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## Merrill Lynch - Global Communications Conference



February 24, 2003

# Forward-Looking Statement Disclosure

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This presentation contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industries in which we operate, our beliefs and our management's assumptions. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecast in such forward-looking statements. These risks and uncertainties include: the failure of the telecommunications market to improve or improve at the pace we anticipate; our ability to secure additional sources of funds on reasonable terms; our credit ratings; our ability to compete effectively; our reliance on a limited number of key customers; our exposure to the credit risk of our customers as a result of our vendor financing arrangements and accounts receivable; our reliance on third parties to manufacture some of our products; the cost and other risks inherent in our long-term sales agreements; our product portfolio and ability to keep pace with technological advances in our industry; the complexity of our products; our ability to retain and recruit key personnel; existing and future litigation; our ability to protect our intellectual property rights and the expenses we may incur in defending such rights; changes in environmental health and safety law; changes to existing regulations or technical standards; and the social, political and economic risks of our foreign operations. For a further list and description of such risks and uncertainties, see the reports filed by Lucent with the Securities and Exchange Commission. Except as otherwise required under federal securities laws and the rules and regulations of the SEC, we do not have any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, changes in assumptions or otherwise.



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## Setting the Context

# Setting the Context: The Market

## Service Provider CapEx Spending Forecasts, Fiscal Q1-01

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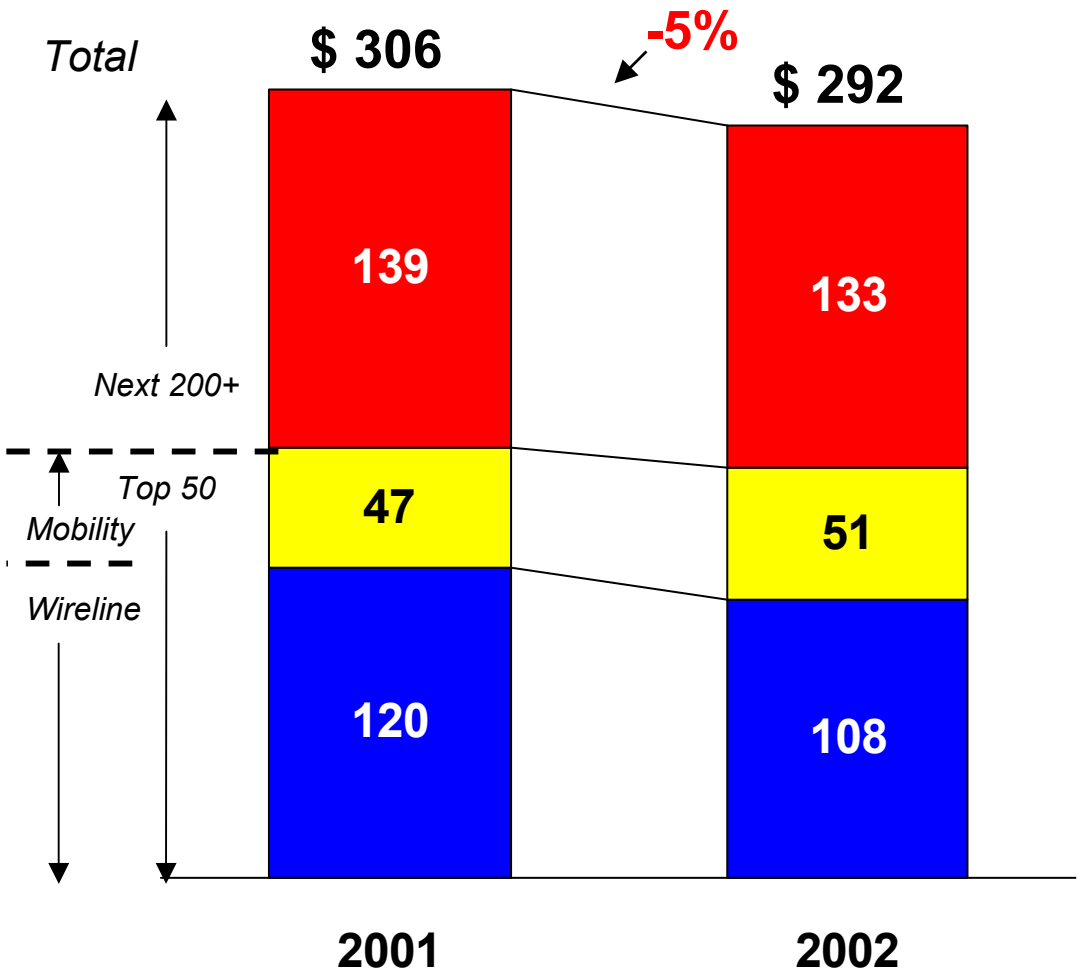
**$ Billions**




** CapEx includes equipment, network construction and other non-network related capital expenditures.*
*Source: Equity analyst reports and SP announcements*
*Note: Wireless CapEx broken out for major integrated service providers*

# Setting the Context: The Company

## Operating Structure – Fiscal Q1-01

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- 5 separate Business Units
- Hundreds of customers
- Presence in 60+ countries
- 40% of spend with over 1000 suppliers
- 16 repair centers
- 540 warehouses
- 15 U.S. factories
- 123,000 employees

# Setting the Context: The Company

## Financial Metrics

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| | Q1-01 |
|---|---|
| Revenue | $4.3B* |
| Quarterly EPS Breakeven Revenue | $5.0B |
| Operating expenses | $2.9B |
| Cash usage (operating activities) | $1.9B** |
| Vendor finance commitments | $7.5B |
| Working Capital (A/R & Inventory) | $14.3B |
| Days Sales Outstanding (DSO) | 132 |
| Days of Supply | 130 |

* excludes Agere and Power Systems

** excludes $0.6B related to receivable sales

# The Market: Today

## Service Provider CapEx Spending Forecasts

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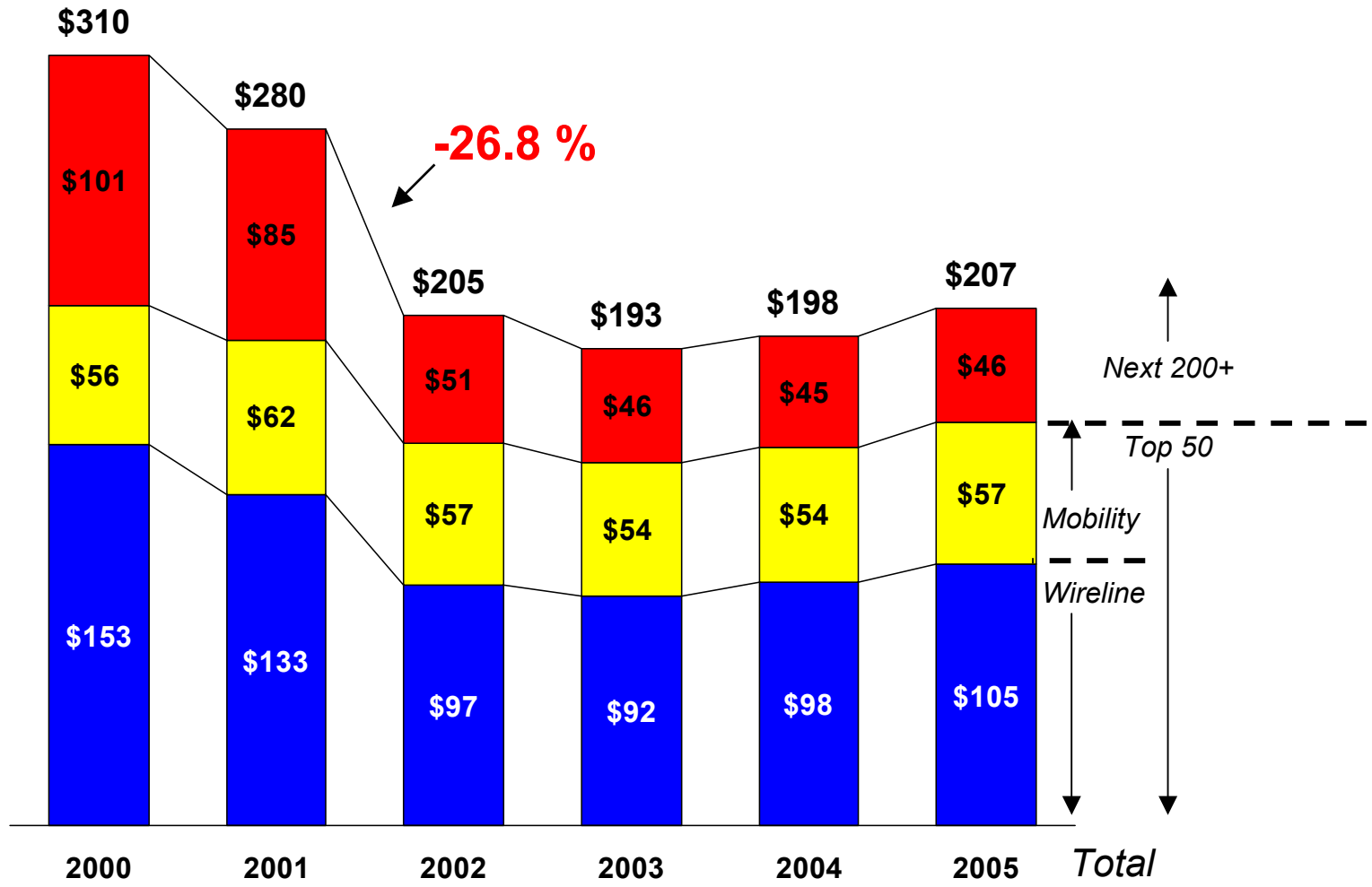
**$ Billions**




*Source: Investment Analyst Reports – Updated October 2002 & Internal Estimates*



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## Actions and Results

# Setting the Context: The Company

## Macro Issues

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- Customer Focus
  - Business not properly aligned with market opportunities
- Operating Structure
  - Opportunities for improvement in supply chain and manufacturing processes
  - Workforce not properly sized with new revenue reality
- Liquidity
  - Operating losses using cash
- Control environment
  - Vendor finance commitments add to liquidity concerns
  - Dynamic environment necessitates re-evaluation of forecasting tools

# Actions & Results: The Company

## Customer Focus

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- **To match the realignment of our customers' businesses, we restructured our operations to target the large service providers**

| | Q1-01 | Q1-03 |
|---|---|---|
| **Business Units** | 5 | 2 (Mobility & INS) |
| **Customers** | Hundreds | Focus on Top 30 |
| **Countries** | 60+ | 20 Core Countries |

# Actions & Results: The Company

## Operating Structure

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- **Through three separate restructuring actions (totaling about $14B), we revamped our supply chain, outsourced manufacturing and streamlined the workforce**

| | Q1-01 | Q1-03 |
|---|---|---|
| **Suppliers** | 40% of spend with over 1000 suppliers | **80% of spend with 60 key suppliers** |
| **Repair Centers** | 16 | **1** |
| **Warehouses** | 540 | **50, all owned by logistics partners** |
| **U.S. Factories** | 15 | **4** |
| **Employees** | 123,000 | **40,000 (35,000 by 9/30/03)** |

# Actions & Results: The Company

## Liquidity and Control Environment

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- **Ensured future liquidity**
  - **Raised $3.5B in two convertible offerings**
  - **Sold Optical Fiber Solutions business for $2.5B**
  - **Monetized real estate assets totaling close to $1B**

- **Dramatically improved control environment**
  - **Established a Corporate Credit Committee to review and approve all vendor finance decisions**
  - **Centralized credit team to perform periodic reviews of customer credit quality**
  - **Developed new planning and sales forecasting tools**
  - **Consolidated data management systems**

# Actions & Results: The Company

## Financial Metrics

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| | From Q1-01 | To Q1-03 | Change |
|---|---|---|---|
| Revenue | $ 4.3B* | $ 2.1B | - 51% |
| Quarterly EPS Breakeven Revenue | $ 5.0B | $ 2.5B | - 50% |
| Operating expenses | $ 2.9B | $ 0.8B | - 72% |
| Cash usage (operating activities) | $ 1.9B** | $ 0.7B | - 63% |
| Vendor finance commitments | $ 7.5B | $ 0.7B | - 91% |
| Working Capital (A/R & Inventory) | $14.3B | $ 2.6B | - 82% |
| Days Sales Outstanding (DSO) | 132 | 68 | - 48% |
| Days of Supply | 130 | 69 | - 47% |

* excludes Agere and Power Systems

** excludes $0.6B related to receivable sales

# Actions & Results: The Company

## Summary

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- **Sufficient liquidity**
  - **December 31, 2002 cash position of $3.7B**
  - **Projected September 30, 2003 cash position of more than $2B**
- **On the path to achieving gross margins in the mid-30% range by the end of fiscal 2003**
  - **Q1-03 sequential improvement of 6 points**
- **Targeting return to profitability by end of fiscal 2003**



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## Breakeven & Beyond

# The Market: Opportunities

## Telecommunications Spending

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- **Underlying primary traffic demand remains strong**
  - **Worldwide Internet subscriber growth**
    - From 600M today to 950M in 2005
  - **Worldwide broadband subscriber growth**
    - From 50M today to 135M in 2005
  - **Wireless subscribers**
    - From 1.1B today to 1.6B in 2005

- **Overcapacity has to be absorbed**
  - **Not if, but *when***
  - **When market does return, LU will be ideally positioned**

# The Market: Opportunities

## Telecommunications Spending

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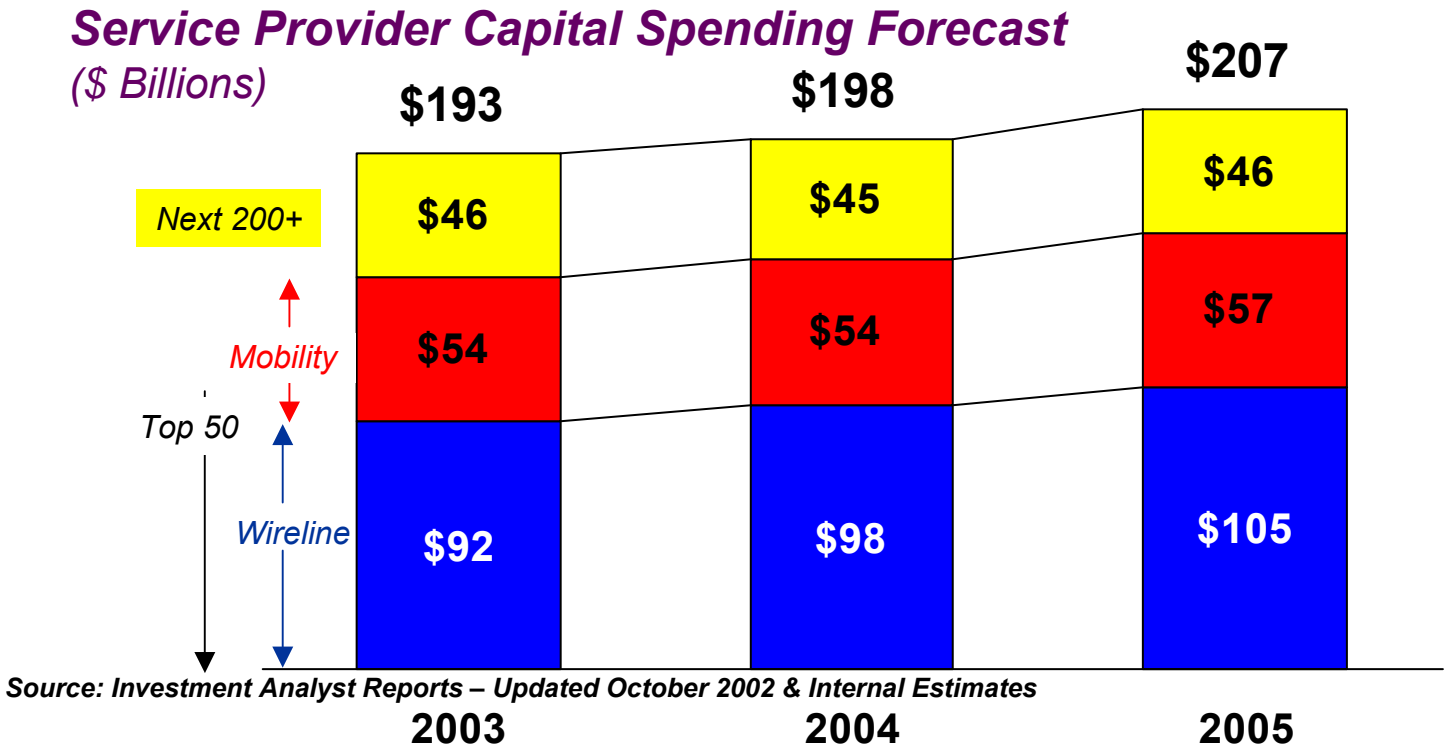
- **Growth in wireline could resume as early as 2004**
- **Small increase in mobility expected in 2005**
- **Annual growth rate in the telecommunications sector will eventually return to around 5%-7%**




*Source: Investment Analyst Reports – Updated October 2002 & Internal Estimates*

# The Company: Opportunities

## Leveraging Strengths

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- A large embedded base of equipment and systems that run today's networks
- Strong, longstanding customer relationships
- An industry-leading product portfolio supported and enhanced by the expertise of Bell Labs
- Unmatched worldwide multi-vendor services capability and a deep understanding of wireline and wireless networks, and how to evolve them

# The Company: Opportunities

## Continued Technological Leadership

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- **Mobility - leader in spread spectrum technology which is at the heart of both cdma2000 and UMTS 3G**
  - **Example: New CDMA base station - platform for both CDMA and UMTS**
    - Currently being deployed by Verizon Wireless

- **INS - *industry-leading offerings in optical, circuit and packet switching, and network operations software***
  - **Example: 5E-XC Switch - triples capacity of 5E, saves space and can reduce annual operating costs by as much as 50 percent**
    - Already being deployed by SBC

# The Company: Opportunities

## Expanding the Services Offering

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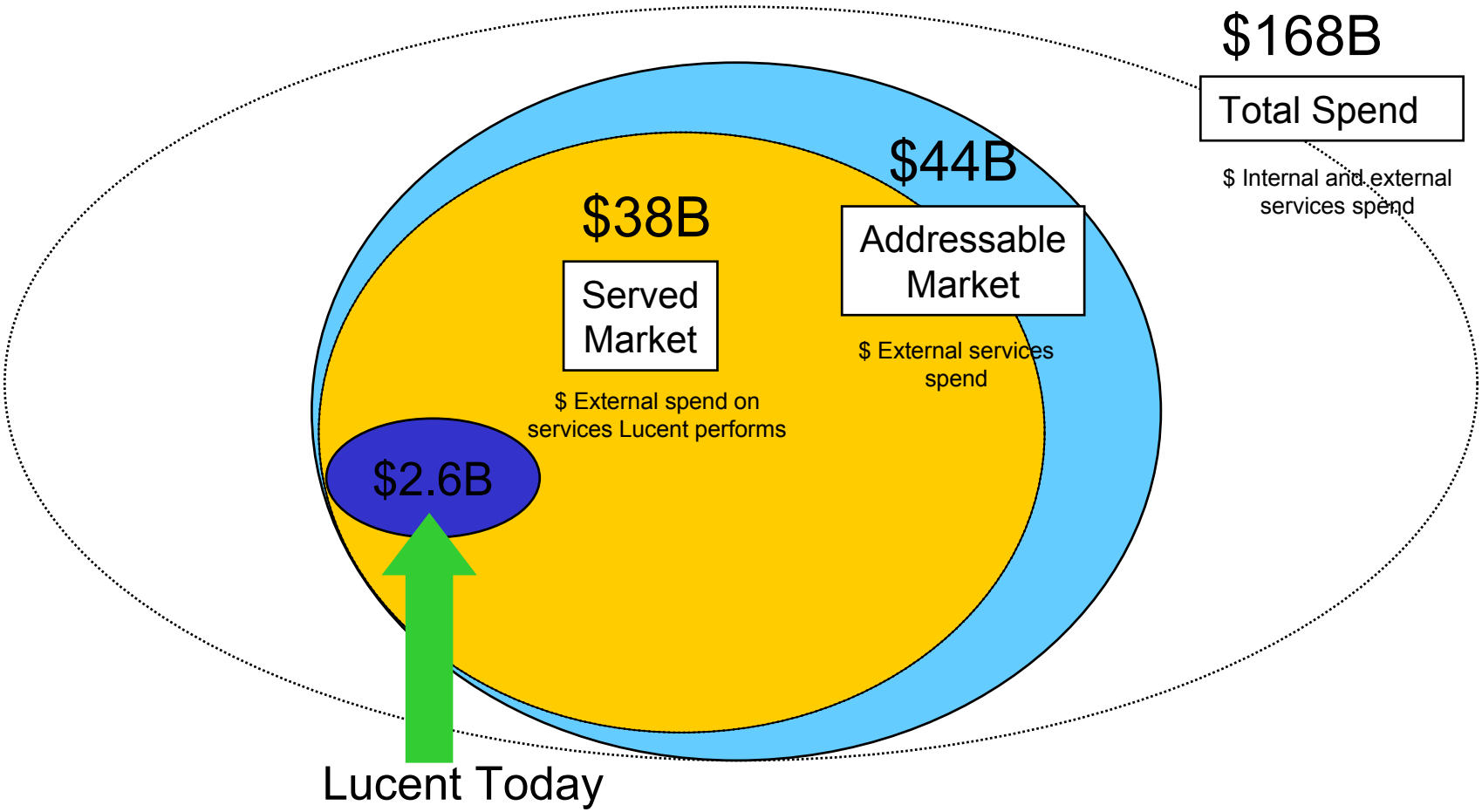
**Telecom Infrastructure Services Market ($B) - 2002**



# The Company: Opportunities

## Integrated Solutions … Not Just Products

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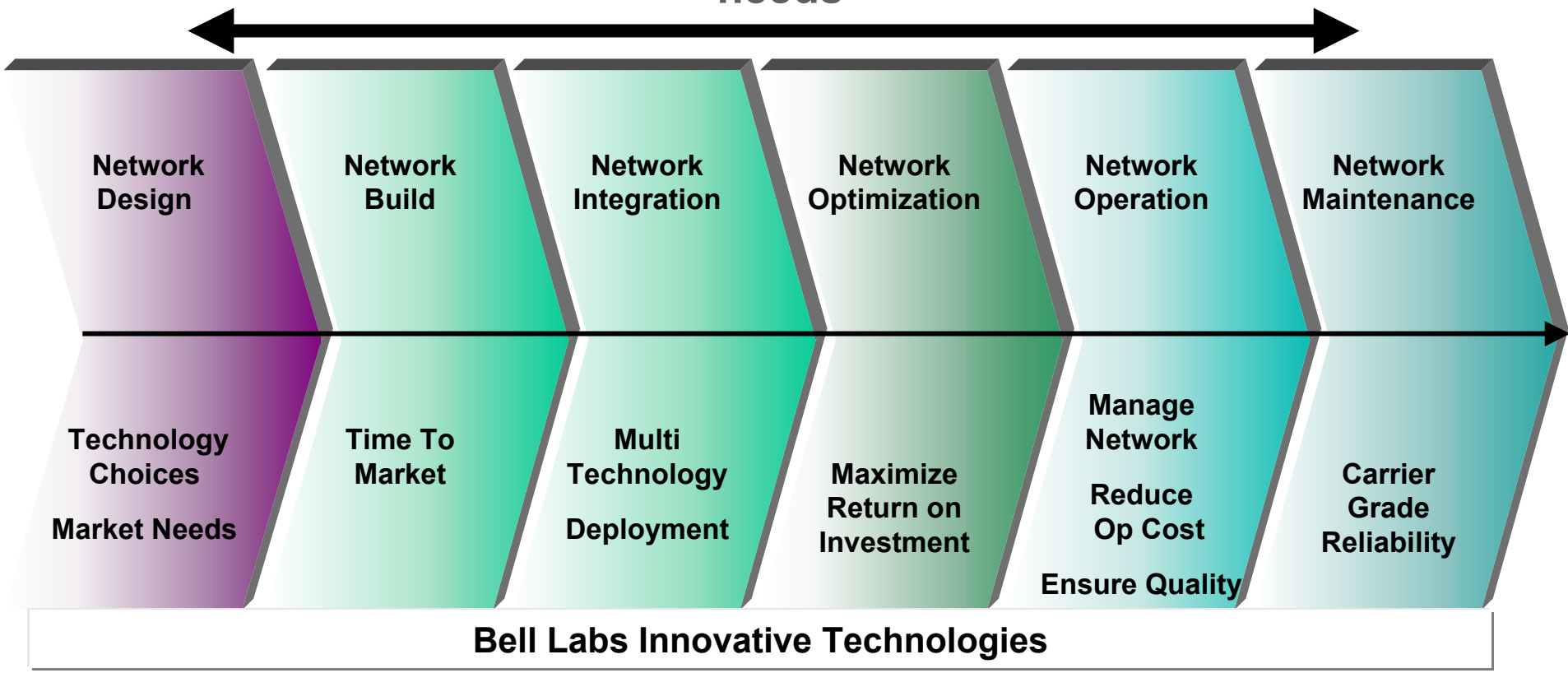
**Lucent supplies end-to-end solutions to meet our customers software, data, and voice needs today and will evolve to address their future needs**



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## Key Takeaways

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- Key relationships with world's largest telecommunications service providers
- Significant progress in realigning with market opportunity
- Not just restructuring, but redesigning
  - Better aligned with customer needs
  - Outsourced manufacturing
  - More efficient structure
  - Positioned product lines to "clear opportunities," present and future
- Industry leading product portfolio; Bell Labs
- Opportunity to expand Services business
- Provider of integrated solutions