today than it was just four years ago when we initiated our restructuring initiatives. Our journey back to profitability in the face of market uncertainties has been extremely challenging, but we have become a stronger, more streamlined and more focused company. Along the way, we learned many valuable lessons and found new ways to improve the way we do business and serve our customers. In just the past year, we implemented a number of new systems and processes — including an improved customer order process, increased standardization across product lines and a new global treasury management system — that have improved our overall efficiency and effectiveness.

While we made progress in many areas during the year, we continued to have to take some difficult actions, most notably reductions to employee work force levels and the level of subsidies for retiree health care. While we have been hiring in certain areas of the company, the overall needs of the business resulted in a net employee work force reduction of 2,700 during the fiscal year to 31,800. Additionally, the cost of providing postretirement health care benefits continues to rise. Our U.S. retiree health care costs were almost 10 percent of our total revenues in 2004. Given the challenges we continue to face in this highly competitive market, we needed to find an affordable balance between providing for the retirees who helped build our heritage and investing in the next-generation products and services that will shape — and ensure — our future. Therefore, we had to make the difficult decision to reduce subsidies for management retirees, and late in the calendar year our U.S.-based unions ratified our new collective bargaining agreement, which includes provisions that cap our liability for retiree health care for represented employees and retirees, enabling us to keep these expenses at an affordable level.

The intense competition in our industry demands that we continue to focus our energies on profitably growing the business, which means not only focusing on the top line, but also continuing to drive improvements in our cost and expense structure and improving our overall efficiency. It is absolutely clear that these are not short-term areas of focus; rather they are fundamental business imperatives that will necessarily influence us going forward.

ARCHITECTS OF NEXT-GENERATION COMMUNICATIONS

After several years of dramatic decline, the telecommunications market has stabilized and started growing, driven by an increasing demand for converged network services. Convergence is about creating networks that deliver communications services that are simple, seamless, secure, personal, portable and virtual, to reach people at work, home or anywhere in between.

At Lucent, we developed and articulated a clear vision around convergence and implemented a strategy to make it happen. This positions us on the leading edge as an increasing number of our customers are looking for strategic partners to help them deliver the next generation of converged communications. In this new environment, we need to do more than deliver equipment in the traditional manner. We must deliver value in the form of products, services, marketing support and partnerships that provide the cost savings and revenue-generating opportunities that will enable customers to deliver on their next-generation visions.

Lucent's implementation of the IMS architecture is the cornerstone of this next-generation convergence. IMS (Internet protocol Multimedia Subsystem) is an open standards-based way to build next-generation networks that deliver new lifestyle communications services to end users. Implementing IMS allows Lucent to focus on delivering what we call "Value over IP™," because next-generation networking is about more than just voice over Internet protocol (VoIP); it's about seamlessly delivering any type of lifestyle service the end user desires (data, images, video, text or multimedia) over any type of device (cell phone, PDA, laptop, PC or other) wherever the user may be.

Over the next few years, the distinction between wireline providers and mobile providers will continue to

blur, and the focus will be on delivering on-demand lifestyle services to the end user. That's why during fiscal 2004 we developed and introduced 10 new products — including network controllers, gateways and signaling and application servers — that support our common platform approach to IMS across our entire wireline and wireless portfolio. This unified approach to building a common IMS platform for wireless and wireline customers is a fundamental change in the way we think about communications systems, software and delivering communications services.

STRATEGY FOR PROFITABLE GROWTH

To address the demand for converged network services, our customers are developing more significant, multiyear plans for next-generation networks that will deliver a "triple play" of voice, video and data services, while managing network operating costs. As a result, analysts project spending in certain next-generation segments (such as mobile high-speed data, VoIP, next-generation optical networking and broadband access) to grow at varying rates, even as spending on such traditional segments as circuit switching continues to decline. These developments play to Lucent's strengths, and we have put in place a two-pronged strategy to capitalize on these opportunities. First, we continue to invest in these key growth areas related to convergence, while leveraging our expertise in designing, deploying and servicing converged networks. At the same time, we continue to expand our revenue base by making strides in such new markets as services, the government sector and emerging markets outside the United States.

In ***mobile high-speed data***, Lucent remains the global leader in the deployment of commercial third-generation (3G) networks, with more than 120,000 spread-spectrum base stations deployed worldwide, 70,000 of which support 3G services. We remain the global leader in CDMA mobile technology and have successfully deployed 3G networks with more than 30 mobile operators worldwide. Our mobile high-speed data solutions are enabling mobile operators to offer businesses and consumers such data services as e-mail and corporate intranet access at speeds comparable to the fastest wireline connections. In addition, we got fiscal 2005 off to a great start announcing important W-CDMA/UMTS wins in both North America and Europe.

Early in fiscal 2004, we unveiled our Accelerate™ Next-Generation Communication solutions — a cost-effective way for our customers to evolve their networks to provide ***IP-based voice, data and multimedia services***. Since then, we have announced more than 25 customers for these solutions and have continued to expand and enhance our IP-based offerings through a combination of internal product development, partnerships and the acquisition of Telica, which has significantly strengthened our VoIP offering — bolstering our strategy to become the leader in converged networks.

Next-generation optical networking also remains a strong area for us. Both the Lucent LambdaXtreme™ Transport and the Lucent LambdaUnite® next-generation systems are finding acceptance with customers seeking to increase the capacity, scalability and intelligence of their backbone networks. And Lucent's Metropolis® portfolio of metro optical networking products now has more than 100 customers.

In ***broadband access***, we continue to deliver solutions that enable customers to deliver a "triple play" of voice, video and data services over high-speed connections. We also have announced an agreement to develop IPTV for broadband networks, as well as several agreements for our network management software offerings that deliver broadband services, troubleshoot networking problems and improve the efficient flow of traffic on customer networks.

SEIZING NEW OPPORTUNITIES

Several years ago we made a strategic decision to further leverage Lucent's inherent capabilities in designing, building, deploying and maintaining complex networks around the world. We created ***Lucent Worldwide Services*** and broadened our professional services and managed services offerings. Our total Services revenues increased 5 percent in fiscal 2004 compared with the prior year, and we have increased our focus on some of the higher growth areas — including maintenance, professional and managed services. We also announced new security and VoIP

assessment and readiness services, enabling customers to build more secure and reliable next-generation networks. In addition, Services continues to create innovative customer-focused programs, including the Client Reference Program that has already led to new revenue.

Our business with the ***government sector*** continues to grow as well — increasing more than 50 percent year over year, albeit on a small base. We continue to address opportunities in this area and expect to grow this business substantially over time as the government sector transitions to VoIP and next-generation converged networks based on IMS.

We also made progress in ***emerging markets*** outside the United States, where we have recently won contracts with service providers in such countries as India, Romania, Vietnam and Pakistan. In some cases, Lucent's innovative technologies are driving new opportunities in various regions. For example, we were the first to deliver wireless solutions globally for the 450 MHz spectrum band (CDMA450). So far, we have deployed commercial networks in 450 MHz spectrum in Russia, Romania, Uzbekistan and Vietnam, and we are conducting numerous trials with customers around the world.

BELL LABS

Bell Labs, the innovation engine that powers Lucent Technologies, remains one of the leading industrial R&D organizations in the world. Building on a heritage of innovation that includes more than 30,000 patents, six Nobel Prizes in physics, nine U.S. National Medals of Science and eight U.S. National Medals of Technology, Bell Labs continued to flourish in 2004. In April, MIT's *Technology Review* magazine selected a Bell Labs patent for improving the quality of VoIP and other data service as one of its "Five Killer Patents" for the year. In June, we announced our plans to open a new R&D facility in Dublin with the support of the Irish government. Meanwhile, Bell Labs continues to pioneer efforts in new areas of innovation, including nanotechnology. The New Jersey Nanotechnology Consortium, based at and run by Bell Labs, is working on everything from next-generation nano batteries and chemical factories on a chip, to liquid lenses, microscopic sensors and chips with thousands of micro-microphones — creating the potential for new industries and technologies. Most important, Bell Labs continues to work side-by-side with Lucent's product teams to develop cutting-edge solutions for our customers. For example, our implementation of the IMS network architecture is distinguished by unique Bell Labs research-enabled technologies that ensure privacy, security, quality and responsiveness of end-user applications.

EXECUTING FOR THE FUTURE

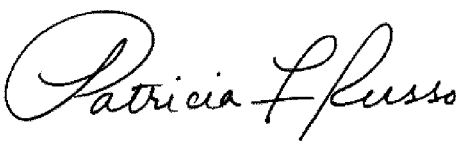
Going forward, the challenge is to ensure that we remain well positioned to capitalize on the market opportunities being created by converged network services. We will do this by working closely with our customers, continuing to invest in the key areas of convergence, looking for opportunities to further improve our systems and processes, and continuing to control costs and expenses. Execution in each of these areas is essential to the long-term success of our business as we continue to evolve into a more customer- and market-driven company.

Along the way, we will maintain the highest standards of corporate governance and business ethics, while continuing to pursue community service opportunities through such initiatives as the new Lucent Connects Global Employee Volunteer program, which supports and encourages team volunteer activities in communities around the world where Lucent employees and customers live and work.

There is still more work to be done as we continue to position ourselves to meet our customers' needs, drive profitable growth and create long-term shareowner value. The good news is we have the people, the relationships and the portfolio to meet the challenges we face in an increasingly competitive environment.

We look forward to seizing the opportunities before us as we work to create new possibilities to enhance people's lives by transforming the way the world communicates.

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



Patricia F. Russo
Chairman and Chief Executive Officer