CHAIRMAN'S MESSAGE

WE ENDED FISCAL 2001

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To Our Shareowners:

A year ago we said fiscal 2001 would be a transition year for Lucent Technologies as we worked to address the issues of focus and execution that had affected our results in fiscal 2000. The global market was still strong last fall as we put restructuring plans in place to get us back on track.

But market conditions deteriorated rapidly, and like others in the industry, during fiscal 2001 we experienced substantial declines in revenue, reflecting industry consolidation, a decline in the Competitive Local Exchange Carrier market, and lower-than-expected capital spending by large service providers in the United States and around the world. We responded with a Phase II restructuring plan to accelerate and deepen our efforts to refocus the company, streamline our operations and drive out even more costs so that we would be well positioned when the market for telecom equipment improved. We also decided to focus on the world's largest service providers, which, despite the softening economy, continue to build and maintain their networks.

And, with a lot of hard work, we made significant progress on our turnaround during the year.

From the end of the first fiscal quarter to the end of the fourth fiscal quarter, we:

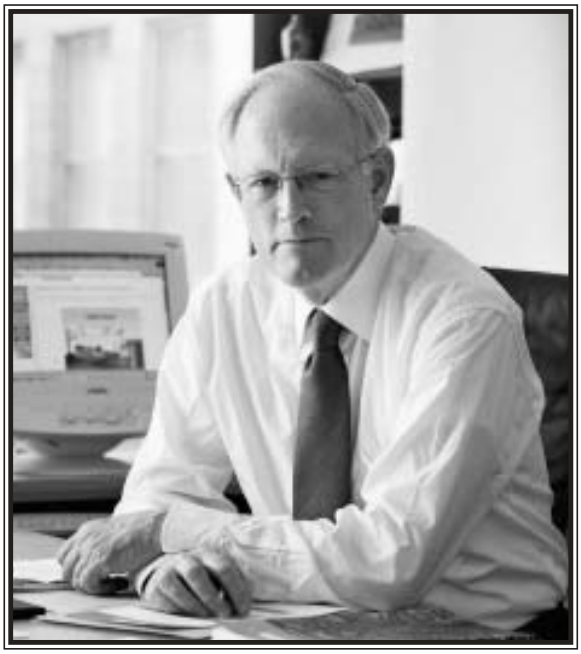
- Improved cash flow by nearly $2 billion, from a negative $2.2 billion to a negative $280 million.*
- Reduced annual expense run rate by $2.4 billion.*
- Reduced headcount by 29,000, from 106,000 (excluding Agere) to 77,000.

And we delivered pro forma sequential improvement to the bottom line for the last three quarters of the year.

This progress demonstrates our ability to lay out a plan, make the difficult decisions and execute.

We are not where we need to be yet. But we have built a track record of solid progress over the past 12 months. Moreover, we have a plan that builds on that progress. We have more than adequate financial resources to execute that plan, and we are aggressively working on implementing it.

*Cash flow includes cash from operations (excluding cash used for the business restructuring and the impacts of accounts receivable securitizations) and capital expenditures. Expense run rate reduction excludes reserves for bad debt and customer financing.



Henry B. Schacht Chairman and Chief Executive Officer

Financial Summary

For the year ended September 30, 2001, revenues declined 26 percent compared with the prior year to $21.3 billion, and the pro forma loss from continuing operations was $4.7 billion, or a loss of $1.39 per basic and diluted share.

Revenues from Lucent Products for the year ended September 30, 2001, decreased 28 percent to $16.8 billion compared with fiscal 2000. Revenues from Lucent Services declined 16 percent to $4.2 billion for the year ended September 30, 2001, compared with fiscal 2000.

We continue to move forward with our intention to spin off Agere Systems Inc., formerly the microelectronics business, as a fully independent company and have accounted for the financial results of that business as discontinued operations.

Creating the Foundation For the Future

We ended fiscal 2001 as a leaner, more focused company as a result of executing on our restructuring plans.

With our Phase I restructuring plan, launched in January 2001, we secured the financial resources we needed by completing negotiations for $6.5 billion in credit facilities. And we achieved reductions in:

- Our annual operating expense run rate of $2 billion.
- Working capital of $3 billion.
- Planned capital spending of $700 million.
- Headcount, through force management and attrition, of about 10,500.

Our Phase II plan, which we launched in August 2001, is designed to further reduce:

- Annual operating expenses by an additional $2 billion.
- Working capital by another $1 billion.
- Planned capital spending by another $750 million.
- Headcount by an additional 15,000 to 20,000, which will result in a headcount for the New Lucent of 57,000 to 62,000.

We made progress toward each of our Phase II restructuring goals in the fourth fiscal quarter, and we intend to meet all of them going forward.

In addition, we bolstered our cash position with a robust funding strategy to put us on firm financial footing for the future.

For example, we announced the sale of our Optical Fiber Solutions business and completed the sale of our manufacturing operations in Oklahoma City and Columbus, Ohio, as we moved to outsource our manufacturing operations for improved efficiencies. We also made a number of real estate transactions designed to consolidate facilities and reduce operating costs.

We raised more than $1.8 billion through a private offering of redeemable convertible preferred stock to qualified investors. This was nearly twice the demand we originally anticipated and represented a major vote of confidence in our restructuring efforts.

We improved our cash flow with an intense focus on inventory reductions and accounts receivable collections.

We have more than adequate financing to support the implementation of our plans.

Realigned and Focused On Customers

Our restructuring plan is critical to the financial health of the company, but restructuring is about far more than cost reduction and financial discipline. It is about better serving our customers with efficiency, speed, quality and responsiveness.

Lucent intends to be the partner of choice for leading service providers by differentiating the company from its competitors through:

- A network vision of service intelligence at every layer, delivering the service richness of the Internet with the reliability of classic voice networks.
- The most complete portfolio of products targeted at service provider customers.
- The industry's most complete network management systems and the most extensive services capability to integrate and manage networks.
- Globally deployed solutions capabilities.
- The largest in-house research and development (R&D) program focused on service providers.

We've streamlined our company into a new business model that reflects the way our customers are organizing and the way they buy—wireline and wireless. We are moving to two major customer segments: Integrated Network Solutions and Mobility Solutions. This positions us to serve our customers more efficiently and effectively.

The substantial job cuts mentioned earlier will not affect our ability to serve customers, but rather, they reflect a more focused customer and country set and a reduced support structure for the New Lucent.

It was very difficult to tell so many good employees that we did not have enough work for them. But we sized the company for the opportunities that exist in our markets.

We also have streamlined our product portfolio to focus on the most profitable opportunities with large service providers. At the end of this process, we have the most complete and competitive portfolio of products of any company addressing the needs of service providers. And we introduced a series of new products in the optical, data and wireless areas at the end of the calendar year that will help us to better serve our customers and grow our revenues.

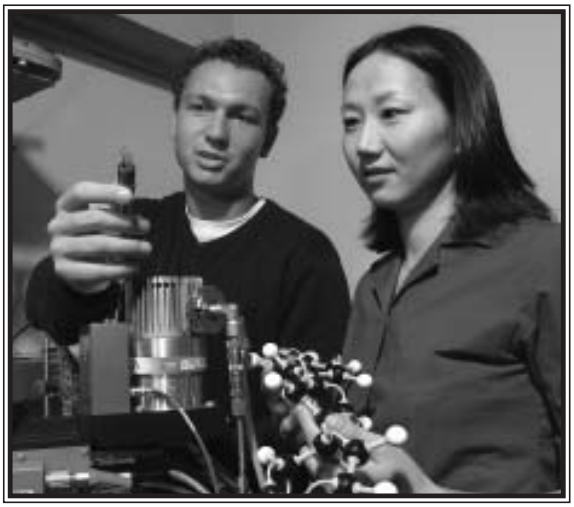
Because in-house R&D is a key competitive differentiator in the current environment, we have linked Bell Labs, our engine of innovation, directly to our strategic agenda and operating units with Bill O'Shea now serving as president of Bell Labs and chief strategy officer. We are allocating 60 percent of our R&D budget to growth products, and we're continuing to shorten the interval between invention and commercialization.

Thanks to Bell Labs we have a host of new products to meet the immediate needs of our customers, including:

- The industry's highest-capacity, most reliable long-haul optical systems. The LambdaRouter is still the only commercially available high-capacity all-optical switch. We're adding next-generation systems called LambdaUnite,™ LambdaXtreme and LambdaManager to meet a variety of customer needs for low-cost, high-capacity optical networking.
- TMX 880, a new multiservice core switch that handles all types of network traffic and, when combined with Lucent's

BELL LABS SCIENTISTS

Hendrik Schon and Zhenan Bao teamed with Hong Meng (not pictured) to fabricate molecular-scale organic transistors. Their work sets the stage for a new era of easily assembled and potentially inexpensive molecular electronics that may provide an alternative to silicon-based electronics.



new optical products, represents the most dynamic and fastest core network offer in the industry.

- SuperHLR, which authenticates and manages profiles and Internet addresses for mobile users with breakthrough software called COPS.
- The Flexent™ OneBTS™ Base Station, which supports integrated intelligent antennas for superior capacity growth in mobile systems, including Universal Mobile Telecommunications System, CDMA2000 and cdmaOne.
- NAVIS™ network management software, which enables service providers to rapidly provision asynchronous transfer mode (ATM) and Internet protocol (IP) services across their networks with simple, automated point-and-click commands.
- New wireless network planning tools, such as OCELOT,™ which help create designs that support dynamic performance in wireless networks while optimizing network coverage, capacity and performance.

Today, Bell Labs research continues to push the frontiers of technology. With approximately 16,000 researchers and developers in 16 countries, Bell Labs is the leading source of new communications technologies. *MIT Technology Review* recently cited Lucent as having the strongest technological base of any telecommunications company.

Recently, Bell Labs made a number of research discoveries, including:

- Molecular-scale transistors—Bell Labs scientists have created organic transistors with a single-molecule channel length, setting the stage for a new class of high-speed, inexpensive carbon-based electronics.
- Buckyballs—Bell Labs scientists have shown that soccer-ball-shaped carbon molecules known as buckyballs can act as superconductors at relatively warm temperatures, raising hopes for inexpensive, power-loss-free organic electronics.
- Brittlestars—A team led by Bell Labs discovered that tiny calcite crystals in marine creatures are near-perfect optical microlenses. This may lead to better-designed optical elements for telecommunications networks.

Progress in the Marketplace

The people of Lucent have been through some difficult times. Thanks to their dedication, we have been able to hold our own in revenues despite poor economic conditions. And we've been able to make a difference in the marketplace. During fiscal 2001:

- We retained market leadership in optical networking for the second consecutive quarter, according to a mid-November report from Dell'Oro Group.
- We maintained world leadership in CDMA wireless networks.
- We led the market in universal remote access and in key segments for Digital Subscriber Line access equipment.
- We were No. 1 in service-level management software.

A Call to Action

The more focused, streamlined New Lucent faced its first major test on September 11, 2001, with the tragic events in New York City, at the Pentagon and in Pennsylvania.

Our hearts went out to everyone affected by those horrible tragedies. We witnessed not only the worst in humanity, but also the best.

Fortunately, we did not lose any Lucent employees in the disasters. But, sadly, we learned that three Lucent retirees were on the airplanes that crashed. We extend our deepest sympathies to their families, friends and former colleagues.

We were truly proud of the way our customers—Verizon, Verizon Wireless, AT&T, Sprint PCS, Cingular and others—responded to the crisis. We were privileged to be able to work with them. More than 500 people from all over Lucent responded immediately and remained on-site restoring service, working 12-hour shifts, seven days a week. As of this writing, they are still at it.

We delivered a number of "cells on wheels" to restore wireless systems and mobile 5ESS® switches to restore wire-

CELLULAR CAPACITY FOR LUCENT CUSTOMERS

needed to be beefed up fast when the World Trade Center disaster took out landlines in lower Manhattan. Lucent installers (front, L-R) Bob Dutko, Bill Jarvis, Gary Richards, Bob Day, Bill Breunig, (back, L-R) Charlie Queen, Bill Daly and Pete Skorupski worked around the clock to get cells on wheels up and running in Liberty State Park in Jersey City, N.J. To aid the recovery, the Lucent Foundation contributed $500,000 to the American Red Cross and another $500,000 to the September 11th Fund, in addition to giving $2 for every $1 donated by our employees to those organizations.



line networks for our customers. We delivered products across every category. And we demonstrated that a streamlined and centralized services organization and supply chain function could respond faster and more effectively than ever before—on a global scale.

We responded the same way halfway around the world. Just days after the tragedy in the United States, the worst typhoon in Taiwan's history left a large part of northern Taiwan without power and telephone service.

Many of our customers were hit especially hard, and Lucent's Taiwan team responded by helping to get telecommunications networks up and running—and in record time.

These were very proud moments for all of us at Lucent, and they represent tangible proof that the New Lucent is shaped for the new realities of the global market.

Looking Ahead to Fiscal 2002

Our operating environment in the coming year will remain challenging. To briefly summarize Lucent's prospects:

- We have a plan that builds on the progress we made in fiscal 2001.
- We have more than adequate financial resources to carry out our plan.
- We have focused our business on large service providers worldwide.
- While Lucent will be a leaner, more focused company, we will still have the largest R&D investment, the most complete and competitive portfolio of products and the leading services capability in the industry to address the needs of service providers.

We will address that market with the unique capability that our customers need, the ability to deliver products that bring "service intelligence" to large, complex networks.

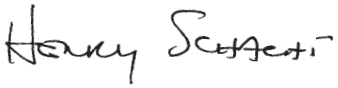
We are a New Lucent, and the people of Lucent are committed to this new mission: "To be the partner of choice for the world's leading service providers by helping them create, build and maintain the most innovative, reliable and cost-effective communications networks and meet their customers' growing needs through the rapid deployment of new communications services."

The progress we've made and the positive developments mentioned above are giving us the momentum we need to finish the work we started in January 2001 and renewed optimism about our prospects going forward.

Only one crucial question remains: Can we execute our plan?

We know we can, and we have the track record to prove it. We're committed to finishing the work we began 13 months ago when we reassembled this management team. And we will.

You can keep up-to-date on the New Lucent and its progress by logging on to our Web site, www.lucent.com.



Henry B. Schacht
Chairman and Chief Executive Officer

November 26, 2001