After launching a new company...

Receiving 809 patents this year alone...

And growing revenues for six straight quarters...

What's next?

1997 Annual Report

*Unlike most one-year-olds,
Lucent Technologies knows exactly what it wants:
To be the leader in serving customers
by making the things that make
communications work —
wired and wireless networks,
technology and systems
for businesses and service providers,
and electronic components.*

*Yet, energized by
our world-renowned Bell Labs
research and development unit
and empowered by our diverse and global work force,
Lucent is like a one-year-old in two ways:
glowing with imagination
and growing with determination.*

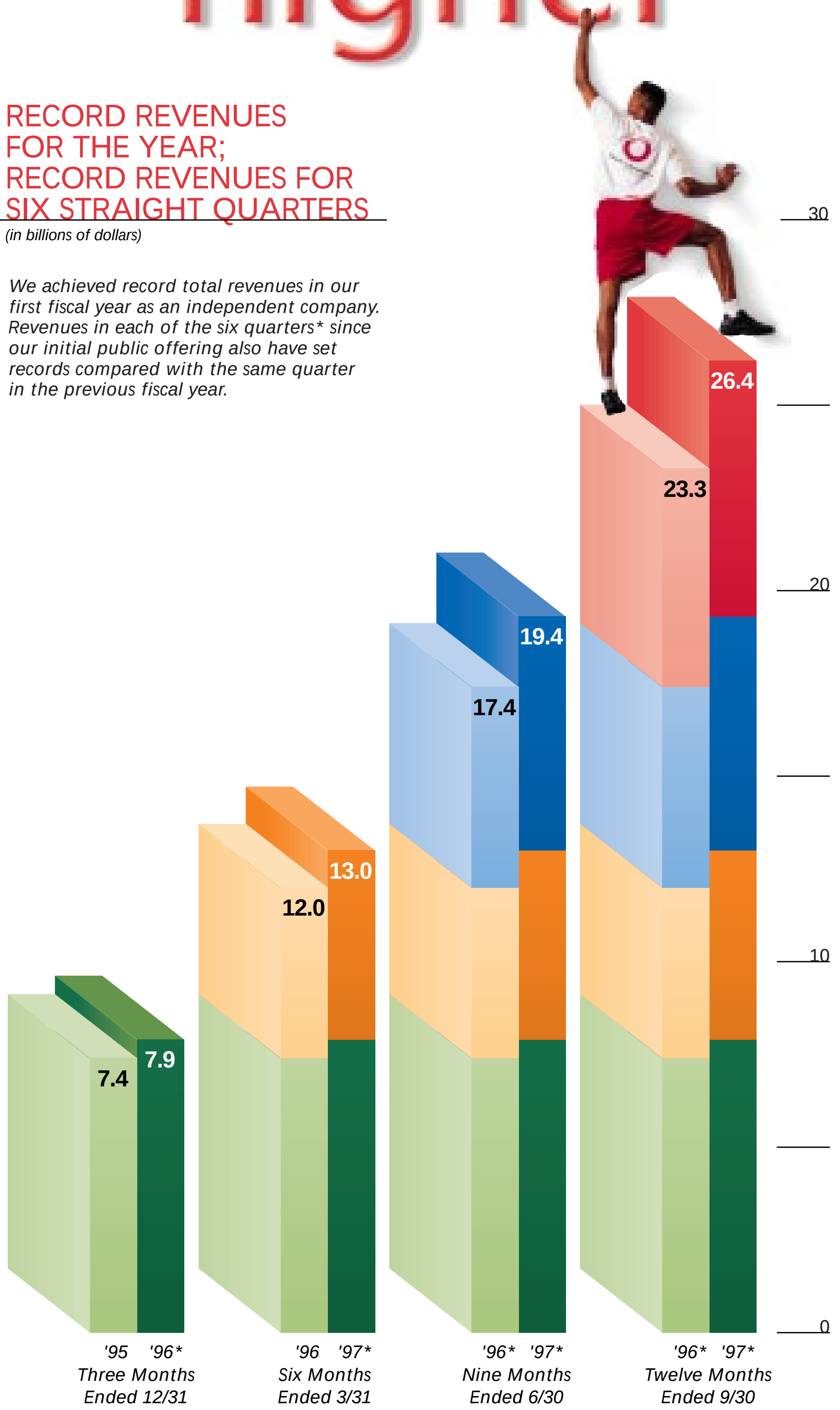
CONTENTS

reaching higher

RECORD REVENUES FOR THE YEAR; RECORD REVENUES FOR SIX STRAIGHT QUARTERS

(in billions of dollars)

We achieved record total revenues in our first fiscal year as an independent company. Revenues in each of the six quarters since our initial public offering also have set records compared with the same quarter in the previous fiscal year.*



REACHING HIGHER

FOR GROWTH AND MARKET LEADERSHIP

TO OUR SHAREOWNERS

Lucent Technologies had an extraordinary first year as an independent company. We grew our business to record levels and strengthened our company for future growth and market leadership.

Now, as the two words on the cover of this annual report say, we're reaching higher. We're strengthening every area of our business as we take aim at the hottest parts of the most dynamic industry in the world. We are reaching higher with a determination to become a high-performance company, delivering consistently solid growth year after year. That job has already begun. We've built a foundation for growth — setting a benchmark for high performance that is designed to produce solid returns to shareowners over the long run.

STRONG EARNINGS GROWTH

Our net income for the fiscal year ended Sept. 30, 1997, increased 43% to $1.5 billion, excluding one-time charges related to our acquisition of Octel Communications Corp. in fiscal 1997 and business restructuring charges recorded in December 1995. Including the Octel charges, net income totaled $541 million, or 84 cents a share, for the 12 months ended Sept. 30, 1997. Revenues for the fiscal year were $26.4 billion, up 13.2% over the previous 12 months.

Each of our three core businesses contributed to the gains, reporting a combined increase of 17.9%. Sales of ***Systems for Network Operators,*** our largest unit, registered an 18.4% increase in revenues during the period. Revenues for our fastest growing unit, ***Microelectronics Group,*** climbed 19%. Our ***Business Communications Systems*** unit, including sales of our SYSTIMAX® Structured Cabling Solutions, posted a 16.4% improvement.

Revenues for our ***Consumer Products*** group declined $418 million for the year ended Sept. 30, 1997, which represents a 29.2% reduction from the previous year. In October 1997, this group became part of Philips Consumer Communications (PCC), a $2.5 billion venture that we launched with Philips Electronics N.V. This venture is ideally positioned in the large and growing global consumer electronics market, and we believe our 40% ownership will be a valuable asset in the future.

A NEW ERA

Our industry has entered an exciting new era. The old world, which revolved around separate networks, such as voice networks to carry phone conversations and data networks for computer traffic, is disappearing. In the evolving new world of digital communications, voice and data are merging into broadband multimedia networks — both wired and wireless — that carry video images as well.

Three important trends have converged to accelerate this change: a rapid rise in the use of computers — for business, education and entertainment; the related and phenomenal global growth of the Internet; and the increasing appeal of wireless communications throughout the world.

LUCENT TECHNOLOGIES FISCAL 1997 HIGHLIGHTS

1996

October 8

Purchased Agile Networks to enhance data networking portfolio

October 16

Announced the K56flex™ modem based on a new technology for high-speed Internet connections

RICHARD A. McGINN
Chief Executive Officer and President

HENRY B. SCHACHT
Chairman

FINANCIAL HIGHLIGHTS

(dollars in millions, except per share amounts)
(unaudited)

	Twelve Months Ended September 30, 1997	Twelve Months Ended September 30, 1996
OPERATIONS		
Revenues	$26,360	$23,286
Gross margin	11,470[a]	9,786[b]
Net income (Excluding Octel and business restructuring charges)	1,507[a]	1,054[b]
FINANCIAL POSITION		
Total assets	$23,811	$22,626
Working capital	1,763	2,068
Shareowners' equity	3,387	2,686
OTHER INFORMATION		
Capital expenditures	$1,635	$1,432
Return on average assets	6.5%[a]	5.3%[b]
Gross margin percentage	43.5%	42.05%[b]
Stock price	$81 3/8	$45 7/8

(a) Excludes impact of $979 ($966 after tax) of one-time charges associated with the acquisition of Octel Communications. Including the impact of these charges, Lucent reported net income of $541.

(b) Excludes impact of $2,801 ($1,847 after tax) of business restructuring and other charges incurred in December 1995. Including the impact of these charges, Lucent reported a net loss of $793.

1997

February 19
Won $105 million contract to build Indonesia's first CDMA network

February 20
Won $330 million in wireless infrastructure equipment contracts in Brazil

March 10
Bell Labs introduced Inferno™ 1.0 software, the first product release for its multimedia network operating system

March 14
Conducted trial of first Internet telephony server with the leading German online bookseller, ABC Buecherdienst GmbH

And each of these trends means opportunities for Lucent Technologies.

Today an estimated 56 million people are routinely communicating over the Internet, compared with 1 million five years ago. During the same period, wireless communications has also seen explosive growth. The number of wireless subscribers worldwide has grown from 21 million to more than 200 million.

In every key area of communications technology — from semiconductors to fiber optics to switches — capacity and speed have dramatically increased, while costs have dramatically decreased. Bell Labs has been an important contributor in each vital area of communications technology progress.

There are few certainties in an industry as dynamic as communications. But we are certain of this: The future will be shaped most by the people who rely on communications networks in their personal and business lives.

Today, not only do people want round-the-clock access to services, they also want instant, reliable access to all forms of communications, including voice, data and video. These demands mean opportunities for Lucent Technologies.

OPPORTUNITIES ABOUND

We are in the right place at the right time. The global market for communications systems and technology, already huge, is growing very rapidly. Industry experts are projecting a worldwide market totaling more than $575 billion by the end of the decade, a $230 billion rise from the end of 1996.

Most of the growth, some 70%, will come from outside the United States. Global demand for communications systems and technology is booming from the combined effects of deregulation and the pressing needs of developing nations for modern communications systems and their social and economic benefits. We intend to be a major player in global markets, and we're already off to a good start. This year more than 24% of our revenues came from outside the United States. In our view, we've only just begun.

What's propelling most of the growth in the global markets are systems and technologies that are driving Lucent's current market success — areas such as wireless systems, messaging systems and call centers, which are all growing at annual rates of 20% or more. Data networking is another hot growth area, along with semiconductors and communications software. Optical networking has the kind of promise many believe will have a revolutionary impact on communications networks. The worldwide demand for switching and fiber-optic systems remains strong. The demand for services and support is really taking off, surprising a lot of industry observers, including us. With the complexity of modern networks, customers have an increasing need for the knowledge and skill to integrate new technologies into their networks. We provide a full range of these services, from network design and engineering all the way to installation and support.

Lucent plays in and across all of these sectors with the broadest portfolio of technologies, systems and services in the marketplace. Backed by Bell Labs' innovations, we've positioned Lucent strategically and operationally to take full advantage of the highest growth opportunities within each of

March 19

Unveiled solutions to help reduce Internet congestion using K56flex modem technology; nearly 300 Internet service providers sign up

April 8

Supplied cellular chip sets for the Radiophone, the first integrated car stereo and cellular phone

April 10

Announced an agreement to sell switching equipment, software and other products to Bell Atlantic over five years

April 15

Won GSM wireless contracts totaling more than $140 million in Taiwan those rapidly expanding sectors. But we're not standing still. We're continuing to invest in each of these high-growth areas to add capabilities that broaden and strengthen our abilities to serve customers better and in more unique ways.

INVESTING, PARTNERING AND DIVESTING

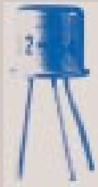
It begins with our engine for innovation and growth, Bell Labs, where we invested more than 11% of our revenues last year. Bell Labs is generating many of the technological innovations that will spark our growth into the next century. The number of patents issued to our scientists and engineers has increased to more than three each workday. We are targeting our R&D investments at the high-growth areas noted above. In addition, to speed our most promising innovations to the marketplace, we're creating an in-house entrepreneurial spirit in the form of business ventures. We've already launched three such ventures — Inferno, **elemedia**™ and Veridicom.

We're also investing in growth opportunities through acquisitions and business partnerships.

For example, we began and ended our first fiscal year with announcements of acquisitions aimed at strengthening our data networking portfolio.

- In October 1996 we purchased Agile Networks, enhancing our multimedia networking capabilities. It's already paying off. Our new data networking switch for service providers and businesses, based on Agile technology, delivers twice the bandwidth at a competitive cost.
- In October 1997 we announced plans to acquire Livingston Enterprises, Inc., a privately held data networking company based in

AN INVENTION THAT CHANGED THE WORLD



It's been called the single most important invention of the 20th century — the key that unlocked the Computer Age. Yet it's barely middle-aged.

Yes, the transistor, Bell Labs' hardest-working invention, turned 50 on Dec. 23, 1997.

While nearly everyone has heard of the transistor, few understand what it does. It has two basic uses: amplification, used in early telephone exchanges, and switching, essential for the millions of lightning-fast on-off connections made by computers.

In 1952, the transistor was first used commercially to make telephone connections electronically, instead of mechanically. Then came the transistorized hearing aid.

In 1954, IBM replaced its computer vacuum tubes with transistors, creating the first fully transistorized computer. That year the transistor also became part of the popular culture with the sale of the first transistor radio — the fastest selling retail item in history.

In time the transistor became faster, less expensive and more reliable. The integrated circuit, consisting of numerous transistors and other electronic devices working together to form the "brains" of computers, was invented in 1958. A six-inch silicon wafer, like the one being inspected at right, can hold upwards of two billion transistors spread among a hundred or a thousand chips.

The result is a world of products — from computers and cell phones to color TVs and copy machines — and new endeavors — from space exploration to medical diagnostics — that have literally changed the world.

April 30
Won $500 million contract as PCS equipment provider to U S West

May 6
Announced industry's first optical networking cross-connect solution that delivers quicker recovery from service interruptions, lower operating costs, higher reliability and greater flexibility

May 21
With U.S. Venture Partners, formed new venture, Veridicom, to address electronic fingerprint identification opportunity

May 28
Demonstrated record-setting, ultra-high-power, single-mode fiber lasers

PASSING THE BATON

On Oct. 6, 1997, Henry Schacht passed the baton symbolizing Lucent's chief executive officer function to Rich McGinn, who had been president and chief operating officer since Lucent was created in 1995.

"Rich and I have had a unique and very productive partnership as we jointly led the creation of Lucent over the past two years," said Schacht, who will continue as chairman. "I look forward to continuing to work with Rich in this next phase of our partnership."

Pleasanton, Calif. The addition of Livingston, a leading global provider of equipment that remotely connects computers to providers of Internet service, increases our ability to address high-growth opportunities in the Internet and data networking business.

In September we completed the acquisition of Octel Communications, a leader in voice messaging capabilities. The combination of Octel and Lucent's Business Communications Systems' messaging unit creates a global business with more than $1 billion in annual revenues. It also will enable us to better serve the global messaging industry, which is growing more than 20% a year.

We launched our venture with Philips Electronics N.V. on Oct. 1, 1997. The new company, Philips Consumer Communications (PCC), is the leader in worldwide sales of corded and cordless phones and answering machines. PCC also produces the most complete line of analog and digital wireless phones and pagers in the industry. Matching Philips' global brand recognition and distribution channels with Lucent's U.S. leadership position in the sale of phones and answering machines positions the new venture for growth. PCC will also draw upon the technological resources of both Philips Research and Bell Labs.

We're also engaged in a number of partnerships, including an agreement with Sun Microsystems, aimed at augmenting our capabilities in specific markets.

At the same time, we're prepared to divest ourselves of activities that fall outside our focus. On Oct. 1, 1997, we announced the completion of the sale of our Advanced Technology Systems (ATS)

June 17

Announced venture with Philips Electronics N.V. to create world leader in consumer communications products

June 24

Unveiled Definity® ProLogix™ Solutions, a new business communications system for branch offices and mid-sized businesses

July 17

Announced plans to acquire Octel Communications, a leader in voice, fax and electronic messaging technologies; completed acquisition in September

July 21

Demonstrated record-breaking 100-channel optical amplifier unit to General Dynamics Corp. ATS provides custom design and manufacturing services related to defense.

We'll continue to reassess our portfolio of offerings, always reaching higher to make the changes needed to remain a leader in an industry that's undergoing rapid and profound changes.

ORGANIZING FOR GROWTH

Just after the close of our 1997 fiscal year we announced that we were reorganizing our business to better focus our resources on customers in the fastest growing areas of the market worldwide.

We appointed two chief operating officers. Dan Stanzione, who has served as president of both our Systems for Network Operators unit and of Bell Labs, will become executive vice president and chief operating officer. He also will remain president of Bell Labs. Ben Verwaayen, who has served as executive vice president and president for international, will become executive vice president and chief operating officer. As former president of the Dutch PTT and the former chairman of Unisource, a consortium of European telecommunications companies and AT&T, Ben brings unparalleled knowledge of the global communications industry and proven skill in creating global partnerships. Ben and Dan will jointly lead our newly organized businesses. In addition, Dan will have oversight of technology, product architecture, and manufacturing. Ben will have oversight of globalization efforts. In our newly created Office of the Chief Executive, Ben and Dan are joined by Don Peterson, executive vice president, chief financial officer, and Pat Russo, executive vice president, corporate staff operations.

From our three core businesses — Systems for Network Operators, Business Communications Systems and Microelectronics Group — we've formed smaller units to sharpen our customer focus. They include a new Global Service Provider Business to give us a more unified contact with customers around the world. We've formed new units to concentrate on Microelectronics, Data Networking Systems, Wireless Networks, Business Communications Systems, Optical Networking, Switching and Access Systems, Network Products, Communications Software, New Ventures and Intellectual Property.

We think of Lucent as a group of hot companies, each tightly focused on customers and markets. Our new organization is designed to streamline the creation and delivery of systems and technologies to our customers.

We're proud of the achievements during our first year as an independent company. We're strong operationally, organizationally and financially. Our record of innovation is second to none. Our products and services are world class. So are our people, who have made the most of what we still call, and what still is, "the opportunity of a lifetime."

We are poised for growth and for high-performance results that produce increased shareowner value.

That means reaching higher. And that's what we intend to do.

HENRY B. SCHACHT
Chairman

RICHARD A. McGINN
Chief Executive Officer and President

November 10, 1997

August 14
Announced installation of 100 millionth line of the 5ESS®-2000 digital switch in Qingdao, China

September 8
Unveiled first in DSP 16000 series, a new type of digital signal processor that requires only one-fifth the memory and uses five times less power than competing DSP chips on the market today

September 17
Announced enhanced portfolio of data networking products

October 6
Richard A. McGinn named chief executive officer and president; Henry B. Schacht to continue as chairman

LEADERSHIP

Henry B. Schacht
Chairman

Richard A. McGinn
Chief Executive Officer and President

Donald K. Peterson
Executive Vice President,
Chief Financial Officer

Patricia F. Russo
Executive Vice President,
Corporate Staff Operations

Daniel C. Stanzione
Executive Vice President,
Chief Operating Officer,
President, Bell Laboratories

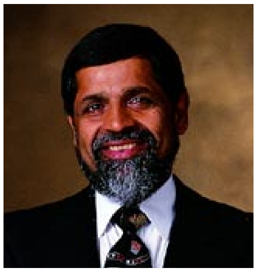
Ben Verwaayen
Executive Vice President,
Chief Operating Officer

Curtis J. Crawford
Group President,
Microelectronics Group and Intellectual Property Division

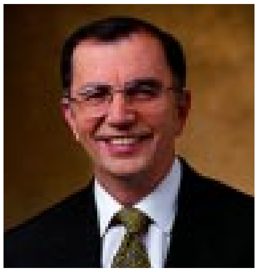
Carleton S. Fiorina
Group President,
Global Service Provider Business

William T. O'Shea
Group President, Business Communications Systems Group and Data Networking Systems Group

Gerald J. Butters
Group President,
Optical Networking Group



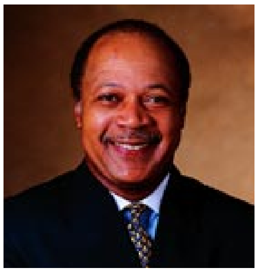
Arun N. Netravali
Executive Vice President, Research, Bell Laboratories



James K. Brewington
Group President,
Wireless Networks Group

Joseph S. Colson, Jr.
President, International Regions,
Global Service Provider Business

Thomas M. Uhlman
President, New Ventures Group



Curtis R. Artis
Senior Vice President,
Human Resources

Kathleen M. Fitzgerald
Senior Vice President, Public Relations and Investor Relations

Richard J. Rawson
Senior Vice President,
General Counsel

We announced a reorganization in mid-October that included the following leaders, not pictured here:

Robert C. Holder
Group President,
Switching and Access Systems Group

William R. Spivey
Group President,
Network Products Group

J. Carl Hsu
Acting Group President,
Communications Software Group

reaching higher

IN A NEW ERA OF COMMUNICATIONS SYSTEMS AND TECHNOLOGY

As the 20th century gives way to the 21st, communications systems and technology have entered a vital new phase. Internet usage, work-at-home capabilities and increasing mobility are creating unprecedented traffic on both public and private networks.

Businesses are becoming more global. Deregulation is spreading among developed nations. Developing countries increasingly are seeing the economic benefits of "connecting" to the world. Wireless links are playing an ever more important role in everyday communications, both in the United States and around the globe.

Lucent is reaching higher to add value and accelerate growth in this new era. By creating high-performance products — from silicon microchips and high-speed fiber-optic networks to the world's most dependable switching systems — we're advancing the technological evolution to a rich new generation of reliable and convenient communications services.

NETWORKING

THE WORLD

SETTING STANDARDS

Built on the legacy of Western Electric and Bell Labs, Lucent has set the standard while the world's voice networks have progressed to near perfection in sound clarity, ease of use and call reliability. Today, as people communicate through computers as well as phones, networks must carry the chatter of computer traffic as reliably as they carry human conversations.

Thanks to advanced digital technologies, the content of all types of communications services — voice calls, data links and video connections — now can be merged. A new generation of communications networks will handle the digital information streams. As these new global networks evolve, the world's communications service providers (once known only as phone companies) will offer consumers more and better communications alternatives than ever before.

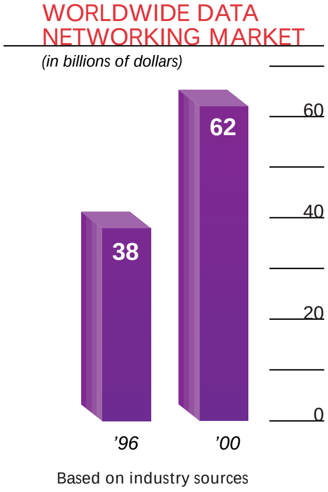
China, which adds 20 million telephones yearly, exemplifies how such advanced networks are growing. In August, we delivered the 100 millionth line of our flagship 5ESS-2000 switch to the Posts and Telecommunications Bureau in Qingdao, China. As a result, the 35,000 subscribers served by the Fuzhou Road central office in Qingdao will connect to the world and take advantage of a vast array of advanced communications services.

The 5ESS switch is a key component in Lucent's AnyMedia™ platform. The switch routes wireline and wireless voice, data and video signals through communications networks with the highest rating of performance reliability. In the United States, customers like Ameritech, the Chicago-based communications service provider, are using the AnyMedia Express family of network technology to keep their networks at the leading edge.

RIGHT: *Lucent technicians Liu Hua (left) and Ge Yi-bo inspect 5ESS switching equipment at the Lucent Joint Venture office in Qingdao, China.*

OPPOSITE PAGE: *One of the many circuit boards that serve as part of Lucent's local number portability technology is installed by Keith Pacini, a switch manager at Ameritech's Systems Integration Lab in Hoffman Estates, Ill.*

PRECEDING PAGE: *As many as 600 digital switches and transmission facilities can be managed from the hub of Lucent's Network Reliability Center in Aurora, Colo.*


WORLDWIDE DATA NETWORKING MARKET
(in billions of dollars)
38
62
60
40
20
0
'96
'00
Based on industry sources

GROWING
IN DATA NETWORKING

THE INTERNET

Nearly everyone, whether they realize it or not, is becoming involved with data networking today. Uses are as common as sending electronic mail to your kids at college, dialing up the Internet for help with homework, pleasure or business, or the common occurrence of exchanging all types of information from computer to computer over local area networks at your place of business.

Analysts say the size of the data networking opportunity for vendors like Lucent is about $40 billion worldwide this year. As service providers and enterprises strive to deliver data networking in the most reliable, easily managed and cost-effective way, they are turning to Lucent because no one has a better track record in networking.

Our focus is on the highest growth segments in this booming sector: intelligent switching, network access, transport and optical networking, network management and support services. Taken together, these areas are growing about 20% a year.

Lucent is putting together a broad and powerful portfolio of data networking product and service solutions to meet the rapidly growing needs of enterprise and service provider customers.

We're already industry leaders in providing data networking switching and network management capabilities to service providers in their core networks. And at the beginning of the fiscal year we acquired Agile Networks, which offers intelligent switching solutions based on virtual local area networking capabilities.

Then, in September, we significantly broadened our offering again by introducing an enhanced portfolio of intelligent switching, access and network management products to dramatically improve data

networking performance. These new products include a next-generation ATM multiservice switch for enterprise and service provider networks that can deliver up to twice the usable bandwidth and up to 25% lower cost per port than competing products.

And we continued our data networking momentum in October by announcing plans to purchase Livingston Enterprises, a leading global supplier of equipment that remotely connects computers to providers of Internet service.

Examples of products that support our vision of data networking include:

Internet Telephony Servers

The Internet Telephony Server and Internet Telephony Server SP allow phone calls, voice mail and faxes to be routed to the Internet from residential and business telephones and fax machines. The Internet Telephony Server SP for carrier networks has been tested by GTE, ICG, MCI and other Lucent customers. The Internet Telephony Server for private networks has been tested by ABC Buecherdienst, a German bookseller; Kanematsu Corp., a Japanese trading company; and KIH, a U.S. Internet service provider.

Asynchronous Transfer Mode (ATM) Switching

This switching technology takes streams of voice, video and data information — such as Internet traffic — and moves it through networks with high speed and reliability. Our GlobeView®-2000 ATM switches are deployed throughout the world. In September, we announced several new ATM switches and related products designed to improve the reliability and manageability of data networks. The first customer for our new carrier ATM switch was the U.S. Department of Energy's Sandia National Labs in New Mexico.

OPPOSITE PAGE, TOP: *In Colorado Springs, Colo., MCI engineers Rick Steele (left) and Josh Glenn test access to the Internet using Lucent's Internet Telephony Server SP.*

OPPOSITE PAGE, BOTTOM: *Networking software from Lucent is at the heart of the Sprint PCS National Network Operations Control Center in Lenexa, Kan.*

INTERNET INNOVATOR

KRISHNA MURTI

"Innovation is a matter of focusing on the priority. The real accomplishment of elemedia has been to take existing technology to market very quickly. We've taken multiyear development cycles and reduced them to six months or in some cases three months. Internal ventures give us the opportunity to be entrepreneurial in a large corporation."

Krishna Murti is head of the Advanced Multimedia Communications Department at Bell Labs in Holmdel, N.J., and vice president of technology for Lucent's elemedia venture. Among its other activities, his department is responsible for developing multimedia signal processing and new multimedia applications for the Internet and wireless communications.

SERVING BUSINESS

Communications technologies like interactive voice messaging, faxing, paging, radio systems, electronic mail (e-mail) and the Internet are changing the ways businesses do business. Lucent's industry-leading products — delivering innovative, cost-effective communications solutions for businesses large and small — have grown dramatically in scope and capability during the past year.

Lucent's DEFINITY® Enterprise Communications Server family of products continues to redefine the PBX — the switching hardware and software that handle all the internal communications of an enterprise — to meet the needs of today's businesses. For example:

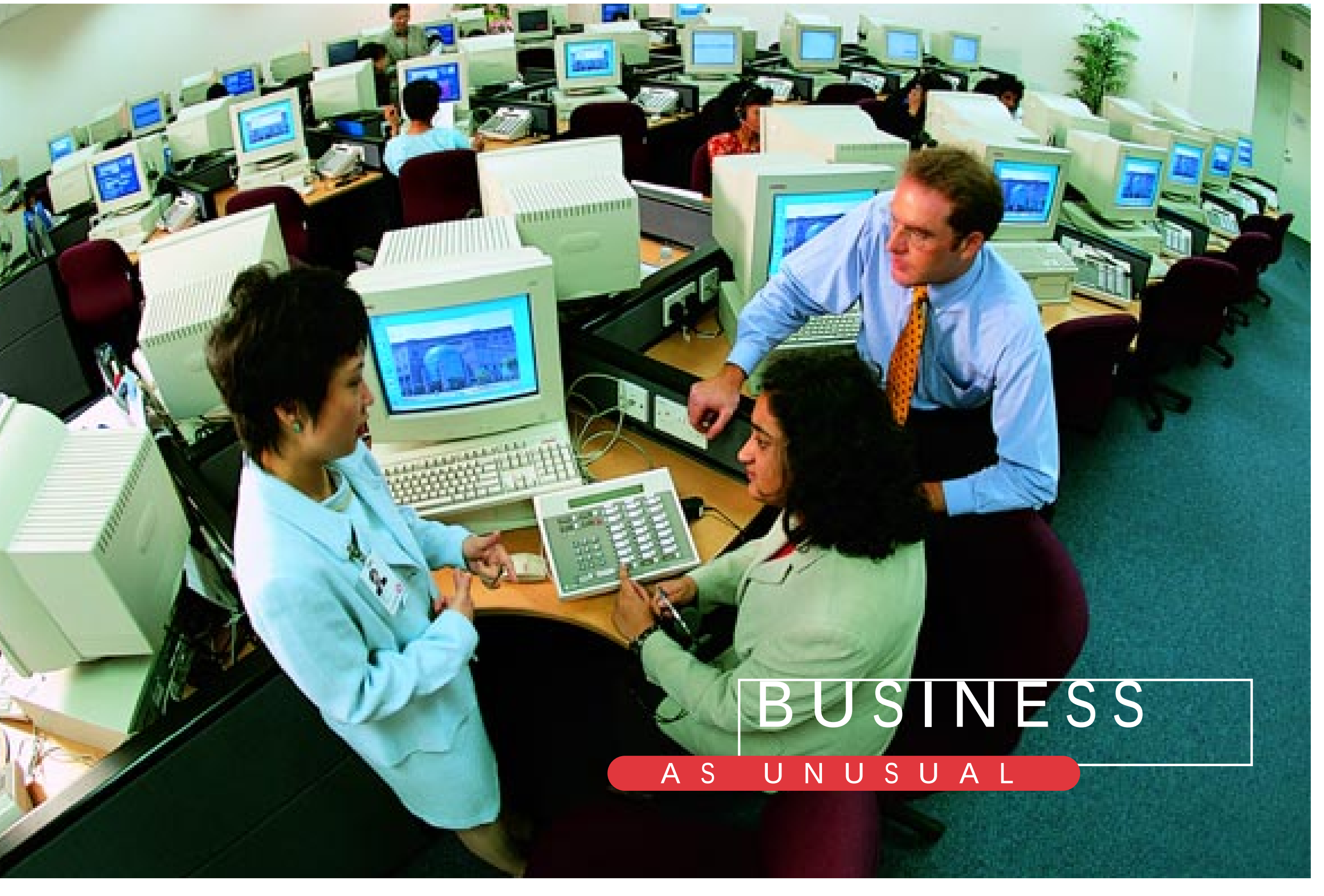
***DEFINITY ProLogix* Solutions**

gives small and mid-sized businesses many of the same capabilities that large customers around the world depend on from the DEFINITY Enterprise Communications Server. These capabilities include remote diagnostics and maintenance, networking for multilocation connections, mobility solutions, remote access for telecommuters over both the Internet and local area networks, and full help desk support.

***DEFINITY* ATM**

makes it possible for customers to manage their data and voice networks from the same communications "platform" for the first time.

Call centers, which allow businesses to use advanced communications technologies to enhance relationships with customers, are another major growth area. We've pioneered the Internet Call Center, which allows customers to simultaneously browse a business's web site and speak to a



LEFT: *The Lucent DEFINITY business communications system helps Jeff Bolling, a lead keeper at Zoo Atlanta, keep track of Kariba, a female lion cub born on July 28, 1997.*

OPPOSITE PAGE: *Erica Shim (left), a Lucent call center specialist, meets with SITEL customers Seema Nasiruddin and Andrew Sidwell at SITEL's Singapore Call Center.*

BELOW: *Robert Cohn (left), formerly chairman and CEO of Octel Communications Corp. and now president of Lucent's Octel Messaging Division, celebrates plans to join forces with Bill O'Shea, group president of Lucent's Business Communications Systems Group.*

representative to place orders or ask questions — all on a single phone call. We've brought the Compact Call Center to market, giving even single-location operations the ability to project a large presence, as well as the Video Multimedia Call Center, which lets customers see and talk to a business's representative.

We're also helping the U.S. Navy tie together its global network of bases and ships at sea. In July, Lucent was named prime contractor on the $2.9 billion project. Solutions we've developed for business — the flagship 5ESS-2000 switch, DEFINITY Enterprise Communications Server, MultiMedia Communications eXchange Server (MMCX), INTUITY™ System and a host of other products — will help create a truly integrated communications network for the 21st century U.S. Navy.

SENDING A MESSAGE

The messaging industry — carrying voice mail and faxes — is growing at 20% annually, with Lucent at the forefront.

The acquisition of Octel Communications Corp. in September confirmed Lucent as a world leader in voice mail solutions. More than 70 million Octel voice mailboxes are now being used globally, including 51% of the world's residential voice mail users and more than a third of the world's wireless voice mailboxes. More than 60% of the Fortune 500 (U.S.), FP 300 (Canada) and FT 500 (UK) look to us and our distributors for messaging solutions.

Lucent innovation is transforming messaging. INTUITY Integrated Messaging for Lotus Notes and Lucent Unified Messenger for Microsoft Exchange give users the ability to send, receive and manage voice, fax and e-mail messages from either their telephones or PCs.

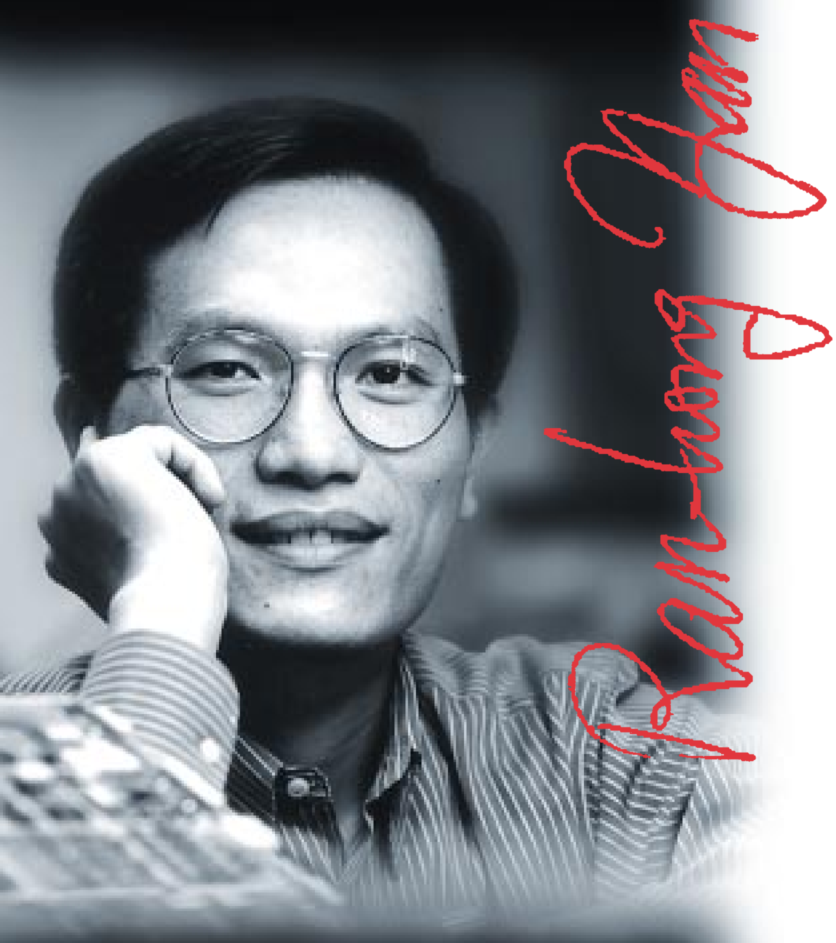
Lucent's messaging outsourcing services are growing impressively, too. We provide voice mail outsourcing to network operators and global businesses — such as Ameritech, British Telecommunications plc, Citicorp, EDS, Ford Motor Company, J.P. Morgan, and WorldCom — serving more than 2 million people.

Lucent's vision for messaging is clear — to enable everyone in the world to send voice messages to and from every home, every car, every mobile phone and every business. We're delivering on that promise in all sectors, including wireless, the fastest growing part of network-based messaging.

CELLULAR INNOVATOR

RAN-HONG YAN

"GSM digital cellular systems and wireless data products are two of the most exciting opportunities for Lucent. Our global wireless teams have a high level of experience and expertise — coupled with the freedom to do research with maximum impact — that allow Bell Labs to attract even more world-class researchers and deliver the best products and service to our customers."



Dr. Ran-hong Yan heads Bell Labs' Global Wireless Research Department in Swindon, England, and Utrecht, the Netherlands, as well as the Wireless Circuits and Systems Research Department in Holmdel, N.J. He has been granted 10 patents with six more pending, and has authored or co-authored more than 80 technical and conference papers.

WIRELESS WORLD

Worldwide demand for wireless communications continues to grow at an astonishing rate. There are an estimated 200 million users of wireless communications systems today, including about 12 million Personal Communications Services (PCS) users. According to analysts, the industry adds an average of 150,000 new wireless subscribers every day. The number of PCS users is expected to double in 1998, then double again in 1999.

The world's three major digital wireless standards — Code Division Multiple Access (CDMA), Time Division Multiple Access (TDMA) and Global System for Mobile Communications (GSM) — are all growing robustly: Total annual cellular and PCS revenues for service providers were expected to reach $33 billion in 1997 and, according to industry analysts, $85 billion within the next decade. We offer network equipment for all three digital standards, as well as for analog cellular, and we're the North American leader in building CDMA networks.

PCS works like digital cellular — providing enhanced sound quality for conversations and greater security for both conversations and data transmissions — but operates at higher frequencies. We're also the North American leader in building networks that provide PCS.

Data services, which include Internet access, e-mail and faxes, previously were associated only

THE WIRELESS EXPLOSION

with wired, high-speed data networks. Now these services are increasingly available to wireless users, and demand is growing. Industry analysts expect the revenues from end users of wireless data services to approach $10 billion by 2001.

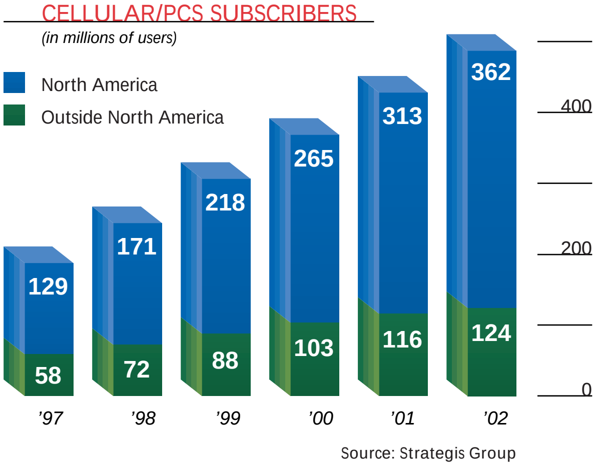
In preparation for this explosive growth, we introduced new technology that allows wireless local area networks (LANs) to handle five times as much data as today's highest capacity wireless LANs. And we introduced wireless LANs that will enable Internet access in a campus environment or neighborhood, sending and receiving voice, data and video simultaneously.

ABOVE: *AT&T Wireless Services customers in the Chicago area are using Lucent's TDMA minicells like this one being tested by AT&T Wireless technician Carlos Lievano.*

OPPOSITE PAGE: *George Jones of the South Wales Police Force in the UK keeps in contact via a radio system based on high-capacity microwave links supplied by Lucent.*

Fixed wireless systems are another high-growth area. This technology can be used, either to add phone lines to an existing network or to build a new network from scratch, in place of the copper wire "local loop" to which homes and offices connect. With half of the world's population still waiting to make their first call, fixed wireless systems offer an attractive alternative to laying cable in areas without telephone service. As a result, analysts expect revenues from fixed wireless infrastructure sales to reach $7 billion in 2001 and continue to rise through the decade. We intend be a leader in this area.

As one might expect, network operators are investing heavily in wireless infrastructure — more than $25 billion worldwide in 1997. They want to see rapid returns on these capital investments. Fast deployment of equipment that works reliably from day one is critical. We have built wireless networks, from contract signing to service delivery, in a mere 80 days. The order-to-shipping interval for our PCS



minicells, which receive and transmit calls in a PCS network, is just 16 days. For its excellence in on-time delivery our Columbus wireless operation was named Ohio's "Exporter of the Year" in 1997.

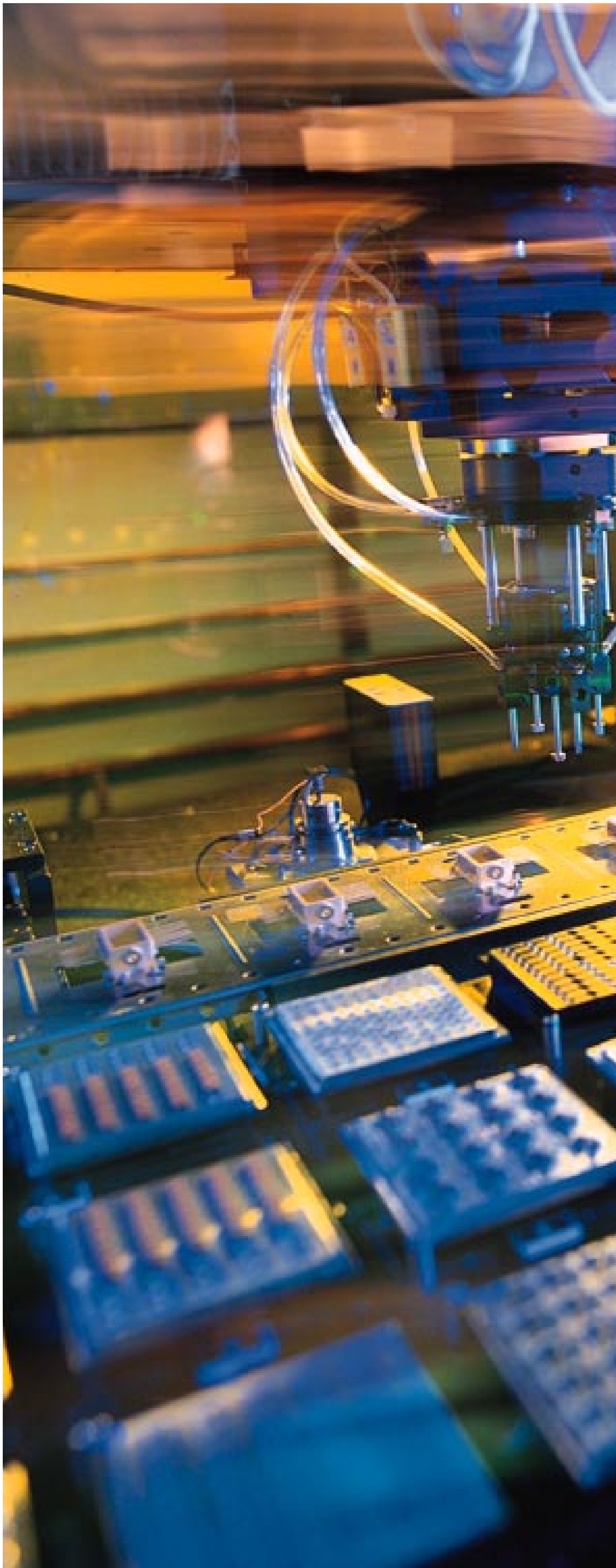
A PROMISE FULFILLED

We've fulfilled our promise to have wireless business systems in every major market around the globe, addressing all of the world's major standards. In addition, in 1997 we announced a major investment in GSM and contracts for GSM cellular or PCS networks in Germany, Hong Kong, Malaysia and Taiwan; CDMA cellular or PCS networks in Indonesia, the Philippines, South Korea and Thailand; and AMPS (analog cellular) networks in Argentina and Brazil.

In the United States, we helped AT&T Wireless Services launch TDMA service in Chicago by supplying the largest regional all-digital wireless network in North America based on TDMA. We announced CDMA contracts with GTE and Frontier Cellular, and extended Bell Atlantic Mobile's CDMA service to four additional markets. We also initiated CDMA PCS service with PrimeCo Personal Communications and Sprint PCS, signed a new wireless contract with U S West, and entered into a five-year, multimillion-dollar agreement to be the sole infrastructure supplier for Ameritech's wireless services, including its new CDMA-based service.

__RIGHT:__ Laser 2000, a state-of-the-art laser chip packaging platform, reduces costs and increases productivity at Lucent's Microelectronics Group facility in Breinigsville, Pa.

__OPPOSITE PAGE:__ Wireless phones containing Lucent's microchips are a vital, everyday tool for Lucent's Karen Aw in Singapore.



MICROELECTRONICS

THE INSIDE STORY

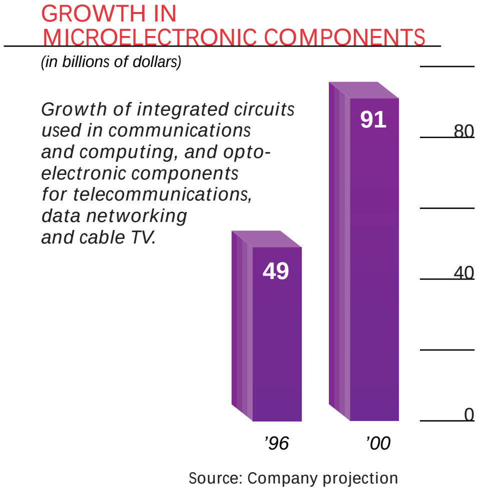
MIGHTY MICROCHIPS

Reaching higher in communications technology doesn't only mean pursuing advanced software and hardware. It also means reaching deeper into the esoteric physics of semiconductor chips that are crucial components in many of the devices used to transmit communications signals to and from the networks.

Among microelectronics manufacturers worldwide, we're No. 1 in global sales of optoelectronic components, power supplies for telecommunications, and standard-cell ASICs (application specific integrated circuits). And we're No. 2 in sales of DSPs (digital signal processors). Our components are in wireless equipment such as cellular phones and base stations and pagers; personal computers; disk drives; modems; telecommunications, data communications, cable TV, and computer networks; optoelectronic systems; digital telephone answering machines; TV set-top boxes; and videoconferencing products.

DSPs are as central to communications as microprocessors are to computers, and the DSP sector ranks among the fastest growing in the semiconductor industry. Customers for Lucent DSPs include the world's leading makers of wireless products: Finland's Nokia, Japan's Sony, Sweden's Ericsson and the U.S.'s Motorola.

In September, we unveiled a new DSP core architecture — the DSP16000 — that can slash the cost of electronics in digital cellular base stations by up to 50%. Our new DSP16210 chip, based on this



architecture, requires only one-fifth the memory and consumes up to five times less power than competing DSPs on the market today.

We're experts in developing the digital communications applications, including encoders, decoders, receivers and other integrated circuits, that link PCs and TVs in digital networks. Together with Compaq Computer, Intel and Microsoft, we're working to speed the deployment of digital television (DTV) technology for personal computers and television sets. In addition, we won an Emmy Award this year for Bell Labs' pioneering development in MPEG digital compression — a part of our work with the Grand Alliance, a consortium of companies working to develop High Definition TV (HDTV).

Communications lasers are another vital semiconductor technology. We're targeting new opportunities as lasers proliferate to meet the demand for high-speed Internet access. One way of addressing this rapidly growing area is through a manufacturing venture with Furukawa of Japan, supporting high-volume, low-cost packaging of lasers and detectors.

We're also making our own optoelectronic components product line even more competitive with a new, automated, state-of-the-art laser chip packaging platform called Laser 2000. It reduces costs substantially, increasing our ability to provide high-quality lasers in large volume at competitive prices.

HIGH-SPEED WEBCASTING

WORLD WIDE WEB

As the number of World Wide Web users increases dramatically, demand for the chips used in high-speed modems also increases. When applied in networks, these modems raise the performance of telecommuting and videoconferencing — as well as Internet "webcasting."

We announced in 1997 a new modem technology — called K56flex — that's designed to reduce the wait when connecting a personal computer to the Internet. Our chipsets permit data to be transferred at nearly twice the speed of most modems used today, through standard phone lines, making low-cost, high-speed Internet access a reality.

AOL Networks, an operating unit of America Online, the world's largest Internet service provider, tested K56flex modems during the summer and is deploying K56flex modem technology in more than 175 markets. As a result, customers using PCs from Compaq Computer, Hewlett-Packard, Sony, and Toshiba will be able to connect to the world's

__ABOVE:__ The world's largest Internet service provider, America Online, is deploying Lucent K56flex modems in more than 175 AOLnet markets.

__OPPOSITE PAGE:__ A dust-free environment is critical at Lucent's Microelectronics Group plant in Singapore, where DSPs and other microchips are inspected by Lucent's Ying Xue Lian (left) and Le Fo Yong.

MICROCHIP INNOVATOR

JILL BENNETT

"By leveraging Lucent's advanced process technology and digital signal processing (DSP) expertise, we've introduced a DSP chip that enables wireless equipment manufacturers to reduce electronic component requirements by half, which gives them drastically improved cost, power and size."

Jill Bennett is technical manager for DSPs designed for wireless products at Bell Labs in Allentown, Pa. The DSPs her group designs are used to lower cost and power requirements, while increasing performance and memory, in wireless base stations, cellular phones, modems and other products used in communications systems.

largest private dial-up network — AOLnet* — at higher speeds. Internet service providers CompuServe, Microsoft Network and Prodigy also plan to use K56flex technology.

Lucent's microchips play a crucial role in a host of other products. Our videoconferencing chip, for example, is hidden in C-Phone Corp.'s C-Phone Home** TV video phone, a set-top box that hooks up like a VCR and converts a television set into a video phone with high-quality video and audio transmission over standard telephone lines.

Another example is the Radiophone that was introduced in Europe in 1997 by Germany-based Blaupunkt-Werke GmbH. The Radiophone uses a chip set from Lucent to introduce a new class of automotive electronics: a dashboard-mounted device that combines a car stereo with a cellular phone in a single unit. A microphone in the dashboard allows hands-free operation, and the other party is heard through the radio's loudspeakers.

In addition, Motorola's family of pagers — the Tenor†, PageFinder† and PageWriter† — contains the Lucent POMP®-15 digital signal processor chip. The chip was selected because of its low power consumption and its ability to integrate data and voice messaging capabilities on one chip.

* *AOLnet is a registered trademark of America Online*
** *C-Phone Home is a trademark of C-Phone Corp.*
† *Tenor is a registered trademark of Motorola; PageFinder and PageWriter are trademarks of Motorola*

AT YOUR SERVICE

SERVING CUSTOMERS

Our expertise in communications technology goes beyond the design and manufacture of electronic and optical equipment, fiber-optic cables and related systems. Increasingly, it involves providing professional services and support — assisting customers in managing their networks to make the fullest use of technology.

Professional services — engineering, installation, maintenance, operations and other functions — generate revenue, stimulate additional product sales, help to enhance our relationships with customers and differentiate us from competitors. As networks grow and integrate voice, data, wired, wireless, Internet and video services, they become more complex. We can help enterprises and service providers reduce the complexity.

Supported by the technical expertise of Bell Labs, we're well prepared to provide help in designing, building, operating and optimizing networks. As a result, customers turn to us more and more frequently for assistance. Of our 34,000 business customers with DEFINITY systems, for example, 90% have purchased service contracts.

In 1997 we created NetCare® Services, a new business that brings together about 1,100 engineers, technicians and consultants to help business customers design, integrate, maintain and manage their networks. Demand for the type of network-oriented services provided by NetCare Services is expected to grow about 18% annually, becoming a $40 billion industry by 2000. We also created a Network Reliability Center in Aurora, Colo., where state-of-the-art tools allow our service provider customers, like WinStar Communications, Inc., and in some cases their customers, to detect and correct problems.

LEFT: *Customer networks across the U.S. are monitored by surveillance technicians Bill Pfeifer (left) and Eric Eggers at Lucent's Network Reliability Center in Colorado.*

OPPOSITE PAGE: *A microelectronic chip set from Lucent combines a car stereo with hands-free cell phone use in Radiophones made by Germany's Blaupunkt-Werke GmbH.*

PROCESS INNOVATOR

MARY MANDICH

"You can't be afraid to think big. And you have to get others, who will be responsible for turning your idea into reality, into the process early. Our colleagues, especially those who will be responsible for manufacturing the products that result from an idea, have a profound impact on how we set goals. Innovation is really a team sport."

Dr. Mary Mandich is a technical manager in the Process Chemistry and Control Technology Research Group at Bell Labs in Murray Hill, N.J. Her research focuses on growing ultrathin films and related processes that are used in fiber-optic technologies.

RESEARCH AND DEVELOPMENT

Bell Labs, home to some of the century's most important inventions — including the transistor, which sparked the computer age 50 years ago — is constantly searching for innovative ways to speed its research developments to market. As a new century approaches, Bell Labs' scientists and engineers are reaching higher to develop the breakthrough technologies that will usher in this new era.

We're investing about 11% of revenues — $3 billion in fiscal 1997 — to create tomorrow's communications technologies. And this increased investment in Bell Labs is paying off. Ideas are being converted into patents at an accelerating pace, averaging more than three a business day, and every employee awarded a patent is recognized and rewarded. Senior managers routinely meet with scientists and engineers to view their work firsthand and share information. We're doing all we can to foster innovation throughout our organization.

Recognition of Bell Labs' accomplishments has increased, and morale is high. R&D magazine named Lucent its R&D Corporation of the Year for 1997, and Red Herring, an influential magazine of high technology, selected Lucent as the No. 1 company with "long-term potential" due to its "vast treasury of assets."

OPTICAL NETWORKS: LIGHTING THE WAY

Network service providers are facing a problem — how to find enough transport capacity to carry the increasing traffic generated by PC-to-PC communications, faxes, video teleconferences and, of course, voice calls. A solution has been found in a new form of optical transmission, called Dense Wavelength Division Multiplexing (DWDM), which is lighting the way to a host of new multimedia services.

Optical networks rely on fiber-optic transmission systems: Information is encoded into the ones and zeros of digital data and transmitted through the networks as light pulses passing through hair-thin strands of glass.

With voice calls increasing at about 10% a year and data "calls" growing at 50%-80% a year, only optical networks can supply the massive increase in carrying capacity — called bandwidth — that network operators require. And multimedia services place even greater demands on bandwidth. Transmitting high-quality video images, for example, requires about a hundred times more bandwidth than a phone call needs.

Lucent's DWDM transmission technology is helping to solve this capacity dilemma for service providers around the world, including AT&T, British Telecommunications plc, China's MPT, Dacom of Korea, TCG and a number of others.

DWDM increases capacity by projecting multiple light beams of different wavelengths, or colors, onto a single glass fiber, which combines the different colors into a single "white" beam. At the end location, the DWDM system acts like a prism, separating the "white" light of the fiber into a rainbow of colors, each carrying its own channel of voice, data and video information.

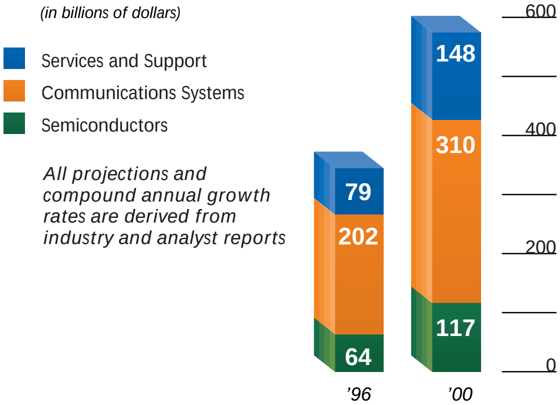
__ABOVE:__ Dena Hall, a fiber-optic lathe production specialist, monitors the progress of a glass preform being made at Lucent's Atlanta Works manufacturing facility.

__RIGHT:__ Liang Na (left) and Li Ping Teng conduct fiber-optic quality control inspections at Lucent facilities in Beijing, China.

__OPPOSITE PAGE:__ Lab manager Richard Williford tests a customer's DEFINITY Enterprise Communications Server at Business Communications Systems' test labs in Denver. Customers increasingly turn to Lucent to manage their voice, data and video networks.

MARKET FOR COMMUNICATIONS SYSTEMS AND TECHNOLOGIES

(in billions of dollars)



Today's commercial DWDM systems, such as those offered by Lucent, make 16 different wavelengths from a single light beam. They boost the standard 2.5 billion bits of information now transmitted over a single fiber 16 times — to 40 billion bits a second — providing enough capacity to transmit the equivalent of 10,000 novels in one second.

And we've shown that capacity can be increased much more. Bell Labs researchers this year demonstrated 206 channels over a single fiber. In coming years, a single optical fiber will be able to carry trillions of bits of information each second.

Building on more than 1,600 patents in optical networking, Bell Labs is also developing a host of other optical components and systems that will vastly increase the speed and capacity of fiber-optic networks.

Examples of key optical networking systems developed at Bell Labs include:

All-Optical Cross-Connect

An industry first, this system allows network service providers to move wavelengths of light from point to point in their networks without making unneeded and costly electronic conversions along the way. It also reduces operating costs, increases system reliability and ensures faster recovery from service interruptions when they do occur.

The Optical Line System

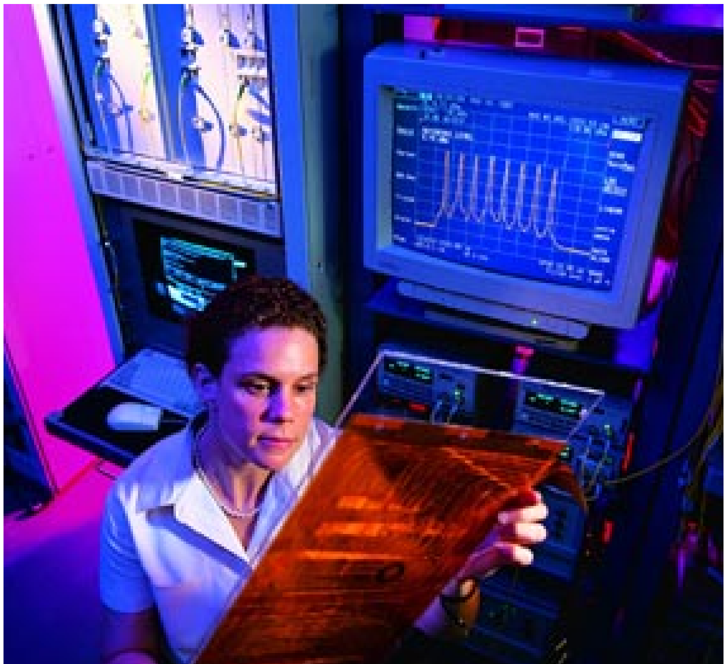
Based on DWDM technology, this transport system enables up to 16 channels of traffic to be directed through the network without being converted from an optical to electronic form — a benefit comparable to flying nonstop instead of making multiple hops by connecting flights. We have the largest deployment of optical line systems worldwide. In addition, our latest Metro feature allows service providers to add capacity cost effectively in fiber-constrained metropolitan areas.

Optical Amplifiers

In July, we demonstrated an experimental optical-fiber amplifier with the ability to boost lightwave signals carried simultaneously over 100 or more channels, or wavelengths, of light. This record-breaking feat demonstrated the potential for creating optical networks that deliver unprecedented network capacity.

Optical-Fiber Lasers

Lasers provide the bursts of light that carry information in fiber-optic networks. Bell Labs, which invented the communications laser, continues to lead in the development of high-powered optical-fiber lasers. Brighter laser light travels longer distances without amplification and may have other uses, such as in long-distance satellite-to-satellite communications.



RIGHT: *Systems Engineer Ginny Nichols helps develop the world's most advanced optical networking equipment at Bell Labs' facilities in Holmdel, N.J.*

OPPOSITE PAGE: *The Inferno network operating system was one of Lucent's first internal ventures. Arma Tareen (left) helped launch the software written by Rob Pike (center) and Phil Winterbottom.*

NEW VENTURES

SPEED R&D TO MARKET

INNOVATIVE INCENTIVES

New ventures — the creation of small enterprises owned in whole or in part by Lucent — are an innovative way to bring research results rapidly to market. They provide additional incentives by giving some of the key R&D people behind a technical breakthrough a significant management role and financial stake in efforts to commercialize the technology. Examples include:

elemedia

Based on Bell Labs' technology, elemedia is a wholly owned Lucent venture that provides software to enable high-quality voice, music and video communications on the Internet. It moved from the lab to the marketplace in less than nine months. Lucent's Internet Telephony Server SP uses elemedia software. External customers include Netscape and Dialogic.

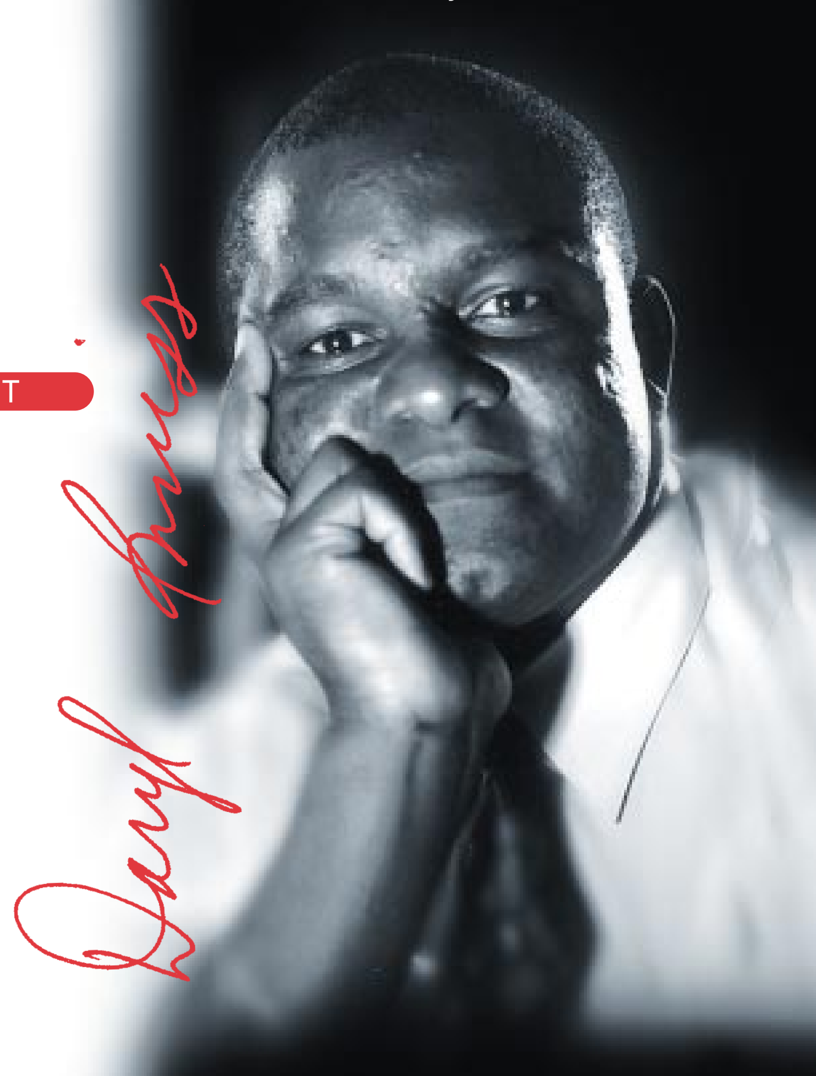
Inferno

A new way to use all kinds of networks to deliver information, Inferno is a network operating system that provides a kind of information

FIBER-OPTIC INNOVATOR

DARYL INNISS

"Part of the power of Bell Labs comes from the fact that you can walk down the hall and find an expert in almost any field. This brings power and strength to your own work. There's a fertilization of ideas that takes place, and we have the ability to drive these ideas into real systems."

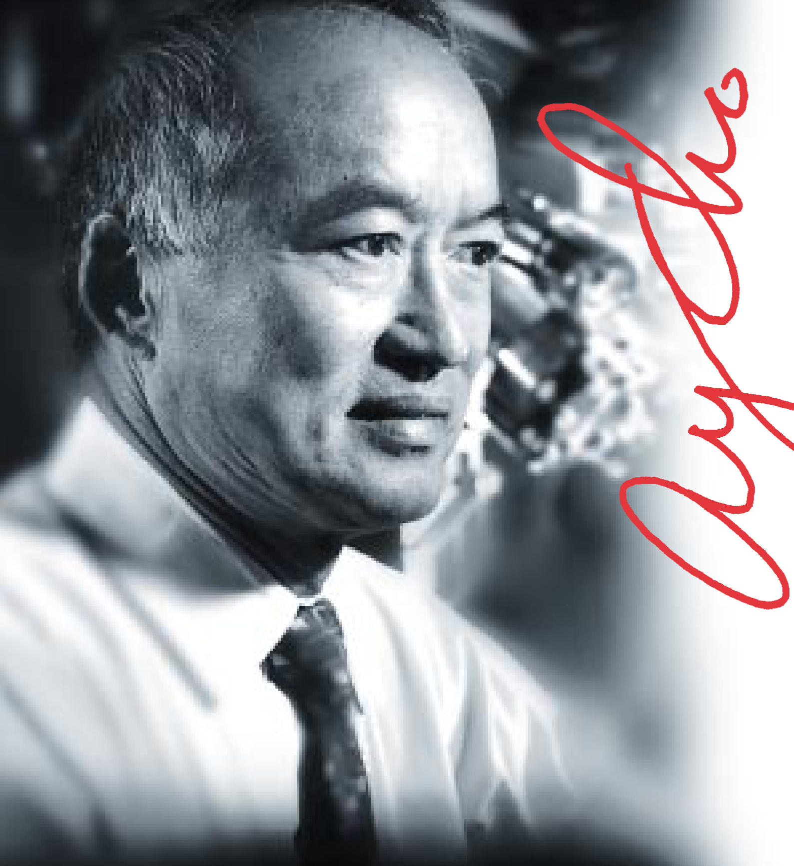


Dr. Daryl Inniss is a member of the technical staff in the Fiber-Optic Research Department in Murray Hill, N.J. Since joining Bell Labs in 1988, he has published more than 25 technical papers and has been awarded nine patents. He is currently studying high-power fiber lasers and amplifiers.

TECHNOLOGICAL INNOVATOR

AL CHO

"We don't have a blank check to do just anything. We must ask ourselves, 'If our work is successful, does anybody care? What will it do for Lucent?' Bell Labs is a unique environment. Technology drives the business today. New technology will drive it tomorrow. Without research, we lose the technology edge for tomorrow."



Born in China, Dr. Alfred Y. Cho joined Bell Labs in 1968 and has been director of semiconductor research since 1990. His pioneering work on molecular beam epitaxy, leading to faster and more efficient semiconductor devices, has had a significant impact on both science and industry. He has received worldwide recognition for this work, including the National Medal of Science in 1993, the IEEE Medal of Honor in 1994, and the C & C (Computer and Communications) Prize in Japan in 1995.

"dial tone" for accessing services. It was selected by Wired magazine as one of the top 10 "wired" technologies in 1997. Inferno is another wholly owned Lucent venture, launched from the lab to the marketplace in eight months. Licensees include Digital Equipment, Epson and many others.

Veridicom, Inc.

A joint venture with U.S. Venture Partners, Veridicom uses Bell Labs' patented fingerprint authentication technology in a host of personal security applications. Created within six months of initial discussions with a venture capital firm, Veridicom is built on made-to-order Bell Labs advances in chip design, software and materials science. Eventually, the company's fingerprint imaging and verification devices could augment or replace personal identification numbers now used in banking and other transactions in which personal security is critical.

GLOBAL GROWTH

With about 20% of our employees located outside the U.S., we're continuing to expand our products and expertise around the world. More than 30 factories supply a variety of products for customers in every time zone. Our projects range from installing PBXs in the frozen steppes of Russia to building wireless networks in the archipelagos of Indonesia in the South Pacific.

We're targeting markets and customers where we have the best chance for long-term growth. In Japan, for example, where NTT manages the world's largest public network, we were the only North American company invited to join a consortium, called DoCoMo, selected to develop a new wireless standard — wideband CDMA.

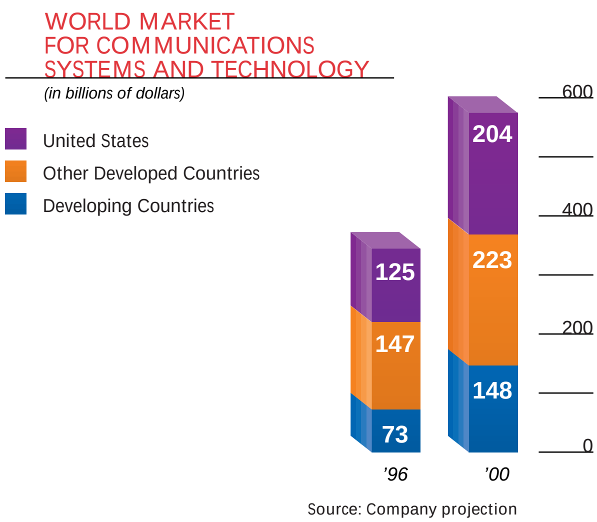
Bell Labs operates facilities in 17 locations outside the United States and collaborates with Lucent business units throughout the world. At Centers of Excellence around the world, Bell Labs engineers and scientists work closely with

WIRELESS CENTER OF EXCELLENCE

customers, solving complex technical problems in ever-changing global markets. They're providing solutions from Budapest in Eastern Europe to Bahrain in the Middle East, from England to Australia, and from Centers in Hong Kong, Moscow, Singapore, Tokyo and Toronto.

Through Bell Labs' global operations, Lucent is reaching higher to bring innovation and excellence to advanced communications systems throughout the world.

ABOVE: *Steve Walker prepares to test the performance of a digital cordless handset in a specially designed acoustic chamber at Bell Labs' Wireless Center of Excellence in Winchester, England.*



BELL LABS

SYSTEMS FOR NETWORK OPERATORS

PROFILE

Bell Labs: Provides breakthrough research and development support to Lucent Technologies' business units. Comprises some 24,000 employees in the U.S. and in 17 other countries. The annual R&D budget is now $3 billion.

Systems for Network Operators: Designs, manufactures and supports networking systems and software for communications service providers and wireless operators. Largest unit of Lucent, with 59% of total revenues, 67,000 employees in 52 countries, manufacturing sites in 17 countries and 20 joint ventures in nine countries.

FOCUS

Bell Labs: On developing technologies that are critical to Lucent's success and on bringing them to market quickly. On applied and longer-term research vital to the company's future. On Centers of Excellence supporting the businesses. On the integration of technology and standards throughout Lucent.

Systems for Network Operators: On building and supporting networks based on the 5ESS-2000 switch and AnyMedia Platform, which deliver wireline, wireless, data and video. On data networking. On wireless networking. On communications software. On switching and access systems. On broadband networking products. On optical networking solutions.

CUSTOMERS

Bell Labs: As the corporation's creative hub, Bell Labs brings innovations to all of Lucent's businesses for their customers.

Systems for Network Operators: Global service providers, leading public network providers, private communications network operators, competitive local exchange carriers and interexchange carriers, and independent telephone companies.

OUTLOOK

Bell Labs: Focusing on advancing high-potential technologies such as digital signal processing, photonics, networking, semiconductors, software and wireless communications.

Systems for Network Operators: Serves a $146 billion industry that is growing about 11% annually. Key segments are growing about 20% per year (wireless), 13% per year (software) and 26% per year (data networking). In addition, growth in emerging non-traditional global segments is expected to exceed 15% a year, as it has for the past five years.

COMPETITIVE EDGE

Bell Labs: One of the world's leading R&D entities, Bell Labs averages three patents each business day. The fact that most of Bell Labs is integrated with Lucent's businesses makes it possible to deliver innovations to customers in the marketplace in record time.

Systems for Network Operators: No. 1 U.S. leader in switching systems, transmission systems, wireless networks and networking software. Network Systems' wireline installed base of approximately 110 million lines represents roughly 58% of the U.S. and 13% of the total worldwide installed base.

MICROELECTRONICS GROUP

Designs, develops and manufactures integrated circuits, power systems and optoelectronic components for use in the communications and computing industries. A $2.7 billion enterprise with 17,000 employees in more than 40 locations around the globe. More than 50% of revenues come from outside the United States.

On offering integrated solutions through a unique ability to combine components, software, algorithms and applications knowledge. On providing components and systems for fast-growing applications, including network communications, wireless, personal computers/multimedia and consumer communications.

World's leading manufacturers of communications and computer systems and products.

Markets include the fastest growing segments in microelectronics: communications and computing. Global sales of integrated circuits for communications and computing, optoelectronic components for telecommunications, data networking and cable TV were $49 billion in 1996 and are projected to grow to $91 billion in 2000.

A world leader in standard-cell ASICs (application specific integrated circuits), transmission ICs, board-mounted power for telecommunications and data, and optoelectronic components for telecommunications. The group's products can be found in cellular phones and base stations, personal computers, local area networks, modems, TV set-top boxes, telephones and digital answering machines.

BUSINESS COMMUNICATIONS SYSTEMS

Designs, manufactures, sells and services advanced voice, data and multimedia communications solutions for businesses worldwide and the U.S. government. Consists of 29,000 employees serving more than 1.5 million business locations globally, with five research and development facilities and four manufacturing locations.

On solutions for customers' sales and service operations, conferencing and collaboration, mobility and distributed workforce, messaging and intelligent networking. Offerings include private branch exchanges (PBXs), key systems, call centers, structured cabling solutions, data networking, voice processing and Octel Messaging solutions, wireless systems, multimedia and Internet capabilities.

Range from small businesses requiring basic telephone systems to Fortune 500 companies requiring total multimedia communications solutions.

The call center industry, with $3 billion-plus in sales today, is experiencing 30% annual growth. The global business wireless segment, just under $1 billion, is expected to double by the year 2000. Data networking among enterprises is expected to grow from $30 billion to $42 billion by 2000.

U.S. leader in business communications, voice processing and business wireless. U.S. and European leader in call center systems. Global leader in structured cabling systems and voice messaging products and services. Front-runner in many aspects of multimedia communications.

BOARD OF DIRECTORS

SEATED (LEFT TO RIGHT)
Henry B. Schacht
Chairman

Richard A. McGinn
Chief Executive Officer and President

SECOND ROW (LEFT TO RIGHT)
Paul A. Allaire
Chairman and Chief Executive Officer of Xerox Corporation

Carla A. Hills
Chairman and Chief Executive Officer of international consulting firm Hills & Company and former U.S. Trade Representative

Drew Lewis
Retired Chairman and Chief Executive Officer of Union Pacific Corporation

BACK ROW (LEFT TO RIGHT)
John A. Young
Vice Chairman of Novell, Inc., and retired President and Chief Executive Officer of the Hewlett-Packard Company

Paul H. O'Neill
Chairman and Chief Executive Officer of Aluminum Company of America (Alcoa)

Donald S. Perkins
Retired Chairman of the Jewel Companies, Inc.

Franklin A. Thomas
Consultant to the TFF Study Group and retired President of The Ford Foundation

CONTENTS

HIGHLIGHTS

Lucent Technologies Inc. ("Lucent" or the "Company") is one of the world's leading designers, developers and manufacturers of communications systems, software and products. These integrated systems and software applications enable network operators and business enterprises to connect, route, manage and store information between and within locations. Lucent is a global market leader in the sale of public communications systems, and is a supplier of systems and software to the world's largest networks. Lucent is also a global leader in the sale of business communications systems and microelectronic components for communications systems and computer manufacturers. Lucent was formed from the systems and technology units that were formerly part of AT&T Corp. ("AT&T"), including the research and development capabilities of Bell Laboratories.

In 1996, Lucent changed its fiscal year to begin October 1st and end September 30th. Due to this change, Lucent reported 1996 audited financial results for a short fiscal period beginning on January 1, 1996 and ending on September 30, 1996. For comparability to the audited financial statements, Lucent has provided unaudited statements of income and cash flows for the twelve months ended September 30, 1996 and for the nine months ended September 30, 1995.

For the fiscal year ended September 30, 1997, Lucent reported net income of $541 million or $0.84 per share compared with a net loss of $793 million or $1.37 per share for the twelve months ended September 30, 1996. During fiscal 1997, Lucent recognized one-time charges related to its acquisition of Octel Communications Corporation ("Octel"), including $945 million for purchased in-process research and development costs. For the twelve months ended September 30, 1996, Lucent recorded $2,801 million of business restructuring and other charges. Excluding these charges from both periods, net income was $1,507 million or $2.34 per share in fiscal 1997 compared with $1,054 million or $1.65 per share (computed on a pro forma basis) for the twelve months ended September 30, 1996. The pro forma presentation assumes that all 636,661,931 common shares outstanding following the completion of Lucent's Initial Public Offering ("IPO") on April 10, 1996 were outstanding since January 1, 1995, and gives no effect to the use of proceeds from the IPO.

STRATEGIC TRANSACTIONS

Since October 1, 1996, Lucent has completed a number of strategic transactions intended to improve the Company's focus on its core businesses. In October 1996, Lucent acquired Agile Networks, Inc. ("Agile"), a provider of advanced intelligent data switching products that support Ethernet as well as emerging asynchronous transfer mode ("ATM") technology. These products enable business customers to manage multimedia networks more effectively. In September 1997, Lucent acquired Octel, a provider of voice, fax and electronic messaging technologies that complement those offered by Lucent. In October 1997, Lucent agreed to acquire Livingston Enterprises, Inc., a global provider of equipment used by Internet service providers to connect their subscribers to the Internet. Such investments provide Lucent additional ways to invest in research and development of leading edge technologies.

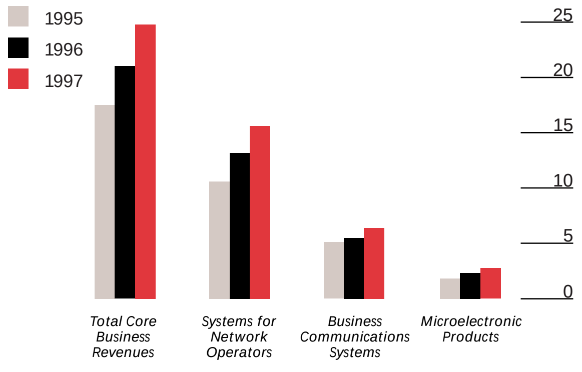
On October 1, 1997, Lucent contributed its Consumer Products business to a new venture formed by Lucent and Philips Electronics N.V. ("Philips"). The venture, which is 40% owned by Lucent, is a worldwide provider of a complete range of personal communications products, including digital and analog wireless phones, corded and cordless phones, answering machines, screen phones and pagers.

During fiscal 1996, Lucent completed the sale of its Paradyne subsidiary. In addition, Lucent completed the sale of its interconnect products and Custom Manufacturing Services businesses in December 1996, and its Advanced Technology Systems ("ATS") unit in October 1997.

The following chart provides Lucent's revenues trend from its three core businesses and excludes revenues from its Consumer Products unit and from Other Systems and Products:

THREE CORE BUSINESSES ANNUAL REVENUES

(in billions of dollars)
For the twelve months ended September 30



Revenues for 1997 from Lucent's three core businesses: Systems for Network Operators, Business Communications Systems and Microelectronic Products, increased 17.9% compared with 1996.

LUCENT'S FORMATION

Prior to February 1, 1996, AT&T conducted Lucent's business through various divisions and subsidiaries. On February 1, 1996, AT&T began executing its decision to separate Lucent into a stand-alone company (the

"Separation") by transferring to Lucent the assets and liabilities related to its business. Additionally, AT&T retained $2,000 million of accounts receivable. In April 1996, Lucent completed the IPO and on September 30, 1996, became independent of AT&T when AT&T distributed to its shareowners all of its Lucent shares.

Lucent's consolidated financial statements for periods prior to February 1, 1996 reflect the financial position, results of operations and cash flows of the operations transferred to Lucent from AT&T in the Separation and were carved out from the financial statements of AT&T using the historical results of operations and historical basis of the assets and liabilities of the business. Additionally, Lucent's 1995 consolidated financial statements include certain assets, liabilities, revenues and expenses which were not historically recorded at the level of, but are primarily associated with, the business. Management believes the assumptions underlying these financial statements are reasonable, although these financial statements may not necessarily reflect the results of operations or financial position had Lucent been a separate, stand-alone entity.

KEY BUSINESS CHALLENGES

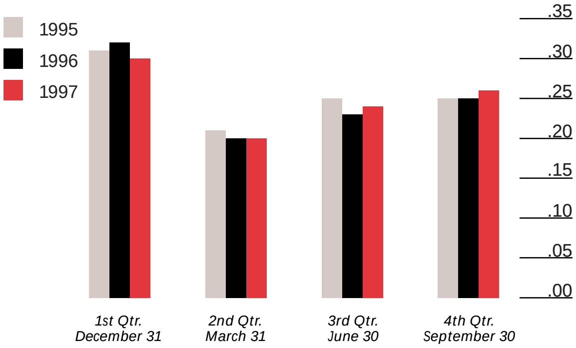
Lucent continues to face significant competition and expects that the level of competition on pricing and product offerings will intensify. Lucent expects that new competitors will enter its markets as a result of both the trend toward global expansion by foreign and domestic competitors as well as continued changes in technology and public policy. These competitors may include entrants from the telecommunications, software, data networking and semiconductor industries. Existing competitors have, and new competitors may have, strong financial capability, technological expertise and well-recognized brand names. As a result, Lucent's management periodically assesses market conditions and redirects the Company's resources to meet the challenges of competition. Steps Lucent may take include acquiring and investing in new businesses, partnering with existing businesses, delivering new technologies, closing and consolidating facilities, disposing of assets, reducing workforce levels or withdrawing from markets.

Lucent's sales continue to be highly seasonal. Many of Lucent's large customers have historically delayed a disproportionate percentage of their capital expenditures until the fourth quarter of the calendar year. Consequently, Lucent's results of operations for the first three quarters of each calendar year historically have, in the aggregate, been significantly less profitable than the fourth calendar quarter. However, Lucent has taken steps to manage the seasonality by changing its year-end and its compensation programs for employees.

The purchasing behavior of Lucent's large customers

QUARTERLY REVENUES

(As a percentage of annual revenues)
New fiscal year basis



Lucent is taking steps to manage seasonality and moderate wide fluctuations in revenues from quarter to quarter.

has increasingly been characterized by the use of fewer, but larger contracts, which contributes to the variability of Lucent's results. These contracts typically involve longer negotiating cycles, require the dedication of substantial amounts of working capital and other resources, and in general require costs which may substantially precede recognition of associated revenues. Moreover, in return for larger, longer-term purchase commitments, customers often demand more stringent acceptance criteria which can also cause revenue recognition delays. Lucent has increasingly provided or arranged long-term financing for customers as a condition to obtain or bid on infrastructure projects. Certain multi-year contracts involve new technologies which may not have been previously deployed on a large-scale commercial basis. Related to these contracts, Lucent may incur significant initial cost overruns and losses which would be recognized in the quarter in which they became ascertainable. Further, profit estimates on such contracts are revised periodically over the lives of the contracts, and such revisions can have a significant impact on reported earnings in any one quarter.

To manage the fluctuation caused by the buying behaviors of large customers, Lucent continues to seek out new types of customers both in the United States and internationally, such as competitive access providers, cable television network operators and computer manufacturers.

Historically, Lucent has relied on a limited number of customers for a substantial portion of its total revenues, including AT&T which continues to be a significant customer. Lucent is seeking to diversify its customer base; nevertheless, 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 the Company's operating results.

FIVE YEAR SUMMARY

(dollars in millions, except per share amounts)
(unaudited)

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,		Year Ended December 31, (Twelve Months)		
	1997	1996[1]	1996[5]	1995	1995[1]	1994	1993
RESULTS OF OPERATIONS							
Revenues	$26,360	$23,286	$15,859	$13,986	$21,413	$19,765	$17,734
Gross margin	11,462	8,894	6,569	6,143	8,468	8,428	7,646
Operating income (loss)	1,631	(947)	487	434	(1,000)	971	669
Income (loss) before cumulative effects of accounting changes	541	(793)	224	150	(867)	482	430
Cumulative effects of accounting changes	–	–	–	–	–	–	(4,208)
Net income (loss)	541	(793)	224	150	(867)	482	(3,778)
Earnings (loss) per common share – Historical[2]	0.84	(1.37)	0.38	0.28	(1.65)	n/a	n/a
Earnings (loss) per common share – Pro Forma[3]	n/a	(1.25)	0.35	0.24	(1.36)	n/a	n/a
Dividends per common share	0.225	0.15	0.15	–	–	n/a	n/a
FINANCIAL POSITION							
Total assets	$23,811	$22,626	$22,626	$18,219	$19,722	$17,340	$17,109
Working capital	1,763	2,068	2,068	188	(384)	246	1,773
Total debt	4,203	3,997	3,997	4,192	4,014	3,164	3,195
Shareowners' equity	3,387	2,686	2,686	2,783	1,434	2,476	2,580
OTHER INFORMATION							
Selling, general and administrative expenses as a percentage of revenues	21.9%	31.3%	26.8%	28.9%	33.1%	27.1%	28.3%
Research and development expenses as a percentage of revenues	11.5[4]	11.0	11.6	12.0	11.1	10.6	11.1
Gross margin percentage	43.5	38.2	41.4	43.9	39.5	42.6	43.1

(1) Includes pretax restructuring and other charges of $2,801 ($1,847 after taxes) recorded as $892 of costs, $1,645 of selling, general and administrative expenses and $264 of research and development expenses.

(2) The calculation of earnings per share on a historical basis includes the retroactive recognition to January 1, 1995 of the 524,624,894 shares owned by AT&T on April 10, 1996.

(3) The calculation of earnings per share on a pro forma basis assumes that all 636,661,931 common shares outstanding on April 10, 1996 were outstanding since January 1, 1995 and gives no effect to the use of proceeds from the IPO.

(4) Excludes one-time charges of $1,024 million of purchased in-process research and development costs from acquisitions of Octel and Agile. Including these charges, research and development expenses as a percentage of revenues were 15.4% for 1997.

(5) Beginning September 30, 1996, Lucent changed its fiscal year-end from December 31 to September 30, and reported results for the nine-month transition period ended September 30, 1996.

TWELVE MONTHS ENDED SEPTEMBER 30, 1997 VERSUS TWELVE MONTHS ENDED SEPTEMBER 30, 1996

REVENUES

Total revenues increased $3,074 million or 13.2% for 1997 compared with 1996, primarily due to gains in sales from Systems for Network Operators, Business Communications Systems and Microelectronic Products. The overall revenue growth was partially offset by the expected decline in revenue from Consumer Products and Other Systems and Products. Revenues for Lucent's three core businesses increased 17.9% for 1997 compared with 1996. Revenue growth continued to be generated from sales both in the United States and internationally (including exports). International revenues increased 11.9% compared with 1996 and represented 24.1% of total revenues in 1997. The increased international sales reflect Lucent's targeted approach toward international revenue expansion for increased profitability. The following table presents Lucent's revenues by product line, and the related percentage of total revenues for the twelve months ended September 30, 1997 and 1996:

	Twelve Months Ended September 30,			
	1997		1996	
(dollars in millions)	$	%	$	%
Systems for Network Operators	$15,614	59%	$13,192	57%
Business Communications Systems	6,411	24	5,509	24
Microelectronic Products	2,755	11	2,315	10
Consumer Products	1,013	4	1,431	6
Other Systems and Products	567	2	839	3
Total	$26,360	100%	$23,286	100%

Revenues from SYSTEMS FOR NETWORK OPERATORS increased $2,422 million or 18.4% compared with 1996. The increase resulted from higher sales of both switching and wireless systems with associated software, fiber-optic cable and professional services. Demand for second lines in businesses and residences for Internet services and data connectivity contributed to the revenue growth for 1997.

Software sales increased $414 million or 21.7% compared with the same period in 1996. The increase was primarily driven by strong demand for associated software for Lucent's new Access Interface Unit ("AIU") as well as software sales to support number portability. The AIU is used in the 5ESS switch and helps speed voice and Internet traffic.

Sales from Systems for Network Operators in the United States increased 22.2%. The revenue increase in the United States was led by sales to traditional service providers and non-traditional customers such as personal communications services ("PCS") wireless providers, competitive access providers and cable television companies. International revenues increased 8.2% compared with 1996, resulting from increased sales in the Europe/Middle East/Africa, Asia/Pacific and Caribbean/Latin America regions. International revenues represented 25.1% of Systems for Network Operators revenues for 1997.

For 1997, sales of wireless infrastructure increased significantly compared with the same period in 1996 primarily due to PCS contracts as customers accepted networks for commercial service in 1997 using various digital technologies. These technologies include Code Division Multiple Access ("CDMA"), Global System for Mobile Communications ("GSM") and Time Division Multiple Access ("TDMA"). The Lucent digital technologies continue to show acceptance in both the international and domestic markets.

Revenues from BUSINESS COMMUNICATIONS SYSTEMS increased $902 million or 16.4% compared with the same period in 1996. This increase was led by sales of DEFINITY® products, SYSTIMAX® structured cabling, messaging systems, integrated offers such as call centers and higher revenues from service contracts. This increase was partially offset by the continued erosion of the rental base. Revenues in the United States increased 17.0% compared with 1996. International revenues increased by 13.2%, reflecting growth in all international regions. The increase in the United States and internationally was primarily due to sales of DEFINITY® products, call centers and messaging systems. In addition, higher sales of SYSTIMAX® structured cabling contributed to the revenue growth in the United States. International revenues represented 15.8% of revenue for 1997.

During fiscal 1997, Lucent acquired Octel and Agile. Combined with Octel, Lucent offers a wide array of messaging products and services to reach most customer segments: wireless customers, central-office-based customers and business customers of any size, while Agile contributes technology that supports a closer integration of applications that combine voice and data. Through these acquisitions, Lucent has added new in-process and existing technologies to its voice and data networking capabilities. Utilizing these acquired in-process technologies, the development of the next generation of products will involve certain risks due to the complexity and uncertainty inherent in research and development efforts.

Sales of MICROELECTRONIC PRODUCTS increased $440 million or 19.0% compared with 1996, due to

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higher sales of customized chips for computing and communications, including components for local area networks, data networking, high-end computer workstations and wireless telephones. Higher sales of power systems and optoelectronic components also contributed to the increase for 1997. Domestic revenues increased 12.5% compared with 1996, led by sales to original equipment manufacturers ("OEMs"). The growth in international revenues of 25.9% was driven by application specific integrated circuits ("ASICs") sales in the Asia/Pacific region as well as the growth of wireless and multimedia integrated circuits and power products sold to customers in Europe for cellular applications. International revenues represented 51.3% of the Microelectronic Products sales for 1997. Microelectronic Products continues to bring to market new technologies, such as the introduction of the K56flex™ modem technology.

Revenues from CONSUMER PRODUCTS decreased $418 million or 29.2% compared with 1996. The decline in revenues was primarily due to decreased product sales related to the closing of the Phone Center Stores, the discontinuation of unprofitable product lines and the continued decrease in phone rental revenues. Lucent's Consumer Products unit was contributed to the venture between Lucent and Philips on October 1, 1997.

Revenues from OTHER SYSTEMS AND PRODUCTS decreased $272 million or 32.4% compared with 1996. The decrease is largely due to the sale of Lucent's Custom Manufacturing Services business in fiscal year 1997 and its Paradyne subsidiary in fiscal year 1996. Revenues in this product line are expected to continue to decline, reflecting the sale of Lucent's ATS unit to General Dynamics Corporation on October 1, 1997. ATS designed and manufactured custom defense systems for the United States government.

GROSS MARGIN

Gross margin percentage increased to 43.5% from 38.2% in 1996 primarily due to the restructuring charges recorded in the quarter ended December 31, 1995. Excluding restructuring charges, gross margin for 1996 was 42.0%. The increase in gross margin percentage for 1997 was due to an overall favorable mix of higher margin product revenues and the benefits associated with the business productivity improvement initiatives.

OPERATING EXPENSES

Selling, general and administrative expenses decreased $1,506 million or 20.7% compared with 1996. Excluding the $1,645 million of restructuring charges recorded in December 1995, selling, general and administrative expenses increased $139 million compared with 1996. This increase was due to expenditures associated with higher sales levels, investment in growth initiatives, and the implementation of SAP, an integrated software platform. These increases were partially offset by the reversal of $174 million of business restructuring liabilities in 1997, the lower start-up costs incurred in 1997, and business productivity improvement initiatives, including lower expenses since some businesses were exited in fiscal 1997 and 1996. Selling, general and administrative expenses as a percentage of revenue declined 2.3 percentage points to 21.9% of revenue compared with 24.2% of revenues, excluding restructuring charges in 1996.

Research and development expenses increased $472 million or 18.5% compared with 1996. Excluding the impact of restructuring charges for the quarter ended December 31, 1995, research and development expenses increased by $736 million, primarily due to expenditures in support of wireless infrastructure, microelectronic products and advanced multimedia communications systems as well as a $127 million write-down of special-purpose Bell Labs assets no longer being used. Research and development expenses represented 11.5% of revenues as compared with 11.0% of revenues in 1996. Research and development expenses as a percentage of revenues increased 1.7 percentage points from 9.8%, excluding restructuring charges in 1996.

Purchased in-process research and development for 1997 reflects one-time write-offs totaling $1,024 million of in-process research and development in connection with the acquisitions of Octel (see Note 1) and Agile.

OTHER INCOME, INTEREST EXPENSE AND PROVISION FOR INCOME TAXES

Other income – net decreased $77 million compared with 1996. This decrease was largely due to gains recognized on the sale of certain investments and insurance recoveries in 1996, offset in part by increased interest income in 1997.

Interest expense increased $12 million compared with 1996 due primarily to replacing a portion of commercial paper with long-term debt in July 1996.

The effective tax rate of 63.1% for 1997 increased from the effective tax rate of 22.4% for the same period of 1996 due to the 1997 write-offs of in-process research and development costs and the tax impact of restructuring charges incurred in 1996. Excluding charges related to the acquisition of Agile and Octel, the effective tax rate for 1997 was 37.2%, a decrease of 3.6 percentage points from the 1996 effective tax rate of 40.8% before

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considering the effects of restructuring charges incurred in 1996. This decrease is primarily attributable to the tax impact of foreign earnings.

CASH FLOWS

Cash provided by operating activities was $1,946 million in 1997, an increase of $967 million compared with the same period in 1996. This increase in cash was largely due to the retention of $2,000 million of customer accounts receivable by AT&T in 1996 as well as the increase in sales associated with higher cash collections. This was offset by changes in accounts payable due to the end of payments to AT&T related to the Separation and the change in other operating assets and liabilities over 1996. The change in other operating assets and liabilities was primarily due to the receipt of a $500 million cash advance made to Lucent in April 1996 by AT&T and the utilization by AT&T of that advance in 1997.

Cash payments of $483 million were charged against the December 1995 business restructuring reserves in 1997. As of September 30, 1997, the workforce had been reduced by approximately 17,900 positions in connection with business restructuring. In addition, approximately 1,000 employees left Lucent's workforce 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.

Comparing 1997 and 1996, cash used in investing activities increased to $3,121 million from $1,638 million primarily due to the acquisition of Octel.

Capital expenditures were $1,635 million and $1,432 million for 1997 and 1996, respectively. Capital expenditures include expenditures for equipment and facilities used in manufacturing and research and development, including expansion of manufacturing capacity and international growth.

Cash provided by financing activities for 1997 was $295 million compared with $2,503 million in 1996. This decrease was primarily due to the proceeds received from the IPO in the year-ago period.

In 1995, Lucent relied on AT&T to provide financing for its operations. The cash flows from financing activities for the period ended September 30, 1996 reflect changes in the Company's assumed capital structure. These cash flows are not necessarily indicative of the cash flows that would have resulted if the Company had been a stand-alone entity.

NINE MONTHS ENDED SEPTEMBER 30, 1996 VERSUS NINE MONTHS ENDED SEPTEMBER 30, 1995

REVENUES

Total revenues increased $1,873 million or 13.4% for the nine-month period of 1996, compared with the same period of 1995, primarily due to gains in sales from Systems for Network Operators, Microelectronic Products and Business Communications Systems. The overall revenue growth was partially offset by the expected decline in revenues from Consumer Products due to the closing of the Phone Center Stores, discontinuance of unprofitable product lines and the decreased telephone rental revenues. Revenue growth continued to be generated from sales both in the United States and internationally (including exports). International revenues represented 23.1% of total revenues in 1996. The following table presents Lucent's revenues by product line, and the related percentage of total revenues for the nine months ended September 30, 1996 and 1995 (1995 has been restated to align intellectual property and other service revenues with Lucent's operating units):

	Nine Months Ended September 30,			
	1996		1995	
(dollars in millions)	$	%	$	%
Systems for Network Operators	$ 8,637	54%	$ 6,914	49%
Business Communications Systems	3,983	25	3,710	27
Microelectronic Products	1,756	11	1,420	10
Consumer Products	880	6	1,238	9
Other Systems and Products	603	4	704	5
Total	$15,859	100%	$13,986	100%

Revenues from SYSTEMS FOR NETWORK OPERATORS increased $1,723 million or 24.9% compared with the same period in 1995. The increase was driven by higher sales of switching, transmission, fiber-optic cable products and professional services. Demand for those products was driven by second-line subscriber growth and customer demand for continued network upgrades.

Software sales increased $117 million or 15.0% compared with the same period in 1995. For 1996, sales of wireless infrastructure increased $69 million or 6.4% compared with the same period in 1995.

Sales from Systems for Network Operators in the United States increased 23.4% and international revenues increased 29.6% compared with the same period in 1995. The revenue increase in the United States was led by sales to AT&T and the Regional Bell Operating Companies, partially offset by a revenue decrease resulting from Lucent's exit from the copper cable business in 1995. Increased sales of infrastructure systems and services drove the international revenue growth in the Asia/Pacific and Europe/Middle East/Africa regions. In addition, the international revenue increase included approximately $298 million in revenue from several manufacturing and other operations of certain subsidiaries of Philips Electronics N.V. acquired in 1996 ("Philips Acquisition"). International revenues represented 24.8% of revenues from Systems for Network Operators in the nine-month period of 1996.

In 1996, Lucent focused resources on marketing CDMA technology since this technology had shown acceptance in both the international and domestic markets. In addition, Lucent made progress in the buildout of CDMA infrastructure for PrimeCo Personal Communications LP in 1996. During the first calendar quarter of 1996, Lucent was awarded a contract from Sprint Spectrum Holdings LP ("Sprint PCS") to supply equipment and services for approximately 60% of Sprint PCS's market areas for its nationwide PCS wireless network over a five-year period.

Revenues from BUSINESS COMMUNICATIONS SYSTEMS increased $273 million or 7.4% compared with the same period in 1995. This increase was primarily due to higher sales in the United States and internationally, partially offset by the continued erosion of the rental base. The revenue growth in the United States was led by sales of DEFINITY® products, SYSTIMAX® structured cabling systems and INTUITY™ voice messaging products as well as higher revenue from call centers and maintenance contracts. International revenues increased by 24.7%, reflecting growth in all international regions.

Sales of MICROELECTRONIC PRODUCTS increased $336 million or 23.7% compared with the same period in 1995 due to higher sales of DSPs and ASICs to OEMs, both internationally and in the United States. Domestic revenues increased 14.7% compared with the same period in 1995, led by sales to OEMs. The growth in international revenues of 34.6% was driven by continued strength of DSPs and ASICs sales in the Asia/Pacific region. International revenues represented 49.0% of the Microelectronic Products sales for the nine-month period of 1996.

Revenues from CONSUMER PRODUCTS decreased $358 million or 28.9% compared with the same period in 1995. The expected decline in revenues was primarily due to the decrease in product sales resulting from the closing of the Phone Center Stores, the discontinuance of unprofitable product lines and the decrease in telephone rentals.

Revenues from OTHER SYSTEMS AND PRODUCTS decreased $101 million or 14.3% compared with the same period in 1995. These revenues included sales from the Paradyne subsidiary sold in July 1996 as well as the Custom Manufacturing Services business, which Lucent sold in December 1996.

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GROSS MARGIN

Gross margin percent declined to 41.4% from 43.9% in the year-ago period due to changes in the mix of revenues, erosion of high margin rental revenues and lower margins on products from the Philips Acquisition. The revenue mix reflected a high proportion of hardware sales and a high proportion of revenues from contracts accounted for on a percentage of completion basis.

OPERATING EXPENSES

Selling, general and administrative expenses increased $207 million or 5.1% compared with the same period in 1995. Included are approximately $160 million due to expenditures associated with start-up related costs such as advertising and creating a new information systems infrastructure, as well as the additional expenses resulting from the Philips Acquisition.

Selling, general and administrative expenses were 26.8% of revenues for the nine-month period of 1996 compared with 28.9% of revenues for the same period in 1995.

Research and development expenses increased $166 million or 9.9% compared with the same period in 1995. Research and development expenses represented 11.6% of revenues for the nine-month period of 1996 compared with 12.0% of revenues for the same period in 1995.

OTHER INCOME AND PROVISION FOR INCOME TAXES

Other income–net increased $54 million compared with the same period in 1995. The increase was primarily due to interest income on short-term investments.

The effective income tax rate of 39.0% for the nine-month period of 1996 decreased from 40.2% in the same period of 1995, primarily due to increased federal research tax credits.

CASH FLOWS

Cash used in operating activities was $4 million compared with $505 million in the same period in 1995.

The change was due to an increase in prepayments from customers. Additionally, inventory in 1996 remained relatively level versus the buildup reported in 1995. These activities were offset by AT&T's retention of $2,000 million of accounts receivable in 1996.

Cash payments of $456 million related to business restructuring were made during the nine months of 1996. The September 30, 1996 remaining balance will result in future cash payments over the next two years. Of the 22,000 employee separations announced as part of the 1995 business restructuring, approximately 11,400 people left the workforce as of September 30, 1996. In addition, approximately 1,000 employees left Lucent's workforce as part of the sale of Paradyne. Actual experience in employee separations, combined with redeployment of employees into other areas of the business, has resulted in lower separation costs than originally anticipated. Lucent anticipates that approximately 70% of the total expected employee separations will be complete by the end of December 1996.

Comparing the nine-month periods ended September 30, 1996 and 1995, cash used in investing activities increased to $1,066 million from $770 million. The increase in cash used in investing activities was largely the result of the Philips Acquisition and higher capital expenditures compared with the same period in 1995. Capital expenditures were $939 million and $784 million for the nine-month periods ended September 30, 1996 and 1995, respectively. These expenditures related to the expansion of manufacturing capacity of Microelectronic Products and the necessary expansion of various other facilities.

Cash provided by financing activities increased primarily due to the proceeds from the IPO in 1996 compared with the same period in 1995.

In 1995, Lucent relied on AT&T to provide financing for its operations. Cash flows from financing activities in 1995 principally reflect changes in Lucent's assumed capital structure. These cash flows are not necessarily indicative of the cash flows from financing activities that would have resulted if Lucent was a stand-alone entity.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Total assets as of September 30, 1997, increased $1,185 million or 5.2% from September 30, 1996, due to increases in contracts in process and other assets offset by decreases in cash and inventory. The increase in contracts in process reflects the buildout for large contracts while the increase in other assets reflects the goodwill associated with the acquisition of Octel. The decrease in cash was largely due to Lucent's cash payments in connection with the acquisition of Octel offset by increased cash collections from customers.

For the year ended September 30, 1997, Lucent's inventory turnover ratio was 4.0 times compared with 3.3 times for the twelve months ended September 30, 1996. The increase was primarily due to improved inventory management at the factories and in the distribution channels. Inventory turnover is defined as cost of sales (excluding costs related to long-term contracts) divided by average inventory during the year.

Accounts receivable were outstanding an average of 64 days for the period ended September 30, 1997 compared with 68 days for the same period in 1996. The decrease in days outstanding was due to a faster level of cash collections in 1997 compared with 1996.

Working capital, defined as current assets less current liabilities, decreased $305 million from September 30, 1996 largely due to the decrease in cash.

The fair value of Lucent's pension plan assets is greater than the projected pension obligations. Lucent records pension income when the expected return on plan assets plus amortization of the transition asset is greater than the interest cost on the projected benefit obligation plus service cost for the year. Consequently, Lucent continued to have a net pension credit that added to prepaid pension costs in 1997 and beyond.

Lucent expects that, from time to time, outstanding commercial paper balances may be replaced with short- or long-term borrowings as market conditions permit. At September 30, 1997, Lucent maintained approximately $5,200 million in credit facilities of which a portion is used to support Lucent's commercial paper program. At September 30, 1997, approximately $5,000 million of these credit facilities were unused. Future financings will be arranged to meet Lucent's requirements with the timing, amount and form of issue depending on prevailing market and general economic conditions. Lucent anticipates that borrowings under its bank credit facilities, the issuance of additional commercial paper, cash generated from operations and short- and long-term debt financings will be adequate to satisfy its future cash requirements, although there can be no assurance that this will be the case.

Network operators, domestically and internationally, increasingly have required their suppliers to arrange or provide long-term financing for them as a condition to obtaining or bidding on infrastructure projects. These projects may require financing in amounts ranging from modest sums to over a billion dollars. In this regard, Lucent entered into a credit agreement in October 1996 to provide Sprint PCS long-term financing of $1,800 million for purchasing equipment and services for its PCS network.

In May 1997, under the $1,800 million credit facility provided by Lucent to Sprint PCS, Lucent closed transactions to lay off $500 million of loans and undrawn commitments and $300 million of undrawn commitments to a group of institutional investors and Sprint Corporation (a partner in Sprint PCS), respectively. As of September 30, 1997, $146 million of these commitments were not yet drawn down by Sprint PCS.

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.

Lucent has also entered into agreements to extend credit of up to an aggregate of approximately $850 million to three other PCS operators for possible future sales. As of September 30, 1997, no amounts had been advanced under these agreements. On October 1, 1997, a commitment for $300 million included in the $850 million expired and was not extended. The agreement relating to about $200 million of credit is subject to fulfillment of certain conditions and completion of final contract documentation. Lucent is continuing to propose, and commit to provide, financing where appropriate for its business, in addition to the above arrangements. The ability of Lucent to arrange or provide financing for network operators will depend on a number of factors, including Lucent's capital structure and level of available credit.

Lucent believes that it will be able to access the capital markets on terms and in amounts that will be satisfactory, and that it will be able to obtain bid and performance bonds, to arrange or provide customer financing as necessary, and to engage in hedging transactions on commercially acceptable terms, although there can be no assurance that this will be the case.

The ratio of total debt to total capital (debt plus equity) was 55.4% at September 30, 1997 compared with 59.8% at September 30, 1996. Excluding the one-time charges related to the acquisition of Octel for the twelve months ended September 30, 1997, the return on assets was 6.5% compared with 5.3% for the twelve months ended September 30, 1996, excluding business restructuring and other charges.

RISK MANAGEMENT

Lucent is exposed to market risk from changes in foreign currency exchange rates and interest rates, which could impact its results of operations and financial condition. Lucent manages its exposure to these market risks through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. Derivative financial instruments are viewed as risk management tools and are not used for speculative or trading purposes. In addition, derivative financial instruments are entered into with a diversified group of major financial institutions in order to manage Lucent's exposure to nonperformance on such instruments.

Lucent uses foreign currency derivative instruments to reduce its exposure to the risk that the eventual net cash inflows and outflows resulting from the sale of products to foreign customers and purchases from foreign suppliers will be adversely affected by changes in exchange rates. The foreign currency exchange contracts are designated for firmly committed or forecasted purchases and sales. The use of these derivative financial instruments allows Lucent to reduce its overall exposure to exchange rate movements, since the gains and losses on these contracts substantially offset losses and gains on the assets, liabilities and transactions being hedged. As of September 30, 1997 and 1996, Lucent's primary foreign currency market exposures include Deutsche marks, Japanese yen and Dutch guilders. There have been no changes in how such exposures are managed since the nine-month period ended September 30, 1996. Management does not foresee or expect any significant changes in foreign currency exposure or in the strategies it employs to manage such exposures in the near future.

Foreign currency exchange contracts are sensitive to changes in foreign currency exchange rates. As of September 30, 1997, 10% appreciations from the prevailing market rates of Deutsche marks, Japanese yen and Dutch guilders would increase the related unrealized gain by $16 million. Conversely, 10% depreciations of these currencies from the prevailing market rates would decrease the related unrealized gain by $20 million. Unrealized gains/losses in foreign currency exchange contracts are defined as the difference between the hypothetical rates and the current market exchange rates. Consistent with the nature of the economic hedge of such foreign currency exchange contracts, such unrealized gains or losses would be offset by corresponding decreases or increases, respectively, of the underlying instrument or transaction being hedged.

While Lucent hedges actual and anticipated transactions with customers, the decline in value of the Asia/Pacific currencies may, if not reversed, adversely affect future product sales because Lucent products may become more expensive for customers to purchase in their local currency.

Lucent manages its ratio of fixed to floating rate debt with the objective of achieving a mix that management believes is appropriate. To manage this mix in a cost effective manner, Lucent, from time to time, enters into interest rate swap agreements, in which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts. Lucent had no material interest rate swap agreements in effect as of September 30, 1997 and 1996. The strategy employed by Lucent to manage its exposure to interest rate fluctuations is unchanged from that date. Management does not foresee or expect any significant changes in its exposure to interest rate fluctuations or in how such exposure is managed in the near future.

Various financial instruments held or issued by Lucent are sensitive to changes in interest rates. Interest rate changes would result in gains/losses in the market value of Lucent's term debt, commercial paper and investments due to differences between the market interest rates and rates at the inception of these financial instruments. Based on Lucent's term debt and commercial paper outstanding at September 30, 1997 and current market perception, a 100 basis point increase in the interest rates as of September 30, 1997 would result in a net reduction of the market value of these instruments of $80 million. Conversely, a 100 basis point decrease in the interest rates would result in an $86 million net increase in the market value of Lucent's term debt and commercial paper outstanding at September 30, 1997. Neither a 100 basis point increase nor decrease from current interest rates would have a material impact on the market value of Lucent's investments.

OTHER

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 about 40 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, among AT&T, Lucent and NCR Corporation ("NCR") dated as of February 1, 1996, and amended and restated as of March 29, 1996 ("Separation and Distribution Agreement"), Lucent is responsible for all liabilities primarily resulting from or related 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 the 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.

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 period of remediation for the applicable site which ranges 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 in respect to 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 and other expenditures that 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.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of financial condition and results of operations and other sections of this Annual Report contain forward-looking statements that are based on current expectations, estimates and projections about the industries in which Lucent operates, management's beliefs and assumptions made by management. In addition, other written or oral statements which constitute forward-looking statements may be made by or on behalf of the Company. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," or 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 ("Future Factors") which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Future Factors include increasing price and product/services competition by foreign and domestic competitors, including new entrants; rapid technological developments and changes and the Company's ability to continue to introduce competitive new products and services on a timely, cost effective basis; the mix of products/services; the achievement of lower costs and expenses; domestic and foreign governmental and public policy changes which may affect the level of new investments and purchases made by customers; changes in environmental and other domestic and foreign governmental regulations; protection and validity of patent and other intellectual property rights; reliance on large customers; technological, implementation and cost/financial risks in increasing use of large, multi-year contracts; the cyclical nature of the Company's business; the outcome of pending and future litigation and governmental proceedings and continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support the Company's future business. These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general domestic and international economic conditions including interest rate and currency exchange rate fluctuations and other Future Factors.

For a further description of Future Factors that could cause actual results to differ materially from such forward-looking statements, see below in this Annual Report and also see the discussion in the Company's Form 10-K for the year ended September 30, 1997 in Item 1 under the section entitled "OUTLOOK-Forward Looking Statements" and the remainder of the OUTLOOK section.

Competition:
See discussion above under KEY BUSINESS CHALLENGES.

Dependence on New Product Development:
The markets for the Company's principal products are characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and evolving methods of building and operating communications systems for network operators and business customers. The Company's operating results will depend to a significant extent on its ability to continue to introduce new systems, products, software and services successfully on a timely basis and to reduce costs of existing systems, software and services. The success of these and other new offerings is dependent on several factors, including proper identification of customer needs, cost, timely completion and introduction, differentiation from offerings of the Company's competitors and market acceptance. In addition, new technological innovations generally require a substantial investment before any assurance is available as to their commercial viability, including, in some cases, certification by international and domestic standards-setting bodies.

Reliance on Major Customers:
See discussion above under KEY BUSINESS CHALLENGES.

Readiness for Year 2000:
Lucent has taken actions to understand the nature and extent of the work required to make its systems, products and infrastructure Year 2000 compliant. Lucent began work several years ago to prepare its products and its financial, information and other computer-based systems for the Year 2000, including replacing and/or updating existing legacy systems. Lucent continues to evaluate the estimated costs associated with these efforts based on actual experience. While these efforts will involve additional costs, Lucent believes, based on available information, that it will be able to manage its total Year 2000 transition without any material adverse effect on its business operations, products or financial prospects.

Multi-Year Contracts:
See discussion above under FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES, AND KEY BUSINESS CHALLENGES.

Seasonality:
See discussion above under KEY BUSINESS CHALLENGES.

Future Capital Requirements:
See discussion above under FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES.

International Growth:
Lucent intends to continue to pursue growth opportunities in international markets. In many international markets, long-standing relationships between potential customers of the Company and their local providers, and protective regulations, including local content requirements and type approvals, create barriers to entry. In addition, pursuit of such international growth opportunities may require significant investments for an extended period before returns on such investments, if any, are realized. Such projects and investments could be adversely affected by reversals or delays in the opening of foreign markets to new competitors, exchange controls, currency fluctuations, investment policies, repatriation of cash, nationalization, social and political risks, taxation, and other factors, depending on the country in which such opportunity arises.

Foreign Exchange:
See discussion above under RISK MANAGEMENT.

REPORTS OF MANAGEMENT AND INDEPENDENT ACCOUNTANTS

REPORT OF MANAGEMENT

Management is responsible for the preparation of Lucent Technologies Inc.'s consolidated financial statements and all related information appearing in this Annual Report. The financial statements and notes have been prepared in conformity with generally accepted accounting principles and include certain amounts which are estimates based upon currently available information and management's judgment of current conditions and circumstances.

To provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that accounting records are reliable for preparing financial statements, management maintains a system of accounting and other controls, including an internal audit function. Even an effective internal control system, no matter how well designed, has inherent limitations—including the possibility of circumvention or overriding of controls—and therefore can provide only reasonable assurance with respect to financial statement presentation. The system of accounting and other controls is improved and modified in response to changes in business conditions and operations and recommendations made by the independent public accountants and the internal auditors.

The Audit and Finance Committee of the Board of Directors, which is composed of directors who are not employees, meets periodically with management, the internal auditors and the independent auditors to review the manner in which these groups of individuals are performing their responsibilities and to carry out the Audit and Finance Committee's oversight role with respect to auditing, internal controls and financial reporting matters. Periodically, both the internal auditors and the independent auditors meet privately with the Audit and Finance Committee and have access to its individual members.

Lucent engaged Coopers & Lybrand L.L.P., independent public accountants, to audit the consolidated financial statements in accordance with generally accepted auditing standards, which include consideration of the internal control structure. Their report appears on this page.

Rich McGinn

Richard A. McGinn
Chief Executive Officer
and President

Donald K Peterson

Donald K. Peterson
Executive Vice President,
Chief Financial Officer

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareowners of Lucent Technologies Inc.:

We have audited the consolidated balance sheets of Lucent Technologies Inc. and subsidiaries as of September 30, 1997 and 1996 and the related consolidated statements of income, changes in shareowners' equity, and cash flows for the year and nine-month period ended September 30, 1997 and 1996, respectively and the year ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lucent Technologies Inc. and subsidiaries as of September 30, 1997 and 1996, and the consolidated results of their operations, and their cash flows for the year and nine-month period ended September 30, 1997 and 1996, respectively and the year ended December 31, 1995, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.
1301 Avenue of the Americas
New York, New York
October 21, 1997

CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except per share amounts)

	Year Ended September 30, (Twelve Months)		Nine Months Ended September 30,		Year Ended December 31, (Twelve Months)
	1997	1996	1996	1995	1995
		Unaudited		*Unaudited*	
REVENUES	$26,360	$23,286	$15,859	$13,986	$21,413
Costs	14,898	14,392	9,290	7,843	12,945
GROSS MARGIN	11,462	8,894	6,569	6,143	8,468
Operating expenses					
Selling, general and administrative	5,784	7,290	4,244	4,037	7,083
Research and development	3,023	2,551	1,838	1,672	2,385
Purchased in-process research and development	1,024	–	–	–	–
Total operating expenses	9,831	9,841	6,082	5,709	9,468
Operating income (loss)	1,631	(947)	487	434	(1,000)
Other income–net	141	218	96	42	164
Interest expense	305	293	216	225	302
Income (loss) before income taxes	1,467	(1,022)	367	251	(1,138)
Provision (benefit) for income taxes	926	(229)	143	101	(271)
NET INCOME (LOSS)	$ 541	$ (793)	$ 224	$ 150	$ (867)
Weighted average common shares outstanding (millions)	644.1	578.1	595.9	524.6	524.6
EARNINGS (LOSS) PER COMMON SHARE	$ 0.84	$ (1.37)	$ 0.38	$ 0.28	$ (1.65)
Dividends per common share	$ 0.225	$ 0.15	$ 0.15	$ –	$ –

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

(dollars in millions, except per share amounts)

	September 30, 1997	September 30, 1996
ASSETS		
Cash and cash equivalents	$ 1,350	$ 2,241
Accounts receivable less allowances of $352 in 1997 and $273 in 1996	5,373	4,914
Inventories	2,926	3,288
Contracts in process (net of progress billings of $2,003 in 1997 and $708 in 1996)	1,046	505
Deferred income taxes–net	1,333	1,617
Other current assets	473	216
Total current assets	12,501	12,781
Property, plant and equipment, net	5,147	4,687
Prepaid pension costs	3,172	2,828
Deferred income taxes–net	1,262	979
Capitalized software development costs	293	362
Other assets	1,436	989
Total assets	$23,811	$22,626
LIABILITIES		
Accounts payable	$ 1,931	$ 1,900
Payroll and benefit-related liabilities	2,178	2,492
Postretirement and postemployment benefit liabilities	239	220
Debt maturing within one year	2,538	2,363
Other current liabilities	3,852	3,738
Total current liabilities	10,738	10,713
Postretirement and postemployment benefit liabilities	6,073	5,642
Long-term debt	1,665	1,634
Other liabilities	1,948	1,951
Total liabilities	$20,424	$19,940
Commitments and contingencies		
SHAREOWNERS' EQUITY		
Preferred stock–par value $1 per share Authorized 250,000,000 shares Issued and outstanding shares: none	$ –	$ –
Common stock–par value $.01 per share Authorized shares: 3,000,000,000 Issued and outstanding shares: 642,062,656 at September 30,1997; 636,662,634 at September 30, 1996	6	6
Additional paid-in capital	3,047	2,595
Guaranteed ESOP obligation	(77)	(106)
Foreign currency translation	(191)	(16)
Retained earnings	602	207
Total shareowners' equity	$ 3,387	$ 2,686
Total liabilities and shareowners' equity	$23,811	$22,626

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNERS' EQUITY

(dollars in millions)

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
PREFERRED STOCK			
COMMON STOCK			
Balance at beginning of period	$ 6	$ –	$ –
Issuance of common shares	–	6	–
Balance at end of period	6	6	–
ADDITIONAL PAID-IN CAPITAL			
Balance at beginning of period	2,595	1,406	–
Issuance of common shares	260	2,881	–
Conversion of Octel stock options	116	–	–
Net loss from 1/1/96 through 1/31/96	–	(72)	–
Dividends declared	–	(7)	–
Accounts receivable holdback by AT&T	–	(2,000)	–
Unrealized gain on investments	40	15	–
Acceptance of ESOP	–	120	–
Other contributions from AT&T	–	252	1,406
Other	36	–	–
Balance at end of period	3,047	2,595	1,406
GUARANTEED ESOP OBLIGATION			
Balance at beginning of period	(106)	–	–
Acceptance of ESOP	–	(120)	–
Amortization of ESOP obligation	29	14	–
Balance at end of period	(77)	(106)	–
FOREIGN CURRENCY TRANSLATION ADJUSTMENTS			
Balance at beginning of period	(16)	28	92
Translation adjustments	(175)	(44)	(64)
Balance at end of period	(191)	(16)	28
SHAREOWNER'S NET INVESTMENT			
Balance at beginning of period	–	–	2,384
Net loss	–	–	(867)
Transfers to AT&T	–	–	(111)
Transfer to additional paid-in capital	–	–	(1,406)
Balance at end of period	–	–	–
RETAINED EARNINGS			
Balance at beginning of period	207	–	–
Net income	541	–	–
Net income from 2/1/96 through 9/30/96	–	296	–
Dividends declared	(146)	(89)	–
Balance at end of period	602	207	–
Total Shareowners' Equity	$3,387	$ 2,686	$ 1,434

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

	Year Ended September 30, (Twelve Months) 1997	Year Ended September 30, (Twelve Months) 1996	Nine Months Ended September 30, 1996	Nine Months Ended September 30, 1995	Year Ended December 31, (Twelve Months) 1995
		Unaudited		*Unaudited*	
OPERATING ACTIVITIES:					
Net income (loss)	$ 541	$ (793)	$ 224	$ 150	$ (867)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Business restructuring charge	(201)	2,515	(98)	–	2,613
Asset impairment and other charges	81	293	105	–	188
Depreciation and amortization	1,450	1,326	937	1,104	1,493
Provision for uncollectibles	127	73	54	50	69
Deferred income taxes	9	(996)	(251)	92	(653)
Purchased in-process research and development	1,024	–	–	–	–
(Increase) decrease in accounts receivable	(389)	(3,114)	(1,506)	405	(1,203)
Increase in inventories and contracts in process	(273)	(309)	(524)	(1,304)	(1,089)
Increase (decrease) in accounts payable	(16)	1,021	629	(121)	271
Changes in other operating assets and liabilities	(315)	1,040	537	(744)	(241)
Other adjustments for noncash items–net	(92)	(77)	(111)	(137)	(103)
Net cash provided by (used in) operating activities	1,946	979	(4)	(505)	478
INVESTING ACTIVITIES:					
Capital expenditures	(1,635)	(1,432)	(939)	(784)	(1,277)
Proceeds from the sale or disposal of property, plant and equipment	108	119	15	14	118
Purchases of equity investments	(149)	(96)	(46)	(36)	(86)
Sales of equity investments	12	102	102	–	–
Dispositions of businesses	181	58	58	10	10
Acquisitions of businesses, net of cash acquired	(1,568)	(234)	(234)	–	–
Other investing activities–net	(70)	(155)	(22)	26	(107)
Net cash used in investing activities	(3,121)	(1,638)	(1,066)	(770)	(1,342)
FINANCING ACTIVITIES:					
Repayments of long-term debt	(16)	(53)	(39)	(32)	(46)
Issuance of long-term debt	52	1,499	1,499	–	–
Proceeds of issuance of common stock	260	2,887	2,887	–	–
Dividends paid	(192)	(48)	(48)	–	–
Proceeds (repayments) of debt sharing agreement–net	–	(67)	–	948	881
Transfers from (to) AT&T	–	(190)	13	92	(111)
(Increase) decrease in short-term borrowings–net	191	(1,525)	(1,436)	89	–
Net cash provided by financing activities	295	2,503	2,876	1,097	724
Effect of exchange rate changes on cash and cash equivalents	(11)	(16)	(13)	11	8
Net increase (decrease) in cash and cash equivalents	(891)	1,828	1,793	(167)	(132)
Cash and cash equivalents at beginning of period	2,241	413	448	580	580
Cash and cash equivalents at end of period	$ 1,350	$ 2,241	$ 2,241	$ 413	$ 448

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(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. ("AT&T") 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 of Common Stock and on April 10, 1996, Lucent issued 112,037,037 shares 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 for the nine months ended September 30, 1996 and the year ended December 31, 1995 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 the consolidated results of Lucent's 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 periods.

Acquisition

In September 1997, Lucent completed the purchase of all outstanding stock of Octel Communications Corporation ("Octel"), a provider of voice, fax and electronic messaging technologies, at an aggregate purchase price of approximately $1,819 ($1,703 in cash). Lucent paid for the Octel shares from its general funds which consist of cash from operations and proceeds from short-term borrowings. The acquisition was accounted for using the purchase method of accounting. The fair market value of Octel's assets and liabilities, which was independently determined, has been included in the statement of financial position as of September 30, 1997. The purchase price was allocated as follows:

Fair value of assets acquired	$ 664
Fair value of liabilities assumed	(157)
Goodwill	181
Acquired existing technology	186
Purchased in-process research and development costs	945
Total	$1,819

Acquired technology valuation included both existing technology and that represented by in-process research and development. The valuation was made by applying the income forecast method which considers the present value of cash flows by product lines.

The fair value of existing technology products was valued at $186 and is being amortized over five years. In-process research and development was valued at $945 and was charged to expense since this technology had not reached technological feasibility and has no alternative use. This technology will require varying additional development, coding and testing efforts over the next one and a half years before assessment of technological feasibility can be determined.

Goodwill is being amortized over seven years.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The consolidated financial statements include all majority-owned subsidiaries in which Lucent exercises significant influence. 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. Investments in which Lucent has less than a 20% ownership interest are accounted for under the cost method of accounting. All material intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements 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.

Earnings Per Common Share

Earnings per common share was calculated by dividing the net income by the weighted average shares of common stock and common stock equivalents outstanding during the periods. Included in the calculation of the weighted average shares outstanding is the retroactive recognition to January 1, 1995 of the 524,624,894 shares owned by AT&T.

Foreign Currency Translation

For operations outside the United States that prepare financial statements in currencies other than the United States dollar, results from 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 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 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 upon 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 upon 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 is 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 proceeds are applied against accumulated depreciation.

Accelerated depreciation 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 sum of the expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and carrying value of the asset.

Goodwill

Goodwill is the excess of the purchase price over the fair value of 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.

(dollars in millions, except per share amounts)

Reclassification

Certain prior year amounts have been reclassified to conform with the 1997 presentation.

3. CHANGES IN ACCOUNTING POLICIES

In February 1997, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share" ("SFAS 128"). SFAS 128 simplifies the standards for computing earnings per share and is effective for financial statements for both interim and annual periods ending after December 15, 1997. Earlier application is not permitted. The adoption of SFAS 128 is not expected to have a material impact on Lucent's previously reported earnings per share.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components in the financial statements. SFAS No. 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 No. 130 will have no impact on Lucent's consolidated results of operations, financial position or cash flows.

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 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 No. 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 No. 131 will have no 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) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
INCLUDED IN COSTS			
Amortization of software development costs	$ 380	$218	$ 312
INCLUDED IN SELLING, GENERAL AND ADMINISTRATIVE EXPENSES			
Amortization of goodwill	$ 32	$ 25	$ 40
INCLUDED IN COSTS AND OPERATING EXPENSES			
Depreciation and amortization of property, plant and equipment	$1,008	$674	$1,109
OTHER INCOME			
Interest income	$ 132	$ 71	$ 44
Minority interests in earnings of subsidiaries	(35)	(21)	(20)
Net equity losses from investments	(64)	(26)	(25)
Increase in cash surrender value of life insurance	54	35	40
Loss on foreign currency transactions	(12)	(4)	(26)
Miscellaneous–net	66	41	151
Total other income–net	$ 141	$ 96	$ 164
DEDUCTED FROM INTEREST EXPENSE			
Capitalized interest	$ 14	$ 14	$ 14

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

Supplementary Balance Sheet Information

	September 30, 1997	September 30, 1996
INVENTORIES		
Completed goods	$ 1,611	$ 1,837
Work in process and raw materials	1,315	1,451
Inventories	$ 2,926	$ 3,288
PROPERTY, PLANT AND EQUIPMENT–NET		
Land and improvements	$ 299	$ 275
Buildings and improvements	2,852	2,875
Machinery, electronic and other equipment	8,403	7,870
Total property, plant and equipment	11,554	11,020
Less: Accumulated depreciation and amortization	(6,407)	(6,333)
Property, plant and equipment–net	$ 5,147	$ 4,687
OTHER CURRENT LIABILITIES		
Advance billings and customer deposits	$ 844	$ 1,202

Supplementary Cash Flow Information

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
Interest payments, net of amounts capitalized	$307	$209	$303
Income tax payments	$781	$142	$224

For information related to the acquisition of Octel, see Note 1.

In addition, 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. BUSINESS RESTRUCTURING AND OTHER CHARGES

In the fourth quarter of calendar year 1995, a pretax 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 reengineering numerous corporate and business unit operations; and selling the Microelectronics interconnect and Paradyne businesses.

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 pretax 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, 1997, the workforce has been reduced by approximately 17,900 positions due to business restructuring. In addition, approximately 1,000 employees left Lucent's workforce 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 anticipates that approximately 90% of the total expected reductions in positions will be complete by September 1998.

The following table displays a rollforward of the liabilities for business restructuring from December 31, 1995 to September 30, 1997:

		1996			
Type of Cost	December 31, 1995 Balance	Additions	Other	Usage	September 30, 1996 Balance
Employee Separation	$1,219	$ –	$ (81)	$(372)	$ 766
Facility Closing	272	–	(35)	(62)	175
Other	416	–	18	(86)	348
Total	$1,907	$ –	$ (98)	$(520)	$ 1,289

		1997			
Type of Cost	September 30, 1996 Balance	Additions	Other	Usage	September 30, 1997 Balance
Employee Separation	$ 766	$ –	$(154)	$(264)	$ 348
Facility Closing	175	–	(24)	(85)	66
Other	348	–	(23)	(170)	155
Total	$1,289	$ –	$(201)	$(519)	$ 569

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

Cash payments of $483 and $456 and noncash related charges of $36 and $64 primarily associated with asset write-offs were charged against the business restructuring reserves for the year and nine-month period ended September 30, 1997 and 1996, respectively. Lucent reversed $201 and $98 of business restructuring reserves primarily related to employee separations for the year and nine-month period ended September 30, 1997 and 1996, respectively.

(dollars in millions, except per share amounts)

For the year and nine-month period ended September 30, 1997 and 1996, respectively, the reversals of business restructuring reserves were offset by a write-down of $127 for special purpose Bell Labs assets no longer being used in 1997 and $105 of non-recurring and other charges in 1996, principally associated with the separation from AT&T.

6. 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) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal income tax effect	5.4	1.4	5.0
Amortization of intangibles	0.2	–	(2.5)
Foreign earnings and dividends taxed at different rates	0.9	4.1	(12.3)
Research credits	(2.6)	(5.0)	0.3
Other differences – net	(1.7)	3.5	(1.7)
Effective income tax rate before purchased in-process research and development costs	37.2%	39.0%	23.8%
Purchased in-process research and development costs	25.9	0.0	0.0
Effective income tax rate	63.1%	39.0%	23.8%

The following table presents the U.S. and foreign components of income before income taxes and the provision for income taxes:

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
INCOME (LOSS) BEFORE INCOME TAXES			
United States	$ 873	$ 101	$(1,253)
Foreign	594	266	115
	$1,467	$ 367	$(1,138)
PROVISION (BENEFIT) FOR INCOME TAXES			
CURRENT			
Federal	$ 464	$ 242	$ 199
State and local	129	53	42
Foreign	226	98	141
	819	393	382
DEFERRED			
Federal	35	(198)	(523)
State and local	77	(45)	(130)
Foreign and other	(5)	(7)	–
	107	(250)	(653)
Provision (benefit) for income taxes	$ 926	$ 143	$ (271)

As of September 30, 1997, Lucent had state and local, and foreign net operating loss carryforwards (tax effected) of $103, which expire primarily after 2000.

The components of deferred tax assets and liabilities at September 30, 1997 and 1996 are as follows:

	September 30, 1997	September 30, 1996
DEFERRED INCOME TAX ASSETS:		
Employee pensions and other benefits, net	$1,777	$ 1,900
Business restructuring	112	417
Reserves and allowances	887	658
Net operating loss/credit carryforwards	107	67
Valuation allowance	(234)	(208)
Other	664	555
Total deferred income tax assets	$3,313	$ 3,389
DEFERRED INCOME TAX LIABILITIES:		
Property, plant and equipment	$ 478	$ 519
Other	240	274
Total deferred income tax liabilities	$ 718	$ 793

Lucent has not provided for United States deferred income taxes or foreign withholding taxes on $2,029 of undistributed earnings of its non-United States subsidiaries as of September 30, 1997, since these earnings are intended to be reinvested indefinitely.

7. DEBT OBLIGATIONS

	September 30, 1997	September 30, 1996
DEBT MATURING WITHIN ONE YEAR		
Commercial paper	$2,364	$2,225
Long-term debt	56	59
Other	118	79
Total debt maturing within one year	$2,538	$2,363
WEIGHTED AVERAGE INTEREST RATES		
Commercial paper	5.5%	5.4%
Long-term debt and other	6.3%	7.1%

Lucent had revolving credit facilities at September 30, 1997 aggregating $5,181 (a portion of which is used to support Lucent's commercial paper program), $4,000 with domestic lenders and $1,181 with foreign lenders. At September 30, 1997, $4,000 with domestic lenders and $955 with foreign lenders were available.

	September 30, 1997	September 30, 1996
LONG-TERM DEBT		
6.90% notes due July 15, 2001	$ 750	$ 750
7.25% notes due July 15, 2006	750	750
Long-term lease obligations	2	4
Other	229	201
Less: Unamortized discount	10	12
Total long-term debt	1,721	1,693
Less: Amounts maturing within one year	56	59
Net long-term debt	$1,665	$1,634

Lucent has an effective shelf registration statement for the issuance of debt securities up to $3,500, of which $1,960 remains available at September 30, 1997.

This table shows the maturities, by year, of the $1,721 in total long-term debt obligations:

					September 30,
1998	1999	2000	2001	2002	Later Years
$56	$52	$23	$761	$0	$829

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

Pension-related benefits for management employees are based principally on career-average pay while benefits for occupational 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.

Effective October 1, 1996, pension obligations under the AT&T plans relating to Lucent's employees and retirees were transferred to Lucent plans. Assets that were formerly held by AT&T's Group Pension Trust were subsequently divided between the master pension trusts for qualified pension plans of Lucent and AT&T. The pension benefit obligation and plan assets transferred to Lucent as of September 30, 1996 were $21,269 and $29,805, respectively.

Also effective October 1, 1996, Lucent established separate postretirement benefit plans for its employees and retirees. Postretirement benefit assets were transferred from AT&T, pro rata, on the basis of the present value of future benefit obligations of the applicable plan. The accumulated postretirement benefit obligation and plan assets transferred to Lucent as of September 30, 1996 were $7,399 and $3,711, respectively.

(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,	
	1997	1996	1997	1996
Plan assets at fair value	$36,204	$29,805	$ 4,152	$ 3,711
Less: benefit obligation	23,187	21,269	7,939	7,399
Funded (Unfunded) status of the plan	13,017	8,536	(3,787)	(3,688)
Unrecognized prior service costs	1,048	1,115	261	367
Unrecognized transition asset	(1,244)	(1,543)	–	–
Unrecognized net gain	(9,669)	(5,308)	(1,256)	(1,110)
Net minimum liability of nonqualified plans	(23)	(19)	–	–
Prepaid (Accrued) benefit cost	$ 3,129	$ 2,781	$(4,782)	$(4,431)
Accumulated pension benefit obligation	22,669	20,475	n/a	n/a
Vested pension benefit obligation	21,246	19,077	n/a	n/a
ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION:				
Retirees	n/a	n/a	5,902	5,510
Fully eligible active plan participants	n/a	n/a	777	821
Other active plan participants	n/a	n/a	1,260	1,068
Accumulated postretirement benefit obligation	n/a	n/a	$ 7,939	$ 7,399
ASSUMPTIONS:				
Weighted average discount rate	7.25%	8.0%	7.25%	8.0%
Rate of increase in future compensation levels	4.50%	5.0%	n/a	n/a

Pension plan assets consist primarily of listed stocks (of which $73 and $6 represent Lucent common stock at September 30, 1997 and 1996, respectively). Postretirement plan assets include listed stocks (of which $2 and $8 represent Lucent common stock at September 30, 1997 and 1996, 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.

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
PENSION COST			
Service cost–benefits earned during the period	$ 312	$ 277	$ 308
Interest cost on projected benefit obligation	1,604	1,172	1,589
Expected return on plan assets(1)	(2,150)	(1,589)	(2,000)
Amortization of unrecognized prior service costs	149	113	160
Amortization of transition asset	(300)	(222)	(289)
Charges (credits) for plan curtailments(2)	56	(16)	97
Net pension credit	$ (329)	$ (265)	$ (135)
POSTRETIREMENT COST			
Service cost–benefits earned during the period	$ 57	$ 51	$ 53
Interest cost on accumulated postretirement benefit obligation	554	408	599
Expected return on plan assets(3)	(264)	(189)	(220)
Amortization of unrecognized prior service costs	35	53	40
Amortization of net (gain) loss	(15)	8	(6)
Charge (credits) for plan curtailments(2)	26	(2)	2
Net postretirement benefit cost	$ 393	$ 329	$ 468

(1) A 9.0% long-term rate of return on pension plan assets was assumed for 1997, 1996 and 1995. The actual return on plan assets was $8,523 and $2,204 for the year and nine-month period ended September 30, 1997 and 1996, respectively, and $5,471 for the year ended December 31, 1995.

(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 1997, 1996 and 1995. The actual return on plan assets was $1,040 and $219 for the year and nine-month period ended September 30, 1997 and 1996, respectively, and $602 for the year ended December 31, 1995.

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 5.4% annual rate of increase in the per capita cost of covered health care benefits (the health care cost trend rate) for 1998, gradually declining to 4.8% 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, 1997 by $394 and the interest and service cost by $31 for the year then ended.

Savings Plans

Effective October 1, 1996, AT&T's savings plans' assets and liabilities related to Lucent employees and retirees were transferred to Lucent plans. Lucent's savings plans allow employees to contribute a portion of their pretax and/or after-tax income in accordance with specified guidelines. Lucent matches a percentage of the employee contributions up to certain limits. The expense amounted to $180 and $131 for the year and nine-month period ended September 30, 1997 and 1996, respectively, and $196 for the year ended December 31, 1995.

Employee Stock Ownership Plan

As of September 30, 1996, Lucent established a leveraged Employee Stock Ownership Plan ("ESOP"), after receiving its portion of the ESOP obligation from AT&T, to fund the employer's contributions to the long-term savings and security plan for nonmanagement employees (the "LTSS Plan"). 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, 1997, the ESOP contained 5.8 million shares of Lucent's common stock. Of the 5.8 million shares, 4.0 million have been allocated to the LTSS Plan and 1.8 million were unallocated. As of September 30, 1997, the unallocated shares had a fair value of $146.

9. STOCK COMPENSATION PLANS

Prior to Lucent's separation from AT&T, certain Lucent employees participated in AT&T stock-based compensation plans under which they received stock options and other equity-based awards. Effective October 1, 1996, such 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"), and awarded a one-time option grant to each full-time employee as of October 1, 1996 to acquire 100 shares of Common Stock under the Lucent Technologies Inc. Founders Grant Stock Option Plan ("FGP"). 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 three years from date of grant. Subject to customary anti-dilution adjustments and certain exceptions, the total number of shares of Common Stock authorized for grant under the 1996 LTIP and the 1997 LTIP in each calendar year amounted to 2.5% of the total outstanding shares of Common Stock as of the first day of the calendar year. Substitute awards do not reduce the shares available for grant under these two plans. The total number of shares of Common Stock authorized for grant under the FGP was 15 million.

Options to purchase Common Stock may be granted either alone or in addition to other awards. The term of each option will be fixed by a Committee of Lucent's Board of Directors ("Committee"), provided that no incentive stock options, as defined in the Internal Revenue Code, will be exercisable after the expiration of ten years from the date the option is granted. Options will be exercisable at such time or times as determined by the Committee at or subsequent to grant.

In connection with Lucent's acquisition of Octel, all Octel stock options held by Octel employees will become exercisable, according to their terms, for Lucent Common Stock, effective September 29, 1997. The value of these options was included as part of the purchase price related to the acquisition of Octel (see Note 1).

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 50 million shares. Since inception of this plan, 3.1 million shares have been purchased at a weighted average price of $50.31.

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 No. 25 and related interpretations in accounting for its plans. Compensation expense was $36 and $11 for the year and nine-month period ended September 30, 1997 and

(dollars in millions, except per share amounts)

1996, respectively, and $11 for the year ended December 31, 1995. If Lucent had elected to adopt the optional recognition provisions of SFAS No. 123 for its stock option plans and the ESPP, net income (loss) and earnings (loss) per share would have been changed to the pro forma amounts indicated below:

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
Net income (loss)			
As reported	$ 541	$ 224	$ (867)
Pro forma	$ 444	$ 202	$ (870)
Earnings (loss) per share			
As reported	$0.84	$0.38	$(1.65)
Pro forma	$0.69	$0.34	$(1.66)

Note: The pro forma disclosures shown may not be representative of the effects on net income and earnings per share in future years because the year ended September 30, 1997 and the nine months ended September 30, 1996 include the incremental fair value of the Lucent stock options that were substituted for AT&T stock options.

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

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

(1) Assumptions for Lucent options awarded during 1997.

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

(3) Assumptions for AT&T options for the years 1996 and 1995.

Presented below is a summary of the status of the Lucent stock options held by Lucent employees and the related transactions for the year ended September 30, 1997. Also shown are the AT&T stock options held by Lucent's employees for the nine months ended September 30, 1996 and the year ended December 31, 1995.

	Shares (000's)	Weighted Average Exercise Price
AT&T options outstanding at January 1, 1995	4,824	$42.66
Granted	2,046	55.08
Exercised	(476)	35.86
Forfeited/Expired	(2)	38.75
AT&T options outstanding at December 31, 1995	6,392	47.44
Granted	1,690	65.81
Exercised	(183)	38.27
Forfeited/Expired	(3)	63.18
AT&T options outstanding at September 30, 1996	7,896	51.36
Lucent options substituted for AT&T options, and outstanding at October 1, 1996	9,786	41.43
Granted*	25,623	46.37
Exercised	(2,022)	33.56
Forfeited/Expired	(980)	47.60
Lucent options outstanding at September 30, 1997	32,407	$45.66

**Includes options covering 12,753 shares of Common Stock granted under the FGP on October 1, 1996 (at a weighted average exercise price of $44.61), and the substitution of 2,471 Lucent options for Octel options on September 29, 1997 (at a weighted average exercise price of $39.99).*

The weighted average fair value of Lucent stock options, calculated using the Black-Scholes option-pricing model, granted during the year ended September 30, 1997 is $14.60 per share. 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 and the year ended December 31, 1995 is $14.13 and $14.15 per share, respectively.

The following table summarizes the status of Lucent's stock options outstanding and exercisable at September 30, 1997:

	Stock Options Outstanding			Stock Options Exercisable	
Range of Exercise Prices	Shares (000's)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Shares (000's)	Weighted Average Exercise Price
$ 3.91 to $42.60	6,138	4.8	$35.83	4,466	$35.85
$42.61 to $44.56	17,547	9.0	44.55	142	43.71
$44.57 to $53.90	7,073	8.6	50.71	810	52.30
$53.91 to $82.09	1,565	8.1	71.74	44	64.04
$83.78	84	9.7	83.78	18	83.78
Total	32,407		$45.66	5,480	$38.87

Performance awards, restricted stock awards and other stock unit awards may also be granted. Presented below is the total number of shares of Common Stock represented by awards granted to Lucent employees for the year ended September 30, 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 and the year ended December 31, 1995:

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
Lucent shares granted (000's)	2,141	n/a	n/a
AT&T shares granted (000's)	n/a	262	295
Weighted average market value of shares granted during the period	$46.38	$66.24	$56.46

10. 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 upon 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 24.1% and 23.1% of consolidated revenues for the year and nine-month period ended September 30, 1997 and 1996, respectively, and 23.3% for the year ended December 31, 1995.

	Year Ended September 30, (Twelve Months) 1997	Nine Months Ended September 30, 1996	Year Ended December 31, (Twelve Months) 1995
REVENUES			
United States	$21,807	$13,334	$17,826
Other geographic areas	4,553	2,525	3,587
	$26,360	$15,859	$21,413
TRANSFERS BETWEEN GEOGRAPHIC AREAS (Eliminated in Consolidation)			
United States	$ 1,927	$ 1,353	$ 1,081
Other geographic areas	1,267	648	911
	$ 3,194	$ 2,001	$ 1,992
OPERATING INCOME (LOSS)			
United States	$ 1,514	$ 940	$ (679)
Other geographic areas	410	(108)	(67)
Corporate, eliminations and nonoperating	(457)	(465)	(392)
Income (loss) before income taxes	$ 1,467	$ 367	$ (1,138)
ASSETS (End of Period)			
United States	$17,054	$16,492	$15,043
Other geographic areas	5,600	3,912	4,696
Corporate assets	1,778	2,744	738
Eliminations	(621)	(522)	(755)
	$23,811	$22,626	$19,722

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 $3,731 and $1,970 for the year and nine-month period ended September 30, 1997 and 1996, respectively, and $2,119 for the year ended December 31, 1995. 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.

11. FINANCIAL INSTRUMENTS

In the normal course of business, Lucent uses various financial instruments, including derivative financial instruments, for purposes other than trading. Derivative financial instruments are not entered into for speculative purposes. Lucent's derivative financial instruments include foreign currency exchange contracts and interest rate swap agreements. 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 these financial instruments.

By their nature, all such instruments involve risk, including market risk and the credit risk of 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 balance sheet. However, Lucent's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and financial guarantees is limited to the amount drawn and outstanding on those instruments.

Exposure to credit risk is controlled through credit approvals, credit limits and monitoring procedures. Requests for providing commitments to extend credit and financial guarantees are reviewed and approved by senior management. Management conducts regular reviews of 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, 1997 and 1996, in management's opinion, there was no significant risk of loss in the event of nonperformance of the counterparties to these financial instruments and there was no significant exposure to any individual customer or counterparty.

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 specified interest rates and purposes.

In October 1996, Lucent entered into a credit agreement with Sprint Spectrum LP ("Sprint PCS") to provide long-term financing of $1,800 for its purchase of equipment and services for its nationwide personal communication services ("PCS") wireless network. In May 1997, under the $1,800 credit facility provided by Lucent to Sprint PCS, Lucent closed transactions 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. As of September 30, 1997, $146 of these commitments were not yet drawn down by Sprint PCS.

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.

During 1997, Lucent also entered into credit agreements to extend credit of up to approximately $850 in total to three other PCS operators for possible future sales. On October 1, 1997, a commitment for $300 included in the $850 expired and was not extended. The agreement relating to about $200 of credit is subject to fulfillment of certain conditions and completion of final contract documentation.

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. Lucent seeks to limit its exposure to credit risks in any single country or region. Certain financial guarantees are backed by amounts held in trust for Lucent.

Foreign Currency Exchange Contracts

Foreign currency exchange contracts, including forward and option contracts, are used to manage exposure to changes in currency exchange rates, principally Dutch guilders, Deutsche marks and Japanese yen. The use of derivative financial instruments allows Lucent to reduce its exposure to the risk that the eventual net cash inflows and outflows resulting from the sale of products to foreign customers and purchases from foreign suppliers will be adversely affected by changes in exchange rates. Generally, foreign currency 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 foreign currency exchange contracts that are designated for firmly committed transactions are deferred in other current assets and liabilities. At September 30, 1997 and 1996, deferred gains and losses associated with foreign currency exchange contracts designated for firm commitments are not material to the consolidated financial statements. Gains and losses on foreign currency exchange contracts that are designated for forecasted transactions are recognized in other income as the exchange rates change.

Fair Value of Financial Instruments Including Derivative Financial Instruments

The tables that follow present the valuation methods and the carrying or notional amounts and estimated fair values of material financial instruments. The notional amounts represent agreed-upon amounts on which calculations of cash to be exchanged are based. Letters of credit, commitments to extend credit and guarantees of debt may exist or expire without being drawn upon. Therefore, the total notional or contract amounts do not necessarily represent future cash flows. For derivative financial instruments, the notional amounts do not represent amounts exchanged by the parties and, therefore, are not a measure of the instruments. Lucent's exposure on its derivative financial instruments is limited to the fair value of the contracts with a positive fair value at the reporting date.

Financial Instrument	Valuation Method
Debt maturing within one year	The carrying amount is a reasonable estimate of fair value.
Long-term debt	Market quotes for similar terms and maturities.
Letters of credit	Fees paid to obtain the obligations.
Foreign currency exchange contracts	Market quotes.
Commitments to extend credit	*
Guarantees of debt	*

**It is not practicable to estimate the fair value of these financial obligations because there are no quoted market prices for transactions that are similar in nature.*

	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	September 30, 1997		September 30, 1996	
ON BALANCE SHEET INSTRUMENTS				
Liabilities:				
Long-term debt	$1,663	$1,748	$1,630	$1,638
DERIVATIVES AND OFF BALANCE SHEET INSTRUMENTS				
Assets:				
Foreign currency exchange contracts	$ 28	$ 54	$ 14	$ 17
Letters of credit	–	2	–	1
Liabilities:				
Foreign currency exchange contracts	$ 31	$ 36	$ 11	$ 14
Letters of credit	–	–	–	–

The following table presents the contract/notional amount of Lucent derivatives and off balance sheet instruments and the amounts drawn down on such instruments:

	Contract/Notional Amount		Amounts Drawn Down and Outstanding	
	September 30, 1997	1996	September 30, 1997	1996
Foreign exchange forward contracts:				
British pounds	$ 136	$ 7		
Dutch guilders	186	128		
Deutsche marks	558	228		
French francs	116	35		
Japanese yen	249	436		
Spanish pesetas	109	47		
Other	388	276		
	$1,742	$1,157		
Foreign exchange option contracts	–	109		
Letters of credit	832	847		
Commitments to extend credit	1,898	156	$ 25	$ 7
Guarantees of debt	309	494	118	346

12. TRANSACTIONS AND AGREEMENTS WITH AT&T

Separation and Distribution Agreement

In connection with the Separation and Distribution, Lucent, AT&T and NCR Corporation ("NCR") executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996 and amended and restated as of March 29, 1996 (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. In addition, Lucent had a number of other agreements with AT&T for federal, state and local tax allocation, tax sharing, general purchase, interim services, system replication and real estate sharing.

(dollars in millions, except per share amounts)

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 relating 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, 1997 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, 1997 would not be material to the annual consolidated financial statements.

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 about 40 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.

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 the financial condition of Lucent or Lucent's results of operations or cash flows. Any amounts of environmental costs that may be incurred in excess of those provided for at September 30, 1997 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 $324 and $182 for the year and nine-month period ended September 30, 1997 and 1996, respectively, and $209 for the year ended December 31, 1995. The table below shows the future minimum lease payments due under noncancelable operating leases at September 30, 1997. Such payments total $1,037.

	Year Ended September 30,					
	1998	1999	2000	2001	2002	Later Years
Operating leases	$300	$235	$171	$103	$55	$173

14. QUARTERLY INFORMATION (unaudited)

	FIRST	SECOND	THIRD	FOURTH	TOTAL
				FISCAL YEAR QUARTERS	
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)[b]	541[b]
Earnings (loss) per weighted average share	$ 1.35	$ 0.10	$ 0.33	$ (0.92)[b]	$ 0.84[b]
Dividends per share	0.075	0.000	0.075	0.075	0.225
Stock price:[d]					
High	53 1/8	60 5/8	74 3/16	90 3/4	90 3/4
Low	42 1/8	44 3/4	49 7/8	72 3/16	42 1/8
Quarter-end close	46 1/4	52 1/2	72 1/16	81 3/8	81 3/8
YEAR ENDED SEPTEMBER 30, 1996					
Revenues	$7,427	$4,577	$5,364	$5,918	$23,286
Gross margin	2,325[a]	1,824	2,170	2,575	8,894[a]
Net income (loss)	(1,017)[a]	(103)	72	255	(793)[a]
Earnings (loss) per weighted average share[c]	$ (1.94)[a]	$ (0.20)	$ 0.11	$ 0.40	$ (1.37)[a]
Dividends per share	0.00	0.00	0.075	0.075	0.15
Stock price:[d]					
High	n/a	n/a	39 1/4	45 7/8	45 7/8
Low	n/a	n/a	29 3/4	30 5/8	29 3/4
Quarter-end close	n/a	n/a	37 7/8	45 7/8	45 7/8

(a) 1996 includes a pretax charge of $2,801 ($1,847 after taxes), to cover restructuring costs of $2,613 and asset impairment and other charges of $188.

(b) As a result of the 1997 acquisition of Octel, Lucent took a charge of $979 ($966 after tax) in the fourth quarter for acquired in-process research and development.

(c) The number of weighted average shares outstanding increased in 1996 as new common shares were issued through the IPO. For this reason, the sum of the quarterly earnings (loss) per weighted average share amounts for 1996 does not equal the earnings per weighted average share for the year. The calculation of earnings per share on a historical basis includes the retroactive recognition to January 1, 1995 of the 524,624,894 shares owned by AT&T.

(d) Obtained from the Composite Tape.

15. SUBSEQUENT EVENTS

On October 1, 1997, Lucent formed a venture with Philips Electronics N.V. called Philips Consumer Communications, L.P. ("PCC"). Lucent's Consumer Products business unit was contributed to PCC at net book value in return for an initial equity interest of 40%. Lucent will account for its interest in PCC under the equity method of accounting. The Consumer Products business unit was not material to the consolidated financial position, results of operations or cash flows of Lucent.

On October 1, 1997, Lucent sold the Advanced Technology Systems unit of its Government Solutions division ("ATS") to General Dynamics Corporation for $265 in cash. A pretax gain of $149 was realized on the sale. ATS was not material to the consolidated financial position, results of operations or cash flows of Lucent.

On October 15, 1997, Lucent announced that it will acquire Livingston Enterprises, Inc., a provider of remote access networking solutions, in a merger involving approximately $610 worth of Lucent common stock and options. Lucent will account for the transaction under purchase accounting.

It is anticipated that approximately $427 of the purchase price would be allocated to in-process research and development. This amount would be charged to income at the date of acquisition, which is currently expected to be in the quarter ending December 31, 1997. The remaining purchase price would be allocated to tangible assets, acquired technology and goodwill, less liabilities assumed. Based on current estimates, Lucent anticipates goodwill and acquired technology to be approximately $180, which will be amortized over periods not exceeding eight years.

SOCIAL RESPONSIBILITY

One of the core values of Lucent Technologies is a strong sense of social responsibility. It is a commitment to help people — and to help communities.

LUCENT TECHNOLOGIES FOUNDATION

In 1997 we announced the formation of the Lucent Technologies Foundation and a corporate contributions program, through which we plan to award about $20 million annually. We're focusing on education, community outreach, and support of our employees' volunteerism and giving.

Education

At the heart of our effort will be a long-term, comprehensive program to improve education from pre-kindergarten through high school. Focused on inner-city schools, the program will aim to improve reading and math skills and encourage students to graduate from high school and attend college.

In the area of higher education, we support science and engineering programs.

Through the Manufacturing Workforce Collaborative, a three-year, $3 million program, Lucent works with community colleges to address knowledge needed by today's manufacturing workers.

In partnership with the National Science Foundation, Lucent has contributed $500,000 for fellowships in the emerging field of industrial ecology.

Lucent also supports programs for top women and minority students in science and engineering.

Community Outreach

Lucent reaches out to communities through organizations such as United Way, to which we contributed $2.7 million in 1997, and the American Red Cross, which used our $50,000 grant to help communities devastated by flooding in 1997. We also made over $2.5 million in corporate contributions to community projects around the world.

Support of Employee Volunteerism and Giving

Through our Matching Gifts program, we matched close to $3 million in employee and retiree gifts to educational institutions and cultural organizations.

Lucent employees have a long history of volunteerism, which we support through Lucent CARES, a program that provides small seed grants based on hours volunteered.

ENVIRONMENT, HEALTH AND SAFETY

To meet expectations of customers and of communities worldwide where we operate and serve, Lucent is committed to high performance in the environment, health and safety (EH&S) arena. We successfully manage EH&S with formal targets for:

- EH&S systems throughout the business,
- lower lost-workday accident rate,
- environmentally preferable product design,
- energy efficiency, and
- recycling.

Through programs such as Lucent's Environmental Heroes we recognize outstanding achievements in EH&S and encourage employees to share in this area of corporate responsibility.

ABOVE: *At Lucent's "Global Day of Caring," volunteers from North Andover, Mass., demonstrate their support for the value of social responsibility. The annual event is supported by the Lucent Telephone Pioneers, one of the nation's largest volunteer organizations made up of active and retired employees. About 10,000 people participated worldwide on Sept. 20, 1997, at projects in 25 U.S. states and 17 other countries.*

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CORPORATE HEADQUARTERS

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1 888 4LUCENT
(1 888 458-2368)

SHAREOWNERS MEETING

The second Lucent Shareowners Meeting will assemble at 9:30 a.m. on Feb. 18, 1998, in the Meadowlands Exposition Center, 355 Plaza Drive, Secaucus, N.J.

SHAREOWNER SERVICES

Questions about stock-related matters should be directed to Lucent's shareowner services and transfer agent, The Bank of New York, at 1 888 LUCENT6 (1 888 582-3686), or by writing to:

Lucent Technologies
c/o The Bank of New York
P.O. Box 11009
Church Street Station
New York, NY 10286-1009

Customer service representatives are available Monday through Friday from 8 a.m. to 8 p.m. (Eastern Standard Time) and Saturday from 9 a.m. to 3 p.m. Shareowners with e-mail addresses can send inquiries electronically. The Bank of New York's e-mail address is:

lu–shareholders–svcs@email.bony.com

Persons outside the United States may call:

973 357-7230

Persons using a telecommunications device for the deaf (TDD) or a teletypewriter (TTY) may call:

1 800 711-7072

The Bank of New York address to which banks and brokers may deliver certificates for transfer is:

101 Barclay Street
New York, NY 10007

To hear information or ask questions about Lucent's products and services, call our special toll-free number:

1 888 4LUCENT
(1 888 458-2368)

DIVIDEND REINVESTMENT PLAN

The BuyDIRECT[SM] dividend reinvestment and stock purchase plan provides owners of common stock a convenient way to purchase additional shares. You may write or call The Bank of New York for a plan brochure and an enrollment form. Please also visit The Bank of New York's stock transfer World Wide Web site at:

http://stock.bankofny.com/lucent

STOCK LISTING

Lucent Technologies (ticker symbol "LU") is listed on the New York Stock Exchange. Shares outstanding as of Oct. 1, 1997:

642,072,290

LUCENT'S WEB SITE

Visit us at www.lucent.com

ENVIRONMENT, HEALTH AND SAFETY

For information about Lucent's environmental programs, view the most recent Environment, Health and Safety Report via the Internet at www.lucent.com/environment

For a printed copy, write to:

Lucent Technologies
Environment, Health and Safety Report
Room D3B47
283 King George Road
Warren, NJ 07059

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Bell Labs Innovations