(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

1. BACKGROUND AND BASIS OF PRESENTATION

BACKGROUND

Lucent Technologies Inc. ("Lucent" or the "Company") was formed from the systems and technology units of AT&T Corp. and the associated assets and liabilities of those units, including Bell Laboratories (the "Separation"). Lucent was incorporated on November 29, 1995 with 1,000 shares of common stock ("Common Stock"), authorized and outstanding, all of which were owned by AT&T. On April 2, 1996, AT&T obtained an additional 524,623,894 shares (pre-split basis) of Common Stock and on April 10, 1996, Lucent issued 112,037,037 shares (pre-split basis) in an Initial Public Offering. On September 30, 1996, AT&T distributed to its shareowners all of its remaining interest in Lucent (the "Distribution").

BASIS OF PRESENTATION

The consolidated financial statements as of and for the nine months ended September 30, 1996, reflect the results of operations, changes in shareowners' equity and cash flows, and the financial position of the business that was transferred to Lucent from AT&T as if Lucent were a separate entity. The consolidated financial statements have been prepared using the historical basis of the assets and liabilities and historical results of operations of these businesses. Additionally, the aforementioned financial statements include an allocation of certain AT&T corporate headquarters assets, liabilities and expenses related to the businesses that were transferred to Lucent from AT&T. Management believes the allocations reflected in the consolidated financial statements are reasonable. The aforementioned financial statements may not necessarily reflect Lucent's consolidated results of operations, financial position, changes in shareowners' equity or cash flows in the future or what they would have been had Lucent been a separate, stand-alone company during such period.

On April 1, 1998, a two-for-one split of Lucent's common stock became effective. Shareowners' equity has been restated to give retroactive recognition to the stock split for all periods presented by reclassifying from retained earnings to common stock the par value of the additional shares arising from the split. In addition, all references in the financial statements and notes to number of shares, per share amounts, stock option data and market prices have been restated to reflect this stock split.

On November 19, 1998, Lucent sold $500 ($495 net of unamortized costs) of 10-year notes and reclassified the amount from debt maturing within one year to long-term debt. The proceeds were used to pay down a portion of Lucent's commercial paper during the first quarter of fiscal 1999.

ACQUISITIONS

The following table presents information about certain acquisitions by Lucent in the fiscal years ended September 30, 1998 and 1997. All charges were recorded in the quarter in which the transaction was completed.

	JNA (1)	LANNET (2)	MASSMEDIA (3)	SDX (4)	YURIE (5)	OPTIMAY (6)	PROMINET (7)	LIVINGSTON (8)	OCTEL (9)
Acquisition Date	9/98	8/98	7/98	7/98	5/98	4/98	1/98	12/97	9/97
Purchase Price	$67 cash	$115 cash	N/S	$207 cash	$1,056 cash & options	$64 cash	$199 stock & options	$610 stock & options	$1,819 cash & options
Goodwill	37	2	1	96	292	1	35	114	181
Existing technology	18	15	–	16	40	18	23	69	186
Purchased in-process research & development costs (after tax)	3	67	8	82	620	48	157	427	945
Amortization period-goodwill (years)	10	7	5	10	7	5	5	5	7
Amortization period-existing technology (years)	10	5	N/A	5	5	5	6	8	5

(1) JNA Telecommunications Limited was an Australian telecom manufacturer, reseller and system integrator.

(2) LANNET, a subsidiary of Madge Networks N.V., was an Israeli-based supplier of Ethernet and asynchronous transfer mode ("ATM") switching solutions for local area networks.

(3) MassMedia Communications, Inc., was a privately held, start-up developer of highly-reliable, next-generation network interoperability software.

(4) SDX Business Systems plc was a United Kingdom-based provider of business communications systems.

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

(6) Optimay GmbH specialized in the development of software products and services for chip sets to be used for Global System for Mobile Communications cellular phones.

(7) Prominet Corporation was a participant in the emerging Gigabit Ethernet networking industry. The merger involved $164 of Lucent stock and options. In addition, under the terms of the agreement, Lucent had contingent obligations to pay former Prominet shareowners $35 in stock. The $35 of stock was paid by Lucent, in July 1998 and recorded primarily as goodwill.

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

(9) Octel Communications Corporation was a provider of voice, fax and electronic messaging technologies.

N/A Not Applicable

N/S Not Significant

All the above acquisitions were accounted for under the purchase method of accounting. The fair market value of the assets and liabilities acquired were independently determined and included in the balance sheet as of the quarter in which the acquisition was completed.

For all the above acquisitions, the acquired technology valuation included both existing technology and purchased in-process research and development. The valuation of these technologies was made by applying the income forecast method, which considers the present value of cash flows by product lines.

Included in the purchase price for the above acquisitions, was purchased in-process research and development, which was a noncash charge to earnings as this technology had not reached technological feasibility and had no future alternative use. This technology will require varying additional development, coding and testing efforts over the next year before technological feasibility can be determined. The remaining purchase price was allocated to tangible assets and intangible assets, including goodwill and existing technology, less liabilities assumed.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF CONSOLIDATION

The consolidated financial statements include all majority-owned subsidiaries in which Lucent exercises control. Investments in which Lucent exercises significant influence, but which it does not control (generally a 20%–50% ownership interest), are accounted for under the equity method of accounting. All material intercompany transactions and balances have been eliminated.

USE OF ESTIMATES

The preparation of financial statements and related disclosures in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. Actual results could differ from those estimates. Estimates are used when accounting for long-term contracts, allowance for uncollectible accounts receivable, inventory obsolescence, product warranty, depreciation, employee benefits, taxes, restructuring reserves and contingencies, among others.

FOREIGN CURRENCY TRANSLATION

For operations outside the United States that prepare financial statements in currencies other than the United States dollar, results of operations and cash flows are translated at average exchange rates during the period, and assets and liabilities are translated at end of period exchange rates. Translation adjustments are included as a separate component of shareowners' equity.

REVENUE RECOGNITION

Revenue is generally recognized when all significant contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured. Revenue from product sales of hardware and software is recognized at time of delivery and acceptance, and after consideration of all the terms and conditions of the customer contract. Sales of services are recognized at time of performance and rental revenue is recognized proportionately over the contract term. Revenues and estimated profits on long-term contracts are generally recognized under the percentage of completion method of accounting using either a units-of-delivery or a cost-to-cost methodology. Profit estimates are revised periodically based on changes in facts. Any losses on contracts are recognized immediately.

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expense as incurred. However, the costs incurred for the development of computer software that will be sold, leased or otherwise marketed are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated future revenues and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when the product is available for general release. Amortization is provided on a product-by-product basis on either the straight-line method over periods not exceeding two years or the sales ratio method. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product are expensed immediately.

CASH AND CASH EQUIVALENTS

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents.

INVENTORIES

Inventories are stated at the lower of cost (determined principally on a first-in, first-out basis) or market.

CONTRACTS IN PROCESS

Contracts in process are valued at cost plus accrued profits less progress billings.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is determined using primarily the unit and group methods. The unit method is used for manufacturing and laboratory equipment and large computer systems. The group method is used for other depreciable assets. When assets that were depreciated

using the unit method are sold or retired, the gains or losses are included in operating results. When assets that were depreciated using the group method are sold or retired, the original cost is deducted from the appropriate account and accumulated depreciation. Any gains or losses are applied against accumulated depreciation.

The accelerated depreciation method is used for certain high technology computer processing equipment. All other facilities and equipment are depreciated on a straight-line basis over their estimated useful lives.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

FINANCIAL INSTRUMENTS

Lucent uses various financial instruments, including foreign currency exchange contracts and interest rate swap agreements to manage and reduce risk to Lucent by generating cash flows, which offset the cash flows of certain transactions in foreign currencies or underlying financial instruments in relation to their amount and timing. Lucent's derivative financial instruments are for purposes other than trading and are not entered into for speculative purposes. Lucent's nonderivative financial instruments include letters of credit, commitments to extend credit and guarantees of debt. Lucent generally does not require collateral to support its financial instruments.

GOODWILL

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. Goodwill is amortized on a straight-line basis over the periods benefited, principally in the range of 5 to 15 years. Goodwill is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the 1998 presentation.

3. RECENT PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 establishes new accounting and reporting standards for derivative financial instruments and for hedging activities. SFAS 133 requires an entity to measure all derivatives at fair value and to recognize them in the balance sheet as an asset or liability, depending on the entity's rights or obligations under the applicable derivative contract. Lucent will designate each derivative as belonging to one of several possible categories, based on the intended use of the derivative. The recognition of changes in fair value of a derivative that affect the income statement will depend on the intended use of the derivative. If the derivative does not qualify as a hedging instrument, the gain or loss on the derivative will be recognized currently in earnings. If the derivative qualifies for special hedge accounting, the gain or loss on the derivative will either (1) be recognized in income along with an offsetting adjustment to the basis of the item being hedged or (2) be deferred in other comprehensive income and reclassified to earnings in the same period or periods during which the hedged transaction affects earnings. SFAS 133 will be effective for Lucent no later than the quarter ending December 31, 1999. SFAS 133 may not be applied retroactively to financial statements of prior periods. SFAS 133 is not expected to have a material impact on Lucent's consolidated results of operations, financial position or cash flows.

In February 1998, FASB issued SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" ("SFAS 132"). SFAS 132 revises employers' disclosures about pension and other postretirement benefit plans. SFAS 132 is effective for fiscal years beginning after December 15, 1997. Restatement of disclosures for earlier periods provided for comparative purposes is required unless the information is not readily available. Lucent is in the process of evaluating the disclosure requirements. The adoption of SFAS 132 will have no impact on Lucent's consolidated results of operations, financial position or cash flows.

In June 1997, FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). SFAS 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures about products and services, geographic areas, and major customers. SFAS 131 is effective for financial statements for fiscal years beginning after December 15, 1997. Financial statement disclosures for prior periods are required to be restated. Lucent is in the process of evaluating the disclosure requirements. The adoption of SFAS 131 will have no impact on Lucent's consolidated results of operations, financial position or cash flows.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

In June 1997, FASB issued SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130 establishes standards for reporting and display of comprehensive income and its components in the financial statements. SFAS 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. Lucent is in the process of determining its preferred format. The adoption of SFAS 130 will have no impact on Lucent's consolidated results of operations, financial position or cash flows.

In March 1998, the American Institute of Certified Public Accountants (the "AICPA") issued Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). SOP 98-1 provides guidance on accounting for the costs of computer software developed or obtained for internal use. This pronouncement identifies the characteristics of internal use software and provides guidance on new cost recognition principles. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. Lucent currently expenses its costs of computer software developed or obtained for internal use and is evaluating the impacts of adopting SOP 98-1.

In October 1997, the AICPA issued Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"). SOP 97-2 provides guidance on when revenue should be recognized and in what amounts for licensing, selling, leasing or otherwise marketing computer software. SOP 97-2 is effective for financial statements for fiscal years beginning after December 15, 1997. During March 1998, the AICPA issued Statement of Position 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition," ("SOP 98-4"). SOP 98-4 defers for one year the limitation of what is considered vendor-specific objective evidence of the fair value of the various elements in a multiple-element arrangement, a requirement to recognize revenue for elements delivered early in the arrangement. Effective October 1, 1998, Lucent has adopted SOP 97-2 and the adoption is not expected to have a material impact on Lucent's consolidated results of operations, financial position or cash flows.

4. SUPPLEMENTARY FINANCIAL INFORMATION

SUPPLEMENTARY INCOME STATEMENT INFORMATION

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,
	1998	**1997**	**1996**
INCLUDED IN COSTS			
Amortization of software development costs	**$ 234**	$ 380	$218
INCLUDED IN SELLING, GENERAL AND ADMINISTRATIVE EXPENSES			
Amortization of goodwill and existing technology	**$ 147**	$ 32	$ 25
INCLUDED IN COSTS AND OPERATING EXPENSES			
Depreciation and amortization of property, plant and equipment	**$ 919**	$1,008	$674
OTHER INCOME–NET			
Interest income	**$ 83**	$ 132	$ 71
Minority interests in earnings of subsidiaries	**(24)**	(35)	(21)
Net equity losses from investments	**(209)**	(64)	(26)
Increase in cash surrender value of life insurance	**52**	54	35
Loss on foreign currency transactions	**(44)**	(12)	(4)
Gains on businesses sold	**208**	–	–
Miscellaneous–net	**97**	66	41
Other income–net	**$ 163**	$ 141	$ 96
DEDUCTED FROM INTEREST EXPENSE			
Capitalized interest	**$ 17**	$ 14	$ 14

SUPPLEMENTARY BALANCE SHEET INFORMATION

	1998	Year Ended September 30, 1997
INVENTORIES		
Completed goods	$ 1,578	$ 1,611
Work in process and raw materials	1,503	1,315
Inventories	$ 3,081	$ 2,926
PROPERTY, PLANT AND EQUIPMENT–NET		
Land and improvements	$ 301	$ 299
Buildings and improvements	3,130	2,852
Machinery, electronic and other equipment	8,354	8,403
Total property, plant and equipment	11,785	11,554
Less: Accumulated depreciation and amortization	(6,382)	(6,407)
Property, plant and equipment–net	$ 5,403	$ 5,147
OTHER CURRENT LIABILITIES		
Advance billings and customer deposits	$ 515	$ 844

SUPPLEMENTARY CASH FLOW INFORMATION

	Year Ended September 30, (Twelve Months) 1998	1997	Nine Months Ended September 30, 1996
Interest payments, net of amounts capitalized	$319	$307	$209
Income tax payments	$714	$781	$142

	Year Ended September 30, (Twelve Months) 1998	1997	Nine Months Ended September 30, 1996
ACQUISITIONS OF BUSINESSES			
Fair value of assets acquired	$2,341	$1,812	$527
Less: Fair value of liabilities assumed	$ 994	$ 244	$293
Acquisitions of businesses	$1,347	$1,568	$234

On October 1, 1997, Lucent contributed its Consumer Products business to a new venture formed by Lucent and Philips Electronics N.V. in exchange for 40% ownership of Philips Consumer Comunications ("PCC"). For the year ended September 30, 1998, the statement of cash flows excludes Lucent's contribution of its Consumer Products business.

For the year ended September 30, 1998, Other income–net includes a charge of $110 related to a write-down associated with Lucent's investment in the PCC venture. This charge was offset by gains of $103, primarily related to the sale of an investment and the sale of certain business operations, including Bell Labs Design Automation Group.

For the year ended September 30, 1998, the statement of cash flows excludes the issuance of common stock related to the acquisitions of Livingston and Prominet and the conversion of stock options related to the acquisitions of Livingston, Prominet, Yurie and Optimay. For the year ended September 30, 1997, the statement of cash flows excludes the conversion of stock options related to the acquisitions of Octel. For information on the 1998 and 1997 acquisitions, see Note 1.

For the year ended September 30, 1997, research and development costs include a $127 write-down of special purpose Bell Labs assets no longer being used.

The statement of cash flows for the nine-month period ended September 30, 1996 excludes $2,000 of customer accounts receivable retained by AT&T as well as net asset transfers of $239 received from AT&T. These transactions have not been reflected on the consolidated statement of cash flows because they were noncash events accounted for as changes in paid-in capital.

5. EARNINGS PER COMMON SHARE

Basic earnings per common share was calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share was calculated by dividing net income by the sum of the weighted average number of common shares outstanding plus all additional common shares that would have been outstanding if potentially dilutive common shares had been issued.

Included in the calculation of the weighted-average shares is the retroactive recognition to January 1, 1996 of the 1,049.2 million shares (524.6 million shares on a pre-split basis) owned by AT&T. The following table reconciles the number of shares utilized in the earnings per share calculations:

	Year Ended September 30, (Twelve Months) 1998	1997	Nine Months Ended September 30, 1996
Net income	$ 970	$ 541	$ 224
Earnings per common share–basic	$ 0.74	$ 0.42	$ 0.19
Earnings per common share–diluted	$ 0.73	$ 0.42	$ 0.19
Number of shares (in millions)			
Common shares–basic	1,304.6	1,278.4	1,191.5
Effect of dilutive securities:			
Stock options	26.8	9.9	0.0
Other	2.0	0.1	0.2
Common shares–diluted	1,333.4	1,288.4	1,191.7

6. BUSINESS RESTRUCTURING AND OTHER CHARGES

In the fourth quarter of calendar year 1995, a pre-tax charge of $2,801 was recorded to cover restructuring costs of $2,613 and asset impairment and other charges of $188. The restructuring plans included restructuring Lucent's Consumer Products business, including closing all of the Company-owned retail Phone Center Stores; consolidating and re-engineering numerous corporate and business unit operations; and selling the Microelectronics' interconnect and Paradyne businesses.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The 1995 business restructuring charge of $2,613 included restructuring liabilities of $1,774, asset impairments of $497 and $342 of benefit plan losses. Benefit plan losses were related to pension and other employee benefit plans and primarily represented losses in 1995 from the actuarial changes that otherwise might have been amortized over future periods.

The pre-tax total charge for restructuring, impairments and other charges of $2,801 for 1995 was recorded as $892 of costs, $1,645 of selling, general and administrative expenses, and $264 of research and development expenses. The charges included $1,509 for employee separations; $627 for asset write-downs; $202 for closing, selling and consolidating facilities; and $463 for other items. The total charges reduced net income by $1,847.

The restructuring charge of $2,613 incorporated the separation costs, both voluntary and involuntary, for nearly 22,000 employees. As of September 30, 1998, the work force had been reduced by approximately 19,900 positions due to business restructuring. In addition, approximately 1,000 employees left Lucent's work force as part of the sale of Paradyne in 1996. Actual experience in employee separations, combined with redeploying employees into other areas of the business, has resulted in lower separation costs than originally anticipated. Lucent expects employee reductions in positions to be substantially complete by September 1999.

The following table displays a rollforward of the liabilities for business restructuring from September 30, 1996 to September 30, 1998:

Type of Cost	September 30, 1996 Balance	1997 Deductions	September 30, 1997 Balance	1998 Deductions	September 30, 1998 Balance
Employee Separation	$ 766	$(418)	$348	$(235)	$113
Facility Closing	175	(109)	66	(23)	43
Other	348	(193)	155	(60)	95
TOTAL	$1,289	$(720)	$569	$(318)	$251

Management believes that the remaining reserves for business restructuring are adequate to complete its plan.

Total deductions to Lucent's business restructuring reserves were $318 and $720 for the years ended September 30, 1998 and 1997, respectively. Included in these deductions were cash payments of $176 and $483 and noncash related charges of $42 and $36 for the years ended September 30, 1998 and 1997, respectively. The noncash related charges were primarily associated with asset write-offs that were charged against the business restructuring reserves. In addition, Lucent reversed $100 and $201 of business restructuring reserves primarily related to favorable experience in employee separations for the years ended September 30, 1998 and 1997, respectively.

7. INCOME TAXES

The following table presents the principal reasons for the difference between the effective tax rate and the United States federal statutory income tax rate:

	Year Ended September 30, (Twelve Months) 1998	1997	Nine Months Ended September 30, 1996
United States federal statutory income tax rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal income tax effect	3.2	5.4	1.4
Foreign earnings and dividends taxed at different rates	1.1	0.9	4.1
Research credits	(2.8)	(2.6)	(5.0)
Other differences–net	(0.5)	(1.5)	3.5
Effective income tax rate before purchased in-process research and development costs	36.0%	37.2%	39.0%
Purchased in-process research and development costs	21.9	25.9	–
Effective income tax rate	57.9%	63.1%	39.0%

The following table presents the United States and foreign components of income before income taxes and the provision for income taxes:

	Year Ended September 30, (Twelve Months) 1998	1997	Nine Months Ended September 30, 1996
INCOME BEFORE INCOME TAXES			
United States	$1,942	$ 873	$ 101
Foreign	364	594	266
Income before income taxes	$2,306	$1,467	$ 367
PROVISION FOR INCOME TAXES			
CURRENT			
Federal	$ 823	$ 464	$ 242
State and local	141	129	53
Foreign	205	226	98
Sub-Total	1,169	819	393
DEFERRED			
Federal	113	35	(198)
State and local	43	77	(45)
Foreign and other	11	(5)	(7)
Sub-Total	167	107	(250)
Provision for income taxes	$1,336	$ 926	$ 143

As of September 30, 1998, Lucent had tax credit carryforwards of $32 and federal, state and local, and foreign net operating loss carryforwards (tax effected) of $179, all of which expire primarily after the year 2000.

The components of deferred tax assets and liabilities at September 30, 1998 and 1997 are as follows:

	September 30, 1998	September 30, 1997
DEFERRED INCOME TAX ASSETS		
Employee pensions and other benefits–net	$1,510	$1,777
Business restructuring	165	112
Reserves and allowances	1,063	887
Net operating loss/credit carryforwards	211	107
Valuation allowance	(261)	(234)
Other	462	664
TOTAL DEFERRED INCOME TAX ASSETS	$3,150	$3,313
DEFERRED INCOME TAX LIABILITIES		
Property, plant and equipment	$ 397	$ 478
Other	380	240
TOTAL DEFERRED INCOME TAX LIABILITIES	$ 777	$ 718

Lucent has not provided for United States deferred income taxes or foreign withholding taxes on $2,432 of undistributed earnings of its non-United States subsidiaries as of September 30, 1998, since these earnings are intended to be reinvested indefinitely.

8. DEBT OBLIGATIONS

	September 30, 1998	September 30, 1997
DEBT MATURING WITHIN ONE YEAR		
Commercial paper (net of $495* expected to be refinanced)	$2,106	$2,364
Long-term debt	39	25
Other	86	149
TOTAL DEBT MATURING WITHIN ONE YEAR	$2,231	$2,538
Weighted Average Interest Rates		
Commercial paper	5.6%	5.5%
Long-term debt and other	7.9%	6.3%

Lucent had revolving credit facilities at September 30, 1998 aggregating $5,211 (a portion of which is used to support Lucent's commercial paper program), $4,000 with domestic lenders and $1,211 with foreign lenders. At September 30, 1998, $4,000 with domestic lenders and $855 with foreign lenders were available.

	September 30, 1998	September 30, 1997
LONG-TERM DEBT		
6.90% notes due July 15, 2001	$ 750	$ 750
7.25% notes due July 15, 2006	750	750
6.50% debentures due January 15, 2028	300	–
Commercial paper expected to be refinanced	495*	–
Long-term lease obligations	1	2
Other	164	198
Less: Unamortized discount	12	10
Total long-term debt	2,448	1,690
Less: Amounts maturing within one year	39	25
NET LONG-TERM DEBT	$2,409	$1,665

Lucent has an effective shelf registration statement for the issuance of debt securities up to $3,500, of which $1,160* remains available at September 30, 1998.

This table shows the maturities, by year, of the $2,448 in total long-term debt obligations:

1999	2000	2001	2002	2003	September 30, Later Years
$39	$71	$773	$14	$14	$1,537*

**On November 19, 1998, Lucent sold $500 ($495 net of unamortized costs) of 10-year 5.5% notes due November 15, 2008 and reclassified the amount from debt maturing within one year to long-term debt. The proceeds were used to pay down a portion of Lucent's commercial paper during the first quarter of fiscal 1999.*

9. EMPLOYEE BENEFIT PLANS

PENSION AND POSTRETIREMENT BENEFITS

Lucent maintains noncontributory defined benefit pension plans covering the majority of its employees and retirees, and postretirement benefit plans for the majority of its retirees that include health care benefits and life insurance coverage. Prior to October 1, 1996, Lucent's financial statements reflect estimates of the costs experienced for its employees and retirees while they were included in AT&T pension and postretirement plans.

Pension-related benefits for management employees are based principally on career-average pay while benefits for nonmanagement employees are not directly pay-related. Pension contributions are determined principally using the aggregate cost method and are made primarily to trust funds held for the sole benefit of plan participants.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The following table shows the Lucent plans' funded status reconciled with amounts reported in Lucent's consolidated balance sheets, and the assumptions used in determining the actuarial present value of the benefit obligation:

	Pension Benefits September 30,		Postretirement Benefits September 30,	
	1998	**1997**	**1998**	**1997**
Plan assets at fair value	**$36,191**	$36,204	**$ 3,959**	$ 4,152
Less: benefit obligation	**27,846**	23,187	**9,193**	7,939
Funded (Unfunded) status of the plan	**8,345**	13,017	**(5,234)**	(3,787)
Unrecognized prior service costs	**1,509**	1,048	**533**	261
Unrecognized transition asset	**(944)**	(1,244)	**–**	–
Unrecognized net gain	**(5,175)**	(9,669)	**(408)**	(1,256)
Net minimum liability of nonqualified plans	**(27)**	(23)	**–**	–
Prepaid (Accrued) benefit cost	**$ 3,708**	$ 3,129	**$(5,109)**	$(4,782)
Accumulated pension benefit obligation	**$26,799**	$22,669	**n/a**	n/a
Vested pension benefit obligation	**$25,112**	$21,246	**n/a**	n/a
Accumulated postretirement benefit obligation:				
Retirees	**n/a**	n/a	**$ 6,662**	$ 5,902
Fully eligible active plan participants	**n/a**	n/a	**1,131**	777
Other active plan participants	**n/a**	n/a	**1,400**	1,260
Accumulated postretirement benefit obligation	**n/a**	n/a	**$ 9,193**	$ 7,939
Assumptions:				
Weighted average discount rate	**6.00%**	7.25%	**6.00%**	7.25%
Rate of increase in future compensation levels	**4.50%**	4.50%	**n/a**	n/a

Pension plan assets consist primarily of listed stocks (of which $126 and $73 represent Lucent common stock at September 30, 1998 and 1997, respectively). Postretirement plan assets include listed stocks (of which $11 and $2 represent Lucent common stock at September 30, 1998 and 1997, respectively). Assets in both plans also include corporate and governmental debt, and cash and cash equivalents. Pension plan assets also include real estate investments, and postretirement plan assets also include life insurance contracts.

The prepaid pension benefit costs shown above are net of pension liabilities for plans where accumulated plan benefits exceed assets. Such liabilities are included in other liabilities in the consolidated balance sheets.

The following table shows the components of pension and postretirement costs for the periods indicated:

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,
	1998	**1997**	**1996**
PENSION COST			
Service cost-benefits earned during the period	**$ 331**	$ 312	$ 277
Interest cost on projected benefit obligation	**1,631**	1,604	1,172
Expected return on plan assets[1]	**(2,384)**	(2,150)	(1,589)
Amortization of unrecognized prior service costs	**164**	149	113
Amortization of transition asset	**(300)**	(300)	(222)
Charges (credits) for plan curtailments[2]	**–**	56	(16)
NET PENSION CREDIT	**$ (558)**	$ (329)	$ (265)
POSTRETIREMENT COST			
Service cost-benefits earned during the period	**$ 63**	$ 57	$ 51
Interest cost on accumulated postretirement benefit obligation	**540**	554	408
Expected return on plan assets[3]	**(263)**	(264)	(189)
Amortization of unrecognized prior service costs	**53**	35	53
Amortization of net loss (gain)	**3**	(15)	8
Charges (credits) for plan curtailments[2]	**–**	26	(2)
NET POSTRETIREMENT BENEFIT COST	**$ 396**	$ 393	$ 329

(1) A 9.0% long-term rate of return on pension plan assets was assumed for 1998, 1997 and 1996. The actual return on plan assets was $1,914 and $8,523 for the years ended September 30, 1998 and 1997, respectively, and $2,204 for the nine-month period ended September 30, 1996.

(2) The 1997 pension and postretirement charges for plan curtailments of $56 and $26, respectively, reflect the final determination of 1996 curtailment effects.

(3) A 9.0% long-term rate of return on postretirement plan assets was assumed for 1998, 1997 and 1996. The actual return on plan assets was $349 and $1,040 for the years ended September 30, 1998 and 1997, respectively, and $219 for the nine-month period ended September 30, 1996.

Pension cost was computed using the projected unit credit method. Lucent is amortizing over approximately 16 years the unrecognized pension transition asset related to the adoption of SFAS No. 87, "Employers' Accounting for Pensions," in 1986. Prior service pension costs are amortized primarily on a straight-line basis over the average remaining service period of active employees.

For postretirement benefit plans, Lucent assumed a 5.5% annual rate of increase in the per capita cost of covered health care benefits (the health care cost trend rate) for 1999, gradually declining to 4.9% by the year 2005, after which the costs would remain level. This assumption has a significant effect on the amounts reported. Increasing the assumed trend rate by 1% in each year would increase Lucent's accumulated postretirement benefit obligation as of September 30, 1998 by $358 and the interest and service cost by $30 for the year then ended.

SAVINGS PLANS

Lucent's savings plans allow employees to contribute a portion of their pre-tax and/or after tax income in accordance with specified guidelines. Lucent matches a percentage of employee contributions up to certain limits. Beginning in 1998, Lucent changed its savings plan for management employees to provide for both a fixed and a variable matching contribution. The fixed match is 50% of qualified management employee contributions and the variable match is based on Company performance. For 1998, Lucent's total match of qualified management employee contributions is 109% as compared with 66⅔% in prior years. Qualified nonmanagement employee contributions continued to be matched at a 66⅔% rate. Savings plan expense amounted to $311 and $180 for the years ended September 30, 1998 and 1997, respectively, and $131 for the nine-month period ended September 30, 1996.

EMPLOYEE STOCK OWNERSHIP PLAN

Lucent's leveraged Employee Stock Ownership Plan ("ESOP") funds the employer's contributions to the Long-Term Savings and Security Plan ("LTSSP") for nonmanagement employees. The ESOP obligation is reported as debt and as a reduction in shareowners' equity. Cash contributions to the ESOP are determined based on the ESOP's total debt service less dividends paid on ESOP shares. As of September 30, 1998, the ESOP contained 10.4 million shares of Lucent's common stock. Of the 10.4 million shares, 8.2 million have been allocated to the LTSSP Plan and 2.2 million were unallocated. As of September 30, 1998, the unallocated shares had a fair value of $154.

10. STOCK COMPENSATION PLANS

Lucent has stock-based compensation plans under which certain employees receive stock options and other equity-based awards. Effective October 1, 1996, any AT&T awards held by Lucent employees were replaced by substitute awards under the Lucent Technologies Inc. 1996 Long-Term Incentive Program ("1996 LTIP").

The 1996 LTIP provides for the grant of stock options, stock appreciation rights, performance awards, restricted stock awards and other stock unit awards. Awards under the 1996 LTIP are generally made to executives. Lucent also awards stock options to selected employees below executive levels under the Lucent Technologies Inc. 1997 Long-Term Incentive Plan ("1997 LTIP"). In addition, the Company has made special, broad-based grants under the Lucent Technologies Inc. Founders Grant Stock Option Plan ("FGP") (1996 world-wide option grants) and the Lucent Technologies Inc. 1998 Global Stock Option Plan ("GSOP") (1998 world-wide option grants to management employees).

Stock options are granted with an exercise price equal to or greater than 100% of market value at the date of grant, generally have a ten-year term and vest within four years from the date of grant. Subject to customary anti-dilution adjustments and certain exceptions, the total number of shares of Common Stock authorized for option grants under the 1996 LTIP is 64 million shares between February 1998 and February 2003. Under the 1997 LTIP, the number of shares authorized for option grants in each calendar year is 1.3% of the total number of outstanding shares of Common Stock as of the first day of the calendar year. The total number of shares of Common Stock originally authorized for grant under the FGP and GSOP are 30 million and 18 million, respectively.

In connection with several of Lucent's acquisitions (see Note 1), outstanding stock options held by employees of acquired companies will become exercisable, according to their terms, for Lucent common stock effective at the acquisition date. The fair value of these options was included as part of the purchase price related to the acquisition. These options did not reduce the shares available for grant under any of Lucent's other option plans.

Lucent established an Employee Stock Purchase Plan (the "ESPP") effective October 1, 1996. Under the terms of the ESPP, eligible employees may have up to 10% of eligible compensation deducted from their pay to purchase Common Stock through June 30, 2001. On the date of exercise, which is the last trading day of each month, the per share purchase price is 85% of the average high and low per share trading price of Common Stock on the New York Stock Exchange on that date. The amount that may be offered pursuant to this plan is 100 million shares. In 1998 and 1997, 4.2 million and 6.2 million shares, respectively, were purchased under the ESPP at a weighted average price of $49.02 and $25.15, respectively.

Lucent has adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation" and, as permitted under SFAS No. 123, applies Accounting Principles Board Opinion ("APB") No. 25 and related interpretations in accounting for its plans. Compensation expense recorded under APB No. 25 was $73 and $36 for the years ended September 30, 1998 and 1997, respectively, and $11 for the nine months ended September 30, 1996. If Lucent had elected to adopt the optional recognition provisions of SFAS No. 123 for its stock option plans and the ESPP, net income and earnings per share would have been changed to the pro forma amounts indicated below:

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,
	1998	**1997**	**1996**
NET INCOME			
As reported	**$ 970**	$ 541	$ 224
Pro forma	**$ 799**	$ 444	$ 202
EARNINGS PER SHARE–BASIC			
As reported	**$0.74**	$0.42	$0.19
Pro forma	**$0.61**	$0.35	$0.17
EARNINGS PER SHARE–DILUTED			
As reported	**$0.73**	$0.42	$0.19
Pro forma	**$0.58**	$0.34	$0.17

Note: The pro forma disclosures shown include the incremental fair value of the Lucent stock options that were substituted for AT&T stock options at the time of the Distribution and may not be representative of the effects on net income and earnings per share in other years.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

The fair value of stock options used to compute pro forma net income and earnings per share disclosures is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	Lucent			AT&T
WEIGHTED AVERAGE ASSUMPTIONS	(1)	(2)	(3)	(4)
Dividend yield	0.26%	0.65%	0.75%	2.4%
Expected volatility	28.2%	22.4%	22.4%	19.4%
Risk-free interest rate	5.5%	6.4%	6.1%	6.4%
Expected holding period (in years)	4.7	5.1	4.5	5.0

(1) Assumptions for Lucent options awarded during 1998.

(2) Assumptions for Lucent options awarded during 1997.

(3) Assumptions for Lucent options substituted for AT&T options effective October 1, 1996.

(4) Assumptions for AT&T options awarded in 1996.

Presented below is a summary of the status of Lucent stock options and the related transactions for the years ended September 30, 1998 and 1997. Also shown is a summary of the status of the AT&T stock options held by Lucent's employees and the related transactions for the nine months ended September 30, 1996.

	Shares (000's)	Weighted Average Exercise Price
AT&T options outstanding at December 31, 1995	12,784	$23.72
Granted	3,380	32.91
Exercised	(366)	19.14
Forfeited/Expired	(6)	31.59
AT&T options outstanding at September 30, 1996	15,792	25.68
Lucent options substituted for AT&T options, and outstanding at October 1, 1996	19,572	20.72
Granted[1] [2]	51,245	23.19
Exercised	(4,044)	16.78
Forfeited/Expired	(1,960)	23.80
Lucent options outstanding at September 30, 1997	64,813	22.83
Granted[2] [3]	41,613	58.07
Exercised	(10,781)	17.63
Forfeited/Expired	(2,045)	24.12
Lucent options outstanding at September 30, 1998	93,600	$39.06

(1) Includes options covering 25,506 shares of Common Stock granted under the FGP in 1996 (at a weighted average exercise price of $22.31). No additional options will be granted under the FGP.

(2) Includes options covering 5,192 and 4,942 shares of Common Stock, which resulted from the conversion of options of acquired companies for the years ended September 30, 1998 and 1997, respectively (at a weighted average exercise price of $10.09 and $20.00, respectively). No additional options will be granted under the converted plans of acquired companies.

(3) Includes options covering 16,178 shares of Common Stock granted under the GSOP on September 1, 1998 (at a weighted average exercise price of $74.69).

The weighted average fair value of Lucent stock options, calculated using the Black-Scholes option-pricing model, granted during the years ended September 30, 1998 and 1997 is $24.53 and $7.30 per share, respectively. The weighted average fair value of AT&T stock options, calculated using the Black-Scholes option-pricing model, granted during the nine months ended September 30, 1996 is $7.07 per share.

The following table summarizes the status of Lucent's stock options outstanding and exercisable at September 30, 1998:

	Stock Options Outstanding			Stock Options Exercisable	
Range of Exercise Prices	Shares (000's)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares (000's)	Weighted Average Exercise Price
$ 0.04 to $21.30	9,561	5.2	$15.42	6,531	$16.61
$21.31 to $22.28	32,218[1]	8.0	22.28	721	22.20
$22.29 to $26.28	10,587	7.9	25.01	1,200	24.73
$26.29 to $43.33	15,414	8.5	38.68	2,845	31.64
$43.34 to $91.66	25,820	9.9	74.75	79	61.62
TOTAL	93,600		$39.06	11,376	$21.89

(1) Note: One-half of the options granted to nonmanagement employees under the FGP, covering approximately 3,890 shares, became exercisable on October 1, 1998.

Other stock unit awards are granted under the 1996 LTIP. Presented below is the total number of shares of Common Stock represented by awards granted to Lucent employees for the years ended September 30, 1998 and 1997, and the total number of AT&T shares represented by awards granted to Lucent employees for the nine-month period ended September 30, 1996:

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,
	1998	1997	1996
Lucent shares granted (000's)	795	4,282	n/a
AT&T shares granted (000's)	n/a	n/a	524
Weighted average market value of shares granted during the period	$44.15	$23.19	$33.12

11. SEGMENT INFORMATION

INDUSTRY SEGMENT

Lucent operates in the global communications networking industry segment. This segment includes wire-line and wireless systems, software and products used for voice, data and video communications.

GEOGRAPHIC SEGMENTS

Transfers between geographic areas are on terms and conditions comparable with sales to external customers. The methods followed in developing the geographic segment data require the use of estimates and do not take into account the extent to which product development, manufacturing and marketing depend on each other. Thus, the information may not be indicative of results if the geographic areas were independent organizations.

Corporate assets are principally cash and temporary cash investments. Data on other geographic areas pertain to operations that are located outside the United States. Revenues from all international activities (other geographic areas revenues plus export revenues) provided 25.7% and 24.1% of consolidated revenues for the years ended September 30, 1998 and 1997, respectively, and 23.1% for the nine-month period ended September 30, 1996.

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,
	1998	**1997**	**1996**
REVENUES			
United States	**$24,416**	$21,807	$13,334
Other geographic areas	**5,731**	4,553	2,525
	$30,147	$26,360	$15,859
TRANSFERS BETWEEN GEOGRAPHIC AREAS (Eliminated in Consolidation)			
United States	**$ 2,371**	$ 1,927	$ 1,353
Other geographic areas	**1,544**	1,267	648
	$ 3,915	$ 3,194	$ 2,001
OPERATING INCOME (LOSS)			
United States	**$ 2,328**[1]	$ 1,514[2]	$ 940
Other geographic areas	**525**	410	(108)
Corporate, eliminations and nonoperating	**(547)**	(457)	(465)
Income before income taxes	**$ 2,306**	$ 1,467	$ 367
ASSETS (End of Period)			
United States	**$19,665**	$17,054	$16,492
Other geographic areas	**6,755**	5,600	3,912
Corporate assets	**1,282**	1,778	2,744
Eliminations	**(982)**	(621)	(522)
	$26,720	$23,811	$22,626

(1) Includes charges of $1,416 of purchased in-process research and development costs associated with the acquisitions of Livingston, Prominet, Optimay, Yurie, SDX, LANNET, MassMedia and JNA.

(2) Includes charges of $1,024 of purchased in-process research and development costs associated with the acquisitions of Octel and Agile.

CONCENTRATIONS

Historically, Lucent has relied on a limited number of customers for a substantial portion of its total revenues. In terms of total revenues, Lucent's largest customer has been AT&T, although other customers may purchase more of any particular system or product line. Revenues from AT&T were $3,775 and $3,731 for the years ended September 30, 1998 and 1997, respectively, and $1,970 for the nine-month period ended September 30, 1996. Lucent expects that a significant portion of its future revenues will continue to be generated by a limited number of customers. The loss of any of these customers or any substantial reduction in orders by any of these customers could materially adversely affect Lucent's operating results. Lucent does not have a concentration of available sources of supply materials, labor, services or other rights that, if suddenly eliminated, could severely impact its operations.

12. FINANCIAL INSTRUMENTS

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

	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	September 30, **1998**		September 30, **1997**	
ASSETS				
Derivative and Off Balance Sheet Instruments:				
Foreign currency forward exchange contracts/purchased options	**$ 26**	**$ 4**	$ 28	$ 54
Letters of credit	**–**	**2**	–	2
LIABILITIES				
Long-term debt[1] [2]	**$2,408**	**$2,559**	$1,663	$1,748
Derivative and Off Balance Sheet Instruments:				
Foreign currency forward exchange contracts/purchased options	**25**	**(4)**	31	36

(1) Excluding long-term lease obligations of $1 at September 30, 1998 and $2 at September 30, 1997.

(2) Reflects the reclassification from debt maturing within one year to long-term debt as a result of the November 19, 1998 sale of $500 ($495 net of unamortized costs) of 10-year notes.

The following methods were used to estimate the fair value of each class of financial instruments:

Financial Instrument	Valuation Method
Long-term debt	Market quotes for instruments with similar terms and maturities
Foreign currency forward exchange contracts/purchased options	Market quotes
Letters of credit	Fees paid to obtain the obligations

The carrying values of cash and cash equivalents, accounts receivable and debt maturing within one year contained in the consolidated balance sheets approximate fair value.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

CREDIT RISK AND MARKET RISK

By their nature, all financial instruments involve risk, including credit risk for nonperformance by counterparties. The contract or notional amounts of these instruments reflect the extent of involvement Lucent has in particular classes of financial instruments. The maximum potential loss may exceed any amounts recognized in the consolidated balance sheets. However, Lucent's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and financial guarantees is limited to the amount drawn and outstanding on those instruments.

Lucent seeks to reduce credit risk on financial instruments by dealing only with financially secure counterparties. Exposure to credit risk is controlled through credit approvals, credit limits and monitoring procedures. Lucent seeks to limit its exposure to credit risks in any single country or region.

All financial instruments inherently expose the holders to market risk, including changes in currency and interest rates. Lucent manages its exposure to these market risks through its regular operating and financing activities and when appropriate, through the use of derivative financial instruments.

DERIVATIVE FINANCIAL INSTRUMENTS

Lucent conducts its business on a multi-national basis in a wide variety of foreign currencies. Consequently, Lucent enters into various foreign exchange forward and purchased option contracts to manage its exposure against adverse changes in those foreign exchange rates. The notional amounts for foreign exchange forward and purchased option contracts represent the U.S. dollar equivalent of an amount exchanged. Generally, foreign currency forward exchange contracts are designated for firmly committed or forecasted sales and purchases that are expected to occur in less than one year. Gains and losses on firmly committed transactions are deferred in other current assets and liabilities and are not material to the consolidated financial statements at September 30, 1998 and 1997. Gains and losses on foreign currency exchange contracts that are designated for forecasted transactions are recognized in other income as the exchange rates change. The following table presents the gross notional amounts of these derivative financial instruments in U.S. dollars:

	Gross Notional Amount September 30, 1998	1997
FOREIGN EXCHANGE FORWARD CONTRACTS		
Singapore dollars	$ 247	$ 59
Deutsche marks	189	558
British pounds	185	136
Australian dollars	142	1
Japanese yen	120	249
Spanish pesetas	113	109
Dutch guilders	110	186
Brazilian reals	82	58
French francs	81	116
Other	186	270
TOTAL	$1,455	$1,742
FOREIGN EXCHANGE PURCHASED OPTION CONTRACTS		
Canadian dollars	$ 66	$ –
Singapore dollars	60	–
Other	4	–
TOTAL	$ 130	$ –

Lucent enters into certain interest rate swap agreements to manage its risk between long-term fixed rate and short-term variable rate instruments. Interest rate swap agreements were not material during 1998 and 1997.

NONDERIVATIVE AND OFF BALANCE SHEET INSTRUMENTS

Requests for providing commitments to extend credit and financial guarantees are reviewed and approved by senior management. Management regularly reviews all outstanding commitments, letters of credit and financial guarantees, and the results of these reviews are considered in assessing the adequacy of Lucent's reserve for possible credit and guarantee losses. At September 30, 1998 and 1997, in management's opinion, there was no significant risk of loss in the event of nonperformance of the counterparties to these financial instruments.

The following table presents the contract amount of Lucent's nonderivative and off balance sheet instruments and the amounts drawn down on such instruments. These instruments may exist or expire without being drawn upon. Therefore, the total contract amount does not necessarily represent future cash flows.

	Contract Amount		Amounts Drawn Down and Outstanding	
	September 30,		September 30,	
	1998	1997	1998	1997
Letters of credit	$ 804	$ 832	$ –	$ –
Commitments to extend credit	2,312	1,898	399	25
Guarantees of debt	292	309	205	118

LETTERS OF CREDIT

Letters of credit are purchased guarantees that ensure Lucent's performance or payment to third parties in accordance with specified terms and conditions.

COMMITMENTS TO EXTEND CREDIT

Commitments to extend credit to third parties are legally binding, conditional agreements generally having fixed expiration or termination dates and specific interest rates and purposes.

Lucent may enter into credit agreements to provide long-term financing for customers. In October 1996, Lucent entered into an agreement to extend $1,800 of long-term financing to Sprint Spectrum Holdings LP ("Sprint PCS") for its purchase of Lucent's equipment and services for its nationwide personal communication services ("PCS") network. In 1997, Lucent closed transactions under this facility to lay off $500 of loans and undrawn commitments and $300 of undrawn commitments to a group of institutional investors and Sprint Corporation (a partner in Sprint PCS), respectively. In 1998, Lucent sold $645 of loans in a private sale. As of September 30, 1998 and 1997, the balance of these commitments not yet drawn down by Sprint PCS were $253 and $146, respectively, and the total drawn loans due were $226 and $17, respectively.

As part of the revenue recognition process, Lucent has assessed the collectibility of the accounts receivable relating to the Sprint PCS purchase contract in light of its financing commitment to Sprint PCS. Lucent has determined that the receivables under the contract are reasonably assured of collection based on various factors among which was the ability of Lucent to sell the loans and commitments without recourse. Lucent intends to continue pursuing opportunities for the sale of future loans and commitments.

In addition, Lucent also entered into agreements with others to extend credit up to an aggregate of approximately $1,371 in 1998 and $850 in 1997 for possible future sales.

GUARANTEES OF DEBT

From time to time, Lucent guarantees the financing for product purchases by customers and the debt of certain unconsolidated joint ventures. Requests for providing such guarantees are reviewed and approved by senior management. Certain financial guarantees are backed by amounts held in trust for Lucent or assigned to a third party reinsurer.

13. COMMITMENTS AND CONTINGENCIES

In the normal course of business, Lucent is subject to proceedings, lawsuits and other claims, including proceedings under government laws and regulations related to environmental and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at September 30, 1998 cannot be ascertained. While these matters could affect the operating results of any one quarter when resolved in future periods and while there can be no assurance with respect thereto, management believes that after final disposition, any monetary liability or financial impact to Lucent beyond that provided for at September 30, 1998 would not be material to the annual consolidated financial statements.

In connection with the Separation and Distribution, Lucent, AT&T and NCR Corporation executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996, as amended and restated (the "Separation and Distribution Agreement"), and certain related agreements. The Separation and Distribution Agreement, among other things, provides that Lucent will indemnify AT&T and NCR for all liabilities relating to Lucent's business and operations and for all contingent liabilities relating to Lucent's business and operations or otherwise assigned to Lucent. In addition to contingent liabilities relating to the present or former business of Lucent, any contingent liabilities relating to AT&T's discontinued computer operations (other than those of NCR) were assigned to Lucent. The Separation and Distribution Agreement provides for the sharing of contingent liabilities not allocated to one of the parties, in the following proportions: AT&T: 75%, Lucent: 22%, and NCR: 3%. The Separation and Distribution Agreement also provides that each party will share specified portions of contingent liabilities related to the business of any of the other parties that exceed specified levels.

ENVIRONMENTAL MATTERS

Lucent's current and historical operations are subject to a wide range of environmental protection laws. In the United States, these laws often require parties to fund remedial action regardless of fault. Lucent has remedial and investigatory activities underway at numerous current and former facilities. In addition, Lucent was named a successor to AT&T as a potentially responsible party ("PRP") at numerous "Superfund" sites pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") or comparable state statutes. Under the Separation and Distribution Agreement, Lucent is responsible for all liabilities primarily resulting from or relating to the operation of Lucent's business as conducted at any time prior to or after the Separation including related businesses discontinued or disposed of prior to the Separation, and Lucent's assets including, without limitation, those associated with these sites. In addition, under such Separation and Distribution Agreement, Lucent is required to pay a portion of contingent liabilities paid out in excess of certain amounts by AT&T and NCR, including environmental liabilities.

(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

It is often difficult to estimate the future impact of environmental matters, including potential liabilities. Lucent records an environmental reserve when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. This practice is followed whether the claims are asserted or unasserted. Management expects that the amounts reserved will be paid out over the periods of remediation for the applicable sites which range from 5 to 30 years. Reserves for estimated losses from environmental remediation are, depending on the site, based primarily upon internal or third-party environmental studies, and estimates as to the number, participation level and financial viability of any other PRPs, the extent of the contamination and the nature of required remedial actions. Accruals are adjusted as further information develops or circumstances change. The amounts provided for in Lucent's consolidated financial statements for environmental reserves are the gross undiscounted amount of such reserves, without deductions for insurance or third-party indemnity claims. In those cases where insurance carriers or third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts are reflected as receivables in the financial statements. Although Lucent believes that its reserves are adequate, there can be no assurance that the amount of capital expenditures and other expenses which will be required relating to remedial actions and compliance with applicable environmental laws will not exceed the amounts reflected in Lucent's reserves or will not have a material adverse effect on Lucent's financial condition, results of operations or cash flows. Any amounts of environmental costs that may be incurred in excess of those provided for at September 30, 1998 cannot be determined.

LEASE COMMITMENTS

Lucent leases land, buildings and equipment under agreements that expire in various years through 2016. Rental expense under operating leases was $408 and $324 for the years ended September 30, 1998 and 1997, respectively, and $182 for the nine-month period ended September 30, 1996. The table below shows the future minimum lease payments due under noncancelable operating leases at September 30, 1998. Such payments total $876.

	Year Ended September 30,					
	1999	2000	2001	2002	2003	Later Years
Operating leases	$250	$188	$113	$74	$55	$196

14. QUARTERLY INFORMATION (UNAUDITED)

	FISCAL YEAR QUARTERS				
	FIRST	SECOND	THIRD	FOURTH	TOTAL
YEAR ENDED SEPTEMBER 30, 1998					
Revenues	$ 8,724	$6,157	$ 7,228	$ 8,038	$30,147
Gross margin	4,205	2,724	3,279	3,783	13,991
Net income (loss)	792[a]	23[b]	(233)[c]	388[d]	970[a,b,c,d]
Earnings (loss) per common share–basic	$ 0.62[a]	$ 0.02[b]	$ (0.18)[c]	$ 0.30[d]	$ 0.74[a,b,c,d]
Earnings (loss) per common share–diluted	$ 0.61[a]	$ 0.02[b]	$ (0.18)[c]	$ 0.29[d]	$ 0.73[a,b,c,d]
Dividends per share	$ 0.075	$ 0.00	$ 0.04	$ 0.04	$ 0.155
Stock price:[f]					
High	45 9/32	64 1/8	83 11/16	108 1/2	108 1/2
Low	36 9/16	36 23/32	64	68 3/8	36 9/16
Quarter-end close	39 15/16	63 15/16	83 1/16	69 1/4	69 1/4
YEAR ENDED SEPTEMBER 30, 1997					
Revenues	$ 7,938	$ 5,149	$ 6,340	$ 6,933	$ 26,360
Gross margin	3,642	2,168	2,600	3,052	11,462
Net income (loss)	859	66	213	(597)[e]	541[e]
Earnings (loss) per common share–basic	$ 0.67	$ 0.05	$ 0.17	$ (0.47)[e]	$ 0.42[e]
Earnings (loss) per common share–diluted	$ 0.67	$ 0.05	$ 0.17	$ (0.47)[e]	$ 0.42[e]
Dividends per share	$0.0375	$ 0.000	$0.0375	$0.0375	$ 0.1125
Stock price:[f]					
High	26 9/16	30 5/16	37 3/32	45 3/8	45 3/8
Low	21 1/16	22 3/8	24 15/16	36 3/32	21 1/16
Quarter-end close	23 1/8	26 1/4	36 1/32	40 11/16	40 11/16

(a) As a result of the 1998 acquisition of Livingston, Lucent recorded a non-tax charge of $427 in the first quarter for purchased in-process research and development.

(b) As a result of the 1998 acquisition of Prominet, Lucent recorded a non-tax charge of $157 in the second quarter for purchased in-process research and development.

(c) As a result of the 1998 acquisitions of Yurie and Optimay, Lucent recorded a non-tax charge of $668 in the fourth quarter for purchased in-process research and development.

(d) As a result of the 1998 acquisitions of SDX, MassMedia, LANNET and JNA, Lucent recorded a charge of $164 ($160 after tax) in the fourth quarter for purchased in-process research and development.

(e) As a result of the 1997 acquisition of Octel, Lucent recorded a charge of $979 ($966 after tax) in the fourth quarter for purchased in-process research and development and other charges.

(f) Obtained from the Composite Tape. Stock prices have been restated to reflect the two-for-one split of the Company's common stock effective April 1, 1998.

15. SUBSEQUENT EVENTS

Quadritek Systems, Inc.

On October 1, 1998, Lucent acquired Quadritek Systems, Inc. for approximately $50 in cash. Quadritek is a privately held start-up company which develops next-generation Internet Protocol ("IP") network administration software solutions. The acquisition will be accounted for using the purchase method of accounting.

Included in the purchase price was approximately $21 ($13 after tax) of in-process research and development which will result in a noncash charge to earnings in the quarter ending December 31, 1998. The remaining purchase price will be allocated to tangible assets and intangible assets, including goodwill and existing technology, less liabilities assumed.

Philips Consumer Communications

On October 22, 1998, Lucent and Philips announced their intention to end the PCC venture. On October 1, 1997, Lucent contributed its consumer products business in exchange for 40% ownership of the PCC venture. It is expected Lucent and Philips will each regain control of their original businesses by November 30, 1998. Lucent plans to close down the wireless handset business it previously contributed to PCC and to sell the remaining businesses. Lucent expects that these activities will be completed during the first calendar quarter of 1999.

WinStar Communications, Inc.

On October 22, 1998, Lucent announced that it had entered into a five-year agreement with WinStar Communications, Inc. to provide WinStar with a fixed wireless broadband telecommunications network in major domestic and international markets. In connection with this agreement, Lucent entered into a credit agreement with WinStar to provide up to $2,000 in equipment financing to fund the buildout of this network. The maximum amount of credit that Lucent is obligated to extend to WinStar at any one time is $500.