AGERE SYSTEMS INC
Form 424B4
June 14, 2002

Filed Pursuant to Rule 424(b)(2)
Registration No. 333-81632

PROSPECTUS

$410,000,000

[AGERE SYSTEMS LOGO]
6.5% CONVERTIBLE SUBORDINATED NOTES DUE 2009

Interest on the notes is payable on June 15 and December 15 of each year, beginning on December 15, 2002.

Holders may convert their notes into shares of our Class A common stock at an initial conversion price of $3.3075 per share (subject to adjustment in certain events) at any time following issuance of the notes, unless we have previously redeemed or repurchased the notes or unless the notes have matured.

The notes will mature on December 15, 2009. We may redeem the notes in whole or in part at any time on or after June 20, 2007. Redemption prices are set forth under "Description of Notes -- Optional Redemption."

Holders may require us to repurchase all or a portion of their notes upon a fundamental change involving us at a repurchase price equal to 100% of the principal amount of the notes to be repurchased plus any accrued and unpaid interest to, but not including, the repurchase date.

We have also granted the underwriters an option to purchase up to an additional $40.812 million principal amount of the notes to cover over-allotments.

The notes will be unsecured subordinated obligations and will be subordinated in right of payment to all our existing and future senior debt, including our bank debt.

Our Class A common stock is listed on the New York Stock Exchange under the symbol "AGR.A." The last reported sale price of our Class A common stock on June 13, 2002 was $2.45 per share. The notes will not be listed on any securities exchange.

INVESTING IN THE NOTES INVOLVES RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 8.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	PER NOTE	TOTAL
Public offering price	100.00%	$410,000,000
Underwriting discount	2.95%	$ 12,095,000
Proceeds to Agere Systems Inc.	97.05%	$397,905,000

Interest on the notes will accrue from June 19, 2002.

The underwriters expect to deliver the notes in book-entry form through The Depository Trust Company to purchasers on or about June 19, 2002.

JPMORGAN SALOMON SMITH BARNEY

CREDIT SUISSE FIRST BOSTON DEUTSCHE BANK SECURITIES SG COWEN

ABN AMRO ROTHSCHILD LLC BNY CAPITAL MARKETS, INC.

June 13, 2002

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS. WE HAVE NOT AUTHORIZED ANYONE TO PROVIDE YOU WITH DIFFERENT INFORMATION. WE ARE NOT MAKING AN OFFER OF THESE SECURITIES IN ANY JURISDICTION WHERE THE OFFER IS NOT PERMITTED. YOU SHOULD NOT ASSUME THAT THE INFORMATION CONTAINED IN THIS PROSPECTUS IS ACCURATE AS OF ANY DATE OTHER THAN THE DATE ON THE FRONT OF THIS PROSPECTUS.

TABLE OF CONTENTS

	PAGE
Industry Data	i
Forward-Looking Statements	ii
Summary	1
Risk Factors	8
Use of Proceeds	20
Capitalization	21
Common Stock Price Range and Dividends	22
Selected Financial Information	23
Management's Discussion and Analysis of Financial Condition and Results of Operations	25
Business	50
Management	67
Arrangements Between Lucent and Our Company	70
Principal Stockholders	82
Certain Indebtedness	83
Description of Notes	85
Description of Common Stock	103
Material Federal Income Tax Consequences	111
Underwriting	115
Legal Matters	117
Experts	117
Where You Can Find More Information	117
Index to Financial Statements	F-1

This prospectus contains trademarks, service marks and registered marks of Agere Systems Inc.

INDUSTRY DATA

In this document, we rely on and refer to information regarding the semiconductor market and its segments and competitors from (1) Gartner Dataquest Alert: Communications Semiconductor and Optical Component Market Share in 2000, issued on June 11, 2001, (2) Gartner, Wireless Communications Semiconductor Competitive Market Shares for 2000, issued on August 29, 2001, (3) Gartner, Wired Communications Semiconductor and Optical Component Market Share, 2000, issued on July 13, 2001, (4) analyst reports and (5) other publicly available sources. Gartner Dataquest is not aware of, and has not consented to, being named in this document. Although we believe that this information is reliable, we have not independently verified the accuracy and completeness of this information.

FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industry in which we operate, management's beliefs and assumptions made by management. Such statements include, in particular, statements about our plans, strategies and prospects under the headings "Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business." Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," 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 risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. We do not have any intention or obligation to update publicly any forward-looking statements after we distribute this prospectus, whether as a result of new information, future events or otherwise.

The assumptions underlying the information on our market segments and product areas have been derived from information currently available to us. If any one or more of these assumptions are incorrect, actual market results may differ from those we expect. While we do not know what impact any such differences may have on our businesses, our future results of operations and financial condition may be materially adversely affected. In addition, we generally cannot assure you that the forward-looking information regarding our market segments and product areas will be achieved, whether or not the assumptions are correct. Conditions in our industry change rapidly and such information must be continually evaluated in light of then current conditions. For a description of recent changes in conditions in our industry, please see "Risk Factors -- Risks Related to Our Business -- The demand for products in our industry has recently declined, and we cannot predict the duration or extent of this trend."

SUMMARY

The following is a summary of some of the information contained in this prospectus. In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in our notes discussed under "Risk Factors" and our combined and consolidated financial statements and notes to our combined and consolidated financial statements included elsewhere in this prospectus.

We describe in this prospectus the businesses contributed to us by Lucent Technologies Inc. as part of our separation from Lucent as if they were our businesses for all historical periods prior to Lucent's contribution to us of the assets and liabilities related to those businesses, which began on February 1, 2001. Please see "Arrangements Between Lucent and Our Company" for a description of this separation. Our historical financial results as part of Lucent contained in this prospectus may not reflect our financial results in the future as a stand-alone company or what our financial results would have been had we been a stand-alone company during the periods presented. Our fiscal year ends on September 30.

AGERE SYSTEMS

OUR COMPANY

Agere Systems designs, develops and manufactures integrated circuits for use in a broad range of communications and computer systems and optoelectronic components for communications networks. We are the world leader in sales of communications components, which include both integrated circuits and optoelectronic components. Communications components are basic building blocks of electronic and photonic products and systems for terrestrial and submarine, or undersea, communications networks and for communications equipment.

As of March 31, 2002, we employed approximately 11,700 people worldwide. We have major research and development and manufacturing sites in the United States, Mexico, Singapore and Thailand. We had revenue of $1,088 million, a net loss of $594 million, net cash used in operating activities of $454 million and EBITDA, on an adjusted basis, of $(286) million for the six months ended March 31, 2002. We had revenue of $4,080 million, a net loss of $4,616 million, net cash provided by operating activities of $269 million and EBITDA, on an adjusted basis, of $(96) million in fiscal 2001. EBITDA equals operating income (loss) plus depreciation and amortization expense. Adjusted EBITDA equals EBITDA plus purchased in-process research and development, net restructuring and separation charges and impairment of goodwill and other acquired intangibles. EBITDA is not intended to represent cash flow or any other measure of performance or liquidity in accordance with generally accepted accounting principles. EBITDA is included here because we believe that you may find it to be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly-titled figures for other companies.

Our business operations are organized into two market-focused groups, Client Systems and Infrastructure Systems, that target the consumer communications and network equipment markets, respectively. Each of these two groups is a reportable operating segment.

The Client Systems segment includes our wireless data, computer communications, storage and wireless terminal solutions products. This segment delivers integrated circuit solutions for a variety of end-user applications such as modems, Internet-enabled cellular terminals and hard-disk drives for computers as well as software, systems and wireless local area network solutions through the ORiNOCO(R) product family. Our Client Systems segment generated revenue of $599 million and $1,406 million for the six months ended March 31, 2002 and the year ended September 30, 2001, respectively.

The Infrastructure Systems segment delivers solutions to the high-speed communications systems market and facilitates the convergence of integrated circuit devices and optoelectronic components. We have consolidated research and development, as well as marketing, for both optoelectronic and integrated circuit devices aimed at communications systems. This allows us to design, develop and deliver complete, interoperable solutions to equipment manufacturers for advanced enterprise, access, metropolitan, long-haul

and undersea applications. Our Infrastructure Systems segment generated revenue of $489 million and $2,674 million for the six months ended March 31, 2002 and the year ended September 30, 2001, respectively.

We sell integrated circuits for use in a broad range of communications networks and computer equipment. Integrated circuits, or chips, are made using semiconductor wafers imprinted with a network of electronic components. They are designed to perform various functions such as processing electronic signals, controlling electronic system functions and processing and storing data.

We also sell active optoelectronic components to manufacturers of communications equipment. Optoelectronic components transmit, process, change, amplify and receive light that carries data and voice traffic over optical networks. Optical networks transmit information as pulses of light, or optical signals, through optical fibers, which are hair-thin glass strands. An optical network utilizes a number of interdependent active optoelectronic and passive optical components. An active component is a device that has both optical and electronic properties. A passive component is a device that functions only in the optical domain. In addition to our broad portfolio of active optoelectronic components, we have started to sell some passive components.

OUR RELATIONSHIP WITH LUCENT

Agere was formed as part of Lucent Technologies' plan to spin-off to its stockholders its microelectronics business, including its integrated circuits and optoelectronics divisions. Our Class A common stock began trading on the New York Stock Exchange following our initial public offering in March 2001. The separation of our business from Lucent's other businesses was substantially completed, including the transfer of all assets and liabilities related to these divisions (other than pension and postretirement plan assets and liabilities) when we completed our initial public offering. On June 1, 2002, Lucent completed our spin-off, distributing to its stockholders all of the Class A common stock and Class B common stock it held on that date. See "Arrangements Between Lucent and Our Company" for further information about our spin-off and our relationship with Lucent.

THE OFFERING

ISSUER.....	Agere Systems Inc., a Delaware corporation.
SECURITIES OFFERED.....	$410 million aggregate principal amount of 6.5% Convertible Subordinated Notes due 2009. We have also granted the underwriters an over-allotment option to purchase up to $40.812 million aggregate principal amount of the notes.
OFFERING PRICE.....	100% of the principal amount of the notes plus accrued interest from June 19, 2002.
MATURITY.....	December 15, 2009, unless earlier redeemed, repurchased or converted. The principal amount of the notes will be paid in cash.
INTEREST.....	The notes will bear interest at an annual rate of 6.5%. Interest on the notes will be paid in

	cash.
INTEREST PAYMENT DATES.....	Interest will be payable semi-annually on June 15 and December 15 of each year, beginning on December 15, 2002.
CONVERSION RIGHTS.....	The notes are convertible at the option of the holder, at any time after the initial date of issuance and prior to redemption, repurchase or maturity, into our Class A common stock at an initial conversion price of $3.3075 per share, subject to adjustment in certain events. See "Description of Notes -- Conversion." The right to convert notes that have been called for redemption will terminate at the close of business on the business day immediately preceding the date of redemption.
REDEMPTION AT THE OPTION OF AGERE.....	On or after June 20, 2007, at any time or from time to time, we may redeem the notes in cash at our option, in whole or in part, on not less than 30 nor more than 60 days' prior written notice to the holders by first-class mail, in cash at the redemption prices set forth herein, plus accrued and unpaid interest to, but not including, the date of the redemption. See "Description of Notes -- Optional Redemption."
REPURCHASE AT THE OPTION OF HOLDERS UPON THE OCCURRENCE OF A FUNDAMENTAL CHANGE.....	Upon a fundamental change, which includes a termination of trading and certain change of control events, each holder of the notes will have the right, subject to certain restrictions and conditions, to require us to repurchase in cash all or any part of such holder's notes at a repurchase price equal to 100% of the principal amount thereof, plus accrued and unpaid interest to, but not including, the date of repurchase. See "Description of Notes -- Fundamental Change Permits Holders to Require Us to Repurchase Notes" and "Risk Factors -- Risks Relating to the Offering -- Even if a fundamental change occurs triggering our obligation to repurchase the notes, we may not be able to repurchase the notes."

SUBORDINATION.....	The notes will be our unsecured subordinated obligations. The notes will be subordinated in right of payment to all existing and future senior indebtedness, including our credit facility. Assuming we had completed this offering as of March 31, 2002 and applied the net proceeds as described in "Use of Proceeds" and the repayment of an additional $540 million of

	borrowings under the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," the notes would have been subordinated to approximately $222 million of senior indebtedness. The notes will also be effectively subordinated to all indebtedness and other liabilities of our subsidiaries. The total balance sheet liabilities of our subsidiaries were approximately $515 million at March 31, 2002. The indenture under which the notes will be issued contains no limitation on the amount of indebtedness or other liabilities, including senior or secured indebtedness, that we or our subsidiaries may incur.
USE OF PROCEEDS.....	We intend to use approximately 50% of the net proceeds from this offering to repay a portion of the short-term debt outstanding under our credit facility and the balance for general corporate purposes.
TRADING.....	We do not intend to apply for listing of the notes on any securities exchange or for inclusion of the notes in any automated quotation system. Our Class A common stock is listed on the New York Stock Exchange under the symbol "AGR.A."
SINKING FUND.....	None.
TRUSTEE.....	The Bank of New York.

RISK FACTORS

See "Risk Factors," which begins on page 8, for a discussion of certain factors that you should consider in evaluating an investment in the notes.

Our principal executive offices are located at 555 Union Boulevard, Allentown, Pennsylvania 18109. Our telephone number is (610) 712-4323. Our World Wide Web site address is www.agere.com. Information contained in our website is not incorporated by reference in this prospectus and, therefore, is not part of this prospectus.

SUMMARY HISTORICAL FINANCIAL INFORMATION

The following table sets forth our summary historical financial information derived from our unaudited financial statements for the six month periods ended March 31, 2002 and 2001, and our audited financial statements for the fiscal years ended September 30, 2001, 2000 and 1999 included elsewhere in this

prospectus. This summary financial information may not be indicative of our future performance as a stand-alone company. You should read the summary financial information in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," our financial statements and the notes thereto included elsewhere in this prospectus.

	SIX MONTHS ENDED MARCH 31,		YEAR ENDED SEPTEMBER 30,		
	2002	2001	2001	2000	1999
	(DOLLARS IN MILLIONS)				
STATEMENT OF OPERATIONS INFORMATION:					
Revenue:					
Client Systems	$ 599	$ 769	$ 1,406	$1,649	$1,424
Infrastructure Systems	489	1,784	2,674	3,059	2,290
Total revenue	1,088	2,553	4,080	4,708	3,714
Costs	1,019	1,532	3,084	2,555	1,949
Gross profit	69	1,021	996	2,153	1,765
Operating expenses:					
Selling, general and administrative	199	336	597	535	573
Research and development	377	537	951	827	683
Purchased in-process research and development	--	--	--	446	17
Amortization of goodwill and other acquired intangibles	37	223	415	189	13
Restructuring and separation -- net	96	47	662	--	--
Impairment of goodwill and other acquired intangibles	176	--	2,762	--	--
Total operating expenses	885	1,143	5,387	1,997	1,286
Operating income (loss)	(816)	(122)	(4,391)	156	479
Cumulative effect of accounting change (net of provision (benefit) for income taxes)	--	(4)	(4)	--	32
Net income (loss)	(594)	(152)	(4,616)	(76)	351
OTHER FINANCIAL DATA:					
Net cash (used in) provided by operating activities	$ (454)	$ 369	$ 269	$ 762	$ 690
Ratio of earnings to fixed charges(1)	n/a	n/a	n/a	2.4	8.7
Deficiency(1)	$ 584	160	$ 4,553	n/a	n/a
SUPPLEMENTAL FINANCIAL DATA:					
EBITDA(2)	$ (558)	$ 320	$(3,520)	$ 822	$ 877
Adjusted EBITDA(3)	(286)	367	(96)	1,268	894

footnotes on next page

	MARCH 31, 2002		SEPTEMBER 30
	HISTORICAL	AS ADJUSTED(4)	HISTORIC
	(DOLLARS IN MILLIONS)		

BALANCE SHEET INFORMATION:			
Cash	$1,604	$1,293	$3,152
Working capital	93	494	156
Total assets	4,291	3,989	6,562
Short-term debt	1,111	400	2,516
Long-term debt	26	436	33
Total stockholders' equity	1,910	1,910	2,461

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(1) For purposes of determining the ratio of earnings to fixed charges, "earnings" are defined as income (loss) from continuing operations before income taxes less undistributed earnings of equity investments plus fixed charges less interest capitalized during the period. "Fixed charges" consist of interest expense on all indebtedness and that portion of operating lease rental expense that is representative of the interest factor. "Deficiency" is the amount by which fixed charges exceeded earnings.

(2) EBITDA equals operating income (loss) plus depreciation and amortization expense. EBITDA is not intended to represent cash flow or any other measure of performance or liquidity in accordance with generally accepted accounting principles. EBITDA is included here because we believe that you may find it to be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly-titled figures for other companies.

(3) The calculation of adjusted EBITDA is shown below:

	SIX MONTHS ENDED MARCH 31,		YEAR ENDED SEPTEMBER 30,		
	2002	2001	2001	2000	1999
	(DOLLARS IN MILLIONS)				
EBITDA	$(558)	$320	$(3,520)	$ 822	$877
Purchased in-process research and development	--	--	--	446	17
Restructuring and separation -- net	96	47	662	--	--
Impairment of goodwill and other acquired intangibles	176	--	2,762	--	--
Adjusted EBITDA	$(286)	$367	$ (96)	$1,268	$894

(4) The "as adjusted" information is derived from data contained in our historical financial statements which has been adjusted to give pro forma effect to the issuance and sale of the notes and the application of the net proceeds therefrom as described under "Use of Proceeds" and the repayment of an additional $540 million of the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," as if such transactions had occurred as of March 31, 2002.

RISK FACTORS

An investment in the notes is subject to a number of risks. You should carefully consider the following risk factors and all the other information contained in this prospectus before investing in our notes.

RISKS RELATED TO OUR SEPARATION FROM LUCENT

OUR HISTORICAL FINANCIAL INFORMATION PRIOR TO THE FEBRUARY 1, 2001 CONTRIBUTION TO US OF OUR BUSINESS FROM LUCENT MAY NOT BE REPRESENTATIVE OF OUR RESULTS AS A STAND-ALONE COMPANY AND, THEREFORE, MAY NOT BE RELIABLE AS AN INDICATOR OF OUR HISTORICAL OR FUTURE RESULTS.

Our historical consolidated and combined financial statements may not be indicative of our future performance as a stand-alone company. This is primarily a result of the three factors described below.

- First, our historical consolidated and combined financial statements reflect allocations, primarily with respect to general corporate expenses, research expense and interest expense, which may be less than the expenses we will incur in the future as a stand-alone company.

- Second, the information does not reflect significant changes that we expect to occur in the future as a result of our separation from Lucent, including changes in how we fund our operations, conduct research and handle tax and employee matters.

- Third, our historical consolidated and combined financial statements include substantial revenue from sales to Lucent. This revenue may not reflect the pricing, volume or percentage of our sales we would have derived from Lucent if we were a stand-alone company.

BECAUSE LUCENT'S BELL LABORATORIES' CENTRAL RESEARCH ORGANIZATION HISTORICALLY PERFORMED IMPORTANT RESEARCH FOR US, WE MUST CONTINUE TO DEVELOP OUR OWN CORE RESEARCH CAPABILITY. WE MAY NOT BE SUCCESSFUL, WHICH COULD MATERIALLY HARM OUR PROSPECTS AND ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

If our separate research efforts are not as successful as when we were part of Lucent, we may not be able to keep pace with the rapid technological change in our industry and our prospects may be harmed. Many of our products use technology and manufacturing processes derived from innovations developed by Lucent's Bell Laboratories central research organization. After the contribution to us of our business in February 2001, Lucent has no obligation to provide research and development for us except as agreed to in the development project agreement and joint design center operating agreement described under "Arrangements Between Lucent and Our Company." We cannot assure you that our independent research efforts will be as successful as the efforts of Bell Laboratories have been historically or that our efforts will not require us to increase our expenditures for the same services over the amounts in our historical combined and consolidated financial statements. A significant increase in our expenditures for the same services may adversely affect our results of operations. We may not be able to recruit engineers and other research and development employees as effectively as Bell Laboratories was able to because of its history, name recognition and size.

WE COULD INCUR SIGNIFICANT TAX LIABILITY IF LUCENT FAILS TO PAY THE TAX LIABILITIES ATTRIBUTABLE TO LUCENT UNDER OUR TAX SHARING AGREEMENT, WHICH COULD REQUIRE US TO PAY A SUBSTANTIAL AMOUNT OF MONEY.

We and Lucent have entered into a tax sharing agreement that allocates responsibility for tax liabilities between us and them. For a discussion of this

agreement, please see "Arrangements Between Lucent and Our Company -- Agreements Providing for the Separation of Our Businesses from Lucent -- Tax Sharing Agreement." Under U.S. federal income tax laws, we and Lucent are jointly and severally liable for Lucent's federal income taxes attributable to periods prior to and including the most recent taxable year of Lucent, which ended on September 30, 2001. This means that if Lucent fails to pay the taxes attributable to it under the tax sharing agreement for those periods, we may be liable for any part of, including the whole amount of, these liabilities.

BECAUSE THE DIVISION OF ENFORCEMENT OF THE SECURITIES AND EXCHANGE COMMISSION IS INVESTIGATING MATTERS BROUGHT TO ITS ATTENTION BY LUCENT, OUR BUSINESS MAY BE AFFECTED IN A MANNER WE CANNOT FORESEE AT THIS TIME.

On November 21, 2000, and again on December 21, 2000, Lucent brought to the attention of the staff of the Securities and Exchange Commission matters relating to its recognition of revenue. Lucent also publicly disclosed these matters in press releases on those dates. Although Lucent has informed us that it has no reason to believe that this investigation by the Division of Enforcement of the Securities and Exchange Commission into these matters concerns our business and we are not aware of any reason why the investigation would affect us, it is possible that the results of the investigation may have an impact on us. Although the investigation could result in no action being taken by the Securities and Exchange Commission, if an action is taken and the investigation is found to concern our business, the action could result in monetary fines or changes in some of our financial and other practices and procedures that we are unable to foresee at this time.

WE ARE LIMITED IN THE AMOUNT OF STOCK THAT WE CAN ISSUE TO RAISE CAPITAL BECAUSE OF POTENTIAL ADVERSE TAX CONSEQUENCES.

Under Section 355(e) of the Internal Revenue Code, Lucent will recognize taxable gain on the distribution of our stock if there are one or more acquisitions of our stock representing 50% or more of our stock (by vote or value) and the stock acquisitions are part of a plan or series of related transactions that includes the distribution. Any shares of our stock acquired within two years before or after the distribution are presumed to be part of such a plan unless we can rebut that presumption. If an issuance of our stock causes the distribution to be taxable to Lucent under Section 355(e), we would be required to indemnify Lucent against that tax under the tax sharing agreement.

The shares of our Class A common stock issued in our initial public offering are considered to be part of a plan that includes the distribution, and the shares of our Class A common stock issued upon the conversion of the notes included in this offering may also be considered to be part of a plan that includes the distribution. We do not currently intend to enter into transactions whereby more than 47% of our outstanding shares may be treated as acquired as part of a plan that includes the distribution. After the completion of this offering, approximately 47% of our outstanding shares may be treated as acquired as part of such a plan. As a practical matter, this prevents us from effecting any significant issuance of our shares if such issuance might be treated as part of a plan that includes the distribution.

Treasury Regulations issued on April 24, 2002 provide safe harbors that may be used to rebut the presumption that shares issued less than two years after the spin-off are part of a plan that includes the spin-off. However, the application of the safe harbors is not clear in many respects, and they might not be available to us for future share issuances. As a result, Section 355(e) may effectively prevent us from issuing shares to raise capital for at least two

years after the spin-off. See "Arrangements Between Lucent and Our Company -- Tax Limitations on Additional Issuances of Our Stock." However, the safe harbors in these new Treasury Regulations generally provide that issuances of our stock to our employees pursuant to ordinary course employee compensation arrangements (such as employee stock purchase plans) will not be treated as acquisitions of our stock pursuant to a plan that includes the spin-off.

RISKS RELATED TO OUR BUSINESS

THE DEMAND FOR PRODUCTS IN OUR INDUSTRY HAS RECENTLY DECLINED, AND WE CANNOT PREDICT THE DURATION OR EXTENT OF THIS TREND. SALES OF OUR INTEGRATED CIRCUITS AND OPTOELECTRONIC COMPONENTS ARE DEPENDENT ON THE GROWTH OF COMMUNICATIONS NETWORKS.

We derive, and expect to continue to derive, a significant amount of revenue from the sale of integrated circuits and optoelectronic components used in optical, wired and wireless communications networks. The current economic downturn has resulted in reduced purchasing in many of the markets we serve worldwide. In particular, the communications equipment industry is currently in a cycle characterized by diminished product demand, excess manufacturing capacity and the erosion of average selling prices. If

the long-term growth in demand for communications networks does not occur as we expect, the demand for many of our integrated circuits and optoelectronic components may decline or grow more slowly than we expect. As a result, we may not be able to grow our business and our revenue may decline from current levels.

IF WE DO NOT COMPLETE OUR ANNOUNCED RESTRUCTURING AND FACILITY CONSOLIDATION ACTIVITIES AS EXPECTED OR EVEN IF WE DO SO, WE MAY NOT ACHIEVE ALL OF THE EXPENSE REDUCTIONS WE ANTICIPATE.

Our business has been experiencing lower revenues due to decreased and canceled customer orders. Our revenue declined significantly in fiscal 2001 and the first quarter of fiscal 2002. During fiscal 2001 and the first quarter of fiscal 2002, we announced a series of restructuring initiatives to align Agere with market conditions. These initiatives are focused on improving gross profit, reducing expenses and streamlining operations. These restructuring initiatives include a worldwide workforce reduction, rationalization of manufacturing capacity and other restructuring initiatives. In addition, we are consolidating our operations at a number of facilities. If we do not complete these restructuring and consolidation activities as expected or even if we do so, we may not achieve all of the expense reductions we anticipate.

BECAUSE WE EXPECT TO CONTINUE TO DERIVE A MAJORITY OF OUR REVENUE FROM SEMICONDUCTOR DEVICES AND THE INTEGRATED CIRCUITS INDUSTRY IS HIGHLY CYCLICAL, OUR REVENUE MAY FLUCTUATE.

We expect to continue to derive a majority of our revenue from integrated circuits products. Because the integrated circuits market segment is highly cyclical, we may have declines in our revenue that are primarily related to industry conditions and not our products. This market segment has experienced significant downturns, often in connection with, or in anticipation of, excess manufacturing capacity worldwide, maturing product cycles and declines in general economic conditions, and we are currently experiencing such a downturn. Historically, revenue derived from integrated circuits has represented 70 to 85% of our consolidated revenues.

OUR QUARTERLY REVENUE AND OPERATING RESULTS MAY VARY SIGNIFICANTLY IN FUTURE

PERIODS DUE TO THE NATURE OF OUR BUSINESS.

Our quarterly revenue and income (loss) from operations may vary significantly from quarter to quarter because of the nature of our revenue and planned product introductions. For example, because of our lengthy sales and design processes, the effects of failing to be selected by a customer to provide a product may result in significantly lower revenue later, as compared to prior periods with more revenue from earlier design wins. In addition, sales of our products for specific customer projects often begin and end abruptly, so revenue may increase rapidly and later decrease just as quickly. The relative timing of the beginning and end of our sales and design processes can make our revenues less predictable.

IF WE FAIL TO KEEP PACE WITH TECHNOLOGICAL ADVANCES IN OUR INDUSTRY OR IF WE PURSUE TECHNOLOGIES THAT DO NOT BECOME COMMERCIALLY ACCEPTED, CUSTOMERS MAY NOT BUY OUR PRODUCTS AND OUR REVENUE MAY DECLINE.

The demand for our products can change quickly and in ways we may not anticipate because our industry is generally characterized by:

- rapid, and sometimes disruptive, technological developments;
- evolving industry standards;
- changes in customer requirements;
- limited ability to accurately forecast future customer orders;
- frequent new product introductions and enhancements; and
- short product life cycles with declining prices over the life cycle of the product.

If we fail to make sufficient investments in research and development programs in order to develop new and enhanced products and solutions, or if we focus on technologies that do not become widely adopted, new technologies could render our current and planned products obsolete, resulting in the need to change the focus of our research and development and product strategies and disrupting our business significantly.

BECAUSE MANY OF OUR CURRENT AND PLANNED PRODUCTS ARE HIGHLY COMPLEX, THEY MAY CONTAIN DEFECTS OR ERRORS THAT ARE DETECTED ONLY AFTER DEPLOYMENT IN COMMERCIAL COMMUNICATIONS NETWORKS, AND IF THIS OCCURS, IT COULD HARM OUR REPUTATION AND RESULT IN INCREASED EXPENSE.

Our products are highly complex and may contain undetected defects, errors or failures. These products can only be fully tested when deployed in commercial communications networks and other equipment. Consequently, our customers may discover errors after the products have been deployed. The occurrence of any defects, errors or failures could result in:

- cancelation of orders;
- product returns, repairs or replacements;
- diversion of our resources;
- legal actions by our customers or our customers' end-users;

- increased insurance costs; and

- other losses to us or to our customers or end users.

Any of these occurrences could also result in the loss of or delay in market acceptance of our products and loss of sales, which would harm our business and adversely affect our revenue and results of operations. We have from time to time experienced defects and expect to experience defects in the future. Because the trend in our industry is moving toward even more complex products in the future, this risk will intensify over time.

OUR PRODUCTS AND TECHNOLOGIES TYPICALLY HAVE LENGTHY DESIGN AND DEVELOPMENT CYCLES. A CUSTOMER MAY DECIDE TO CANCEL OR CHANGE ITS PRODUCT PLANS, WHICH COULD CAUSE US TO GENERATE NO REVENUE FROM A PRODUCT AND ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

We may never generate any revenue from our products after incurring significant design and development expenditures. A delay or cancelation of a customer's plans could significantly adversely affect our financial results. Unlike some of our competitors, we primarily focus on winning competitive selection processes to develop products for use in our customers' equipment. These selection processes can be lengthy. After winning and beginning a product design for a customer, that customer may not begin volume production of their equipment for a period of up to two years, if at all. Due to this lengthy design and development cycle, we may experience delays from the time we begin incurring expenses until the time we generate revenue from our products. We have no assurances that our customers will ultimately market and sell their equipment or that such efforts by our customers will be successful.

BECAUSE OUR SALES ARE CONCENTRATED ON LUCENT AND A FEW OTHER CUSTOMERS, OUR REVENUE MAY MATERIALLY DECLINE IF ONE OR MORE OF OUR KEY CUSTOMERS DO NOT CONTINUE TO PURCHASE OUR EXISTING AND NEW PRODUCTS IN SIGNIFICANT QUANTITIES.

Our customer base is highly concentrated. Our top ten end customers accounted for approximately 53% of our revenue in fiscal 2001. If any one of our key customers decides to purchase significantly less from us or to terminate its relationship with us, our revenue may materially decline. Because our strategy has generally been to develop long-term relationships with a few key customers in the product areas in which we focus and we have a long product design and development cycle for most of our products, we may be unable to replace these customers quickly or at all. We could lose our key customers or significant

sales to our key customers because of factors beyond our control, such as a significant disruption in our customers' businesses generally or in a specific product line.

In particular, we depend on Lucent as a key customer. We derived 14.9% of our revenue from sales to Lucent in fiscal 2001. We expect to continue to be dependent on Lucent for a significant percentage of our revenue.

IF WE FAIL TO ATTRACT, HIRE AND RETAIN QUALIFIED PERSONNEL, WE MAY NOT BE ABLE TO DEVELOP, MARKET OR SELL OUR PRODUCTS OR SUCCESSFULLY MANAGE OUR BUSINESS.

In some fields, there are only a limited number of people in the job market with the requisite skills, particularly people with optoelectronic technology expertise. We have in the past experienced difficulty in identifying and hiring qualified engineers in many areas of our business as well as in retaining our current employees. The loss of the services of any key personnel or our inability to hire new personnel with the requisite skills could restrict our

ability to develop new products or enhance existing products in a timely manner, sell products to our customers or manage our business effectively.

BECAUSE WE ARE SUBJECT TO ORDER AND SHIPMENT UNCERTAINTIES, ANY SIGNIFICANT CANCELLATIONS OR DEFERRALS COULD CAUSE OUR REVENUE TO DECLINE OR FLUCTUATE.

We generally sell products pursuant to purchase orders that customers may cancel or defer on short notice without incurring a significant penalty. Cancelations or deferrals could cause us to hold excess inventory, which could adversely affect our results of operations and restrict our ability to fund our operations. If a customer cancels or defers product shipments, we may incur unanticipated reductions or delays in our revenue. If a customer refuses to accept shipped products or does not timely pay for these products, we could incur significant charges against our income, which could materially and adversely affect our operating results.

IF WE DO NOT ACHIEVE ADEQUATE MANUFACTURING UTILIZATION, YIELDS, VOLUMES OR SUFFICIENT PRODUCT RELIABILITY, OUR GROSS MARGINS WILL BE REDUCED.

Because the majority of our manufacturing costs are relatively fixed, efficient utilization of manufacturing facilities and manufacturing yields are critical to our results of operations. Some of our manufacturing facilities have been underutilized, which has reduced our gross margins. Lower than expected manufacturing yields could impair our gross margins and delay product shipments.

In the event of an increase in demand, failure to increase our manufacturing volumes to meet our customers' increasing needs and satisfy customer demand will have a significant effect on our gross margins. In some cases, existing manufacturing capacity may be insufficient to achieve the volume or cost targets of our customers.

The manufacture of our products involves highly complex and precise processes, requiring production in highly controlled and clean environments. Changes in our manufacturing processes or those of our suppliers or contractors, or their inadvertent use of defective or contaminated materials, could significantly reduce our manufacturing yields and product reliability.

WE HAVE RELATIVELY HIGH GROSS MARGIN ON THE REVENUE WE DERIVE FROM THE LICENSING OF OUR INTELLECTUAL PROPERTY, AND A DECLINE IN THIS REVENUE WOULD HAVE A GREATER IMPACT ON OUR NET INCOME THAN A DECLINE IN REVENUE FROM OUR INTEGRATED CIRCUITS AND OPTOELECTRONIC PRODUCTS.

The revenue we generate from the licensing of our intellectual property has a high gross margin compared to the revenue we generate from our integrated circuits and optoelectronic products. Although we have derived less than 6% of our total revenue in recent years from the licensing of intellectual property, a decline in this licensing revenue would have a greater impact on our profitability than a similar decline in revenues from our integrated circuits and optoelectronic products.

WE DEPEND ON JOINT VENTURES OR OTHER THIRD-PARTY STRATEGIC RELATIONSHIPS FOR THE MANUFACTURE OF SOME OF OUR PRODUCTS, ESPECIALLY INTEGRATED CIRCUITS. IF THESE MANUFACTURERS ARE UNABLE TO FILL OUR ORDERS ON A TIMELY AND RELIABLE BASIS, OUR REVENUE MAY DECLINE.

We currently manufacture our integrated circuits and optoelectronic components through a combination of internal capability, joint ventures and external sourcing with contract manufacturers. Over the past two quarters, approximately 30 to 40% of our revenue was derived principally from integrated

circuits manufactured at joint ventures or through other external sourcing arrangements. To the extent we rely on joint ventures and third-party manufacturing relationships, especially with respect to integrated circuits, we face the following risks:

- their inability to develop manufacturing methods appropriate for our products;
- that the manufacturing costs will be higher than planned;
- that the reliability of our products will decline;
- their unwillingness to devote adequate capacity to produce our products;
- their inability to maintain continuing relationships with our suppliers; and
- the reduction of our control over delivery schedules and costs of our products.

If any of these risks is realized, we could experience an interruption in supply or an increase in costs, which could delay or decrease our revenue or adversely affect our results of operations.

IF OUR CUSTOMERS DO NOT QUALIFY OUR MANUFACTURING LINES OR THE MANUFACTURING LINES OF OUR THIRD-PARTY SUPPLIERS FOR VOLUME SHIPMENTS, OUR REVENUE MAY BE DELAYED OR REDUCED.

Customers will not purchase any of our products, other than limited numbers of evaluation units, prior to qualification of the manufacturing line for the product. We may not always be able to satisfy the qualifications. Delays in qualification can cause a customer to discontinue use of the product and result in a significant loss of revenue.

BECAUSE OUR INTEGRATED CIRCUIT AND OPTOELECTRONIC COMPONENT AVERAGE SELLING PRICES IN PARTICULAR PRODUCT AREAS ARE DECLINING AND SOME OF OUR OLDER PRODUCTS ARE MOVING TOWARD THE END OF THEIR PRODUCT LIFE CYCLES, OUR RESULTS OF OPERATIONS MAY BE ADVERSELY AFFECTED.

We have in the past, and will in the future, experience declines in the average selling prices for some of our integrated circuits and optoelectronic components. For our products, the declines are due to, among other things, downturns in the semiconductor and communications industries, increased competition, lower costs of producing products and greater unit volumes. In addition, because our industry is characterized by rapid technological change and short product life cycles, in any given year we may have a substantial amount of revenue from products that are nearing the end of their product lives. The average age of our products is approximately two years, and approximately one third of our revenues are from products older than two years. If we do not offset sales decreases in older products by increases in sales of other products, including new products, our revenue will decline. If we are not able to replace products in a timely manner, our results of operations may be adversely affected.

WE CONDUCT A SIGNIFICANT AMOUNT OF OUR SALES ACTIVITY AND MANUFACTURING EFFORTS OUTSIDE THE UNITED STATES, WHICH SUBJECTS US TO ADDITIONAL BUSINESS RISKS AND MAY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS DUE TO INCREASED COSTS.

In fiscal 2001, we derived 55% of our revenue from sales of our products shipped to locations outside the United States. We also manufacture a significant portion of our products outside the United States and are dependent

on international suppliers for many of our parts. We intend to continue to pursue growth opportunities in both sales and manufacturing internationally. International operations are subject to a

number of risks and potential costs, which could adversely affect our revenue and results of operations, including:

- our new brand will not be locally recognized, which will cause us to spend significant amounts of time and money to build a brand identity;
- unexpected changes in regulatory requirements;
- inadequate protection of intellectual property in some countries outside of the United States;
- currency exchange rate fluctuations; and
- political and economic instability.

WE ARE SUBJECT TO ENVIRONMENTAL, HEALTH AND SAFETY LAWS, WHICH COULD INCREASE OUR COSTS AND RESTRICT OUR OPERATIONS IN THE FUTURE.

We are subject to a variety of laws relating to the use, disposal, clean-up of, and human exposure to, hazardous chemicals. Any failure by us to comply with present and future environmental, health and safety requirements could subject us to future liabilities or the suspension of production. In addition, compliance with these or future laws could restrict our ability to expand our facilities or require us to acquire costly pollution control equipment, incur other significant expenses or modify our manufacturing processes. In the event of the discovery of additional contaminants or the imposition of additional cleanup obligations at these or other sites, we could be adversely affected.

THE COMMUNICATIONS COMPONENT INDUSTRY IS INTENSELY COMPETITIVE, AND OUR FAILURE TO COMPETE EFFECTIVELY COULD HURT OUR REVENUE.

The market segments for optoelectronic components and integrated circuits are intensely competitive and subject to rapid and disruptive technological change. We expect the intensity of competition to continue to increase in the future as existing competitors enhance and expand their product offerings and as new participants enter the market. Increased competition may result in price reductions, reduced gross margins and loss of market share. We cannot assure you that we will be able to compete successfully against existing or future competitors, which may hurt our revenue.

WE MAY BE SUBJECT TO INTELLECTUAL PROPERTY LITIGATION AND INFRINGEMENT CLAIMS, WHICH COULD CAUSE US TO INCUR SIGNIFICANT EXPENSES OR PREVENT US FROM SELLING OUR PRODUCTS. IF WE ARE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS, OUR BUSINESSES AND PROSPECTS MAY BE HARMED.

Like other companies in the semiconductor industry, we experience frequent litigation regarding patent and other intellectual property rights. From time to time, we receive notices from third parties of potential infringement and receive claims of potential infringement when we attempt to license our intellectual property to others. Defending these claims could be costly and time consuming and would divert the attention of management and key personnel from other business issues. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement also might require us to enter into costly royalty or license agreements. However, we may be unable to obtain royalty or

license agreements on terms acceptable to us or at all. In addition, third parties may attempt to appropriate the confidential information and proprietary technologies and processes used in our business, which we may be unable to prevent and would harm our businesses and prospects.

IF WE CANNOT MAINTAIN OUR STRATEGIC RELATIONSHIPS OR IF OUR STRATEGIC RELATIONSHIPS FAIL TO MEET THEIR GOALS OF DEVELOPING TECHNOLOGIES OR PROCESSES, WE WILL LOSE OUR INVESTMENT AND MAY FAIL TO KEEP PACE WITH THE RAPID TECHNOLOGICAL DEVELOPMENTS IN OUR INDUSTRY.

In the past, we have entered into strategic relationships to develop technologies and manufacturing processes. If any of our strategic relationships do not accomplish our intended goals or do not develop the

technology or processes sought, we will not realize a return on our investment. Currently our only material strategic investment is Silicon Manufacturing Partners Pte Ltd., a joint venture entered into with Chartered Semiconductor. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources -- Contractual Obligations and Commitments."

WE MAY NOT HAVE FINANCING FOR FUTURE STRATEGIC INITIATIVES, WHICH MAY PREVENT US FROM ADDRESSING GAPS IN OUR PRODUCT OFFERINGS THAT MAY ARISE IN THE FUTURE, IMPROVING OUR TECHNOLOGY OR INCREASING OUR MANUFACTURING CAPACITY.

If we are unable to incur additional debt or issue equity for future strategic initiatives, we may fail to address gaps in our product offerings, improve our technology or increase our manufacturing capacity. We cannot assure you that such financing will be available to us on acceptable terms or at all. Our credit agreement restricts our ability to incur debt and requires us to use a portion of the proceeds from any debt or equity issuance to repay the credit facility, as described in "Certain Indebtedness." Also, in connection with our spin-off from Lucent, we are significantly restricted in our ability to issue stock in order to raise capital. See "Arrangements Between Lucent and Our Company -- Tax Limitations on Additional Issuance of Our Stock."

IF WE ARE UNABLE TO EXTEND OR REFINANCE OUR CREDIT FACILITY WHEN IT MATURES ON SEPTEMBER 30, 2002, WE MAY NOT HAVE SUFFICIENT CASH AVAILABLE TO REPAY THAT FACILITY OR TO FUND OUR OPERATIONS.

We cannot assure you that we will be able to extend or refinance our credit facility before it matures on September 30, 2002. While we currently have sufficient cash on hand to repay amounts outstanding under the credit facility when it matures, we cannot assure you that we will have sufficient cash to repay those amounts when due. In recent periods, we have incurred substantial losses and used cash on hand to fund our operations and other cash needs, and we expect these conditions to continue in the near future. If we are required to repay our credit facility, and we are unable to obtain alternate sources of financing, we may not be able to fund our operations, make capital expenditures or service our debt. Under these circumstances, we would consider actions such as eliminating employee bonuses, accelerating already planned expense reductions, imposing further limits on capital spending and retiming certain restructuring activities to enable us to meet our cash requirements. However, we cannot assure you that these actions will be feasible at the time or prove adequate. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

RISKS RELATED TO THE OFFERING

WE HAVE A SIGNIFICANT AMOUNT OF DEBT, WHICH SUBJECTS US TO VARIOUS RESTRICTIONS AND INTEREST COSTS.

We have a credit facility under which $960 million was outstanding at March 31, 2002. See "Certain Indebtedness" for a description of the credit facility. We will use approximately 50% of the net proceeds from the notes to repay a portion of this short-term debt. After giving pro forma effect to the issuance and sale of the notes and the application of the net proceeds therefrom as described under "Use of Proceeds" and the repayment of an additional $540 million of the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," as of March 31, 2002, our total outstanding debt would have been $836 million.

The credit facility is secured by our principal domestic assets other than the proceeds of our initial public offering. The maturity date of the credit facility has been extended from February 22, 2002 to September 30, 2002. In addition, if we raise at least $500 million in equity or debt capital markets transactions before September 30, 2002, or $90 million after giving effect to this offering, the maturity date of the credit facility will be extended to September 30, 2004, with the credit facility required to be reduced to $750 million on September 30, 2002 and $500 million on September 30, 2003. The credit facility imposes, and future indebtedness may impose, various restrictions and covenants on us which could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take

advantage of business opportunities. Our interest expense may be materially different as a stand-alone company than the interest expense reflected in our historical combined statement of operations for periods prior to completion of our initial public offering. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources" for details about our historical interest expense and interest expense under our credit facility.

WE AND OUR SUBSIDIARIES MAY BE ABLE TO INCUR SUBSTANTIALLY MORE DEBT.

Subject to the restrictions in our credit facility, we may incur significant additional debt. Although the terms of our credit facility contain restrictions on the incurrence of additional debt, these restrictions are subject to a number of qualifications and exceptions, and debt incurred in compliance with these restrictions could be substantial. New debt may be senior debt. If new debt is added to our and our subsidiaries' current debt levels, the related risks that we and they now face could intensify.

RESTRICTIONS IN OUR CREDIT FACILITY MAY LIMIT OUR ACTIVITIES.

Our credit facility contain restrictions on our activities, including covenants limiting our ability to:

- incur indebtedness;
- incur or permit to exist liens or security interests on our assets;
- merge or consolidate with another entity or sell all or substantially all of our assets;
- make investments in non-affiliates and certain of our subsidiaries;
- declare or pay dividends on our capital stock;

- consummate certain transactions with our affiliates; and

- consummate certain sale and leaseback or collateralized mortgage obligation transactions.

We also are required to satisfy specified financial covenants under the terms of our credit facility. These restrictions may make it difficult for us to successfully execute our business strategy or to compete in the worldwide integrated circuits and optoelectronic components industries with companies not similarly restricted.

BECAUSE THE NOTES WILL BE OUR SUBORDINATED OBLIGATIONS, WE MAY NOT MAKE ANY PAYMENTS ON THE NOTES IF ANY OF OUR SENIOR INDEBTEDNESS IS NOT PAID WHEN DUE.

The notes will be our unsecured subordinated obligations, subordinate in right of payment to all of our existing and future senior indebtedness, including all indebtedness under our credit facility. We may not pay principal of, premium, if any, or interest on the notes when due if any senior indebtedness is not paid in cash when due. In addition, in the event of an acceleration of the notes because of an event of default, the holders of senior indebtedness will be entitled to payment in full in cash in respect of such senior indebtedness before the holders of the notes will be entitled to receive any payment in respect of the notes. Moreover, the indenture provides that, under certain circumstances, no payment with respect to the notes may be made if certain non-payment defaults occur with respect to certain designated senior indebtedness, including indebtedness under our credit facility.

IN THE EVENT OF OUR BANKRUPTCY OR LIQUIDATION, OUR ASSETS WILL NOT BE AVAILABLE TO MAKE ANY PAYMENTS TO THE HOLDERS OF THE NOTES UNTIL WE HAVE MADE ALL PAYMENTS TO HOLDERS OF SENIOR INDEBTEDNESS.

In the event of insolvency, liquidation, reorganization or a similar proceeding, our senior indebtedness must be paid in full before the principal of, and premium, if any, and interest on the notes may be paid. In the event of a bankruptcy, liquidation or reorganization, holders of the notes will participate ratably (based upon respective amounts owed to each holder or creditor) with all holders of subordinated indebtedness that is deemed to be of the same class as the notes in the remaining assets. If any of these events occur, we cannot assure you that there would be sufficient assets to pay amounts due on the notes. After giving

pro forma effect to the issuance and sale of the notes and the application of the net proceeds therefrom as described under "Use of Proceeds" and the repayment of an additional $540 million of the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," as of March 31, 2002, we would have had approximately $222 million of senior indebtedness outstanding.

YOUR RIGHT TO RECEIVE PAYMENTS ON THE NOTES IS UNSECURED AND WILL BE EFFECTIVELY SUBORDINATED TO OUR AND OUR SUBSIDIARIES' EXISTING AND FUTURE SECURED INDEBTEDNESS.

The notes will be general unsecured subordinated obligations, effectively junior to any secured debt that we and our subsidiaries have and may have in the future to the extent of the value of the assets securing that debt. Our borrowings under our credit facility and accounts receivable securitization are secured. After giving pro forma effect to the issuance and sale of the notes and the application of the net proceeds therefrom as described under "Use of

Proceeds" and the repayment of an additional $540 million of the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources," as of March 31, 2002, we and our subsidiaries would have had $385 million of secured indebtedness outstanding.

In the event of liquidation, dissolution, reorganization, bankruptcy or any similar proceeding, whether voluntarily or involuntarily instituted, the holders of our secured debt will be entitled to be paid from our or our subsidiaries' assets, as applicable, before any payment may be made with respect to the notes. If any of the foregoing events occurs, we cannot assure you that we will have sufficient assets to pay amounts due on our secured debt and the notes. As a result, the holders of the notes may receive less, ratably, than the holders of secured debt in the event of our liquidation, dissolution, reorganization, bankruptcy or other similar occurrence.

SOME SIGNIFICANT RESTRUCTURING TRANSACTIONS MAY NOT CONSTITUTE A FUNDAMENTAL CHANGE, IN WHICH CASE WE WOULD NOT BE OBLIGATED TO OFFER TO REPURCHASE THE NOTES.

Upon the occurrence of a fundamental change, which includes certain specific kinds of change of control events, we will be required to offer to repurchase all outstanding notes. The fundamental change repurchase feature is a result of negotiations between us and the underwriters. The reason for giving holders of the notes this right to require us to repurchase the notes in the event of a change of control is that note holders will have purchased our notes based in part on their comfort with our management. However, the fundamental change provisions will not afford protection to holders of notes in the event of certain transactions. For example, certain transactions, such as leveraged recapitalizations, refinancings, restructurings or acquisitions initiated by us, would not constitute a change of control and therefore not constitute a fundamental change requiring us to repurchase the notes. Certain other transactions may not constitute a change of control because they do not involve a change in voting power or beneficial ownership of the magnitude required under the definition of change of control. In the event of any such transaction, note holders would not have the right to require us to repurchase the notes, even though each of these transactions could increase the amount of our indebtedness, or otherwise adversely affect our capital structure or credit ratings, thus adversely affecting the holders of notes.

In addition, the definition of change of control includes a phrase relating to the sale of all or substantially all of our assets, determined on a consolidated basis. Although there is a limited body of case law interpreting the phrase "substantially all," there is no precise established definition of the phrase under New York law (which governs the indenture and the notes). Accordingly, the ability of a holder of notes to require us to repurchase the notes as a result of a sale of less than all of our assets, determined on a consolidated basis, may be uncertain. See "Description of Notes -- Fundamental Change Permits Holders to Require Us to Repurchase Notes."

EVEN IF A FUNDAMENTAL CHANGE DOES OCCUR TRIGGERING OUR OBLIGATION TO REPURCHASE THE NOTES, WE MAY NOT BE ABLE TO REPURCHASE THE NOTES.

The source of funds for any repurchase required as a result of any fundamental change will be our available cash, cash generated from our operations or other sources, including borrowings, sales of assets or funds provided by a new controlling entity. We cannot assure you, however, that sufficient funds will be available at the time of the fundamental change to make the required repurchase of notes. Under our credit facility, a change in control

(as defined in the credit agreement) constitutes an event of default allowing the lenders to require repayment of the facility. Even if the credit facility were to remain outstanding, restrictions in the credit facility will not allow such repurchases. Consequently, if we are unable to prepay our indebtedness under our credit facility or obtain the requisite consent under our credit facility, we will be unable to fulfill our repurchase obligations if holders of notes exercise their repurchase rights following a change of control that constitutes a fundamental change, resulting in an event of default under the indenture. Furthermore, such event of default under the indenture will result in a cross-default under our credit facility and may constitute an event of default under other, future senior debt. Under these circumstances, the subordination provisions in the indenture would restrict payments to you before these obligations are satisfied. Additionally, the fundamental change repurchase feature of the notes may in certain circumstances make it more difficult or discourage a sale or takeover of us and thus, the removal of incumbent management. See "Description of Notes -- Fundamental Change Permits Holders to Require Us to Repurchase Notes."

THERE IS NO ESTABLISHED TRADING MARKET FOR THE NOTES, AND ANY MARKET FOR THE NOTES MAY BE ILLIQUID.

We do not intend to apply for a listing of the notes on a securities exchange. There is currently no established market for the notes, and we cannot assure you of any of the following:

- the liquidity of any market that may develop for the notes;

- your ability to sell the notes; or

- the price at which you will be able to sell the notes.

Although the underwriters have advised us that they currently intend to make a market for the notes, the underwriters are not obligated to do so. Any underwriters that make a market in the notes may discontinue their market making at any time at their discretion without notice to the holders of the notes. In addition, market-making activity by the underwriters will be subject to the limits imposed by the Securities Act of 1933 and the Securities Exchange Act of 1934. As a result, we cannot assure you that any market in the notes will develop or, if one does develop, that it will be maintained. If a market for the notes does develop, prevailing interest rates, the markets for similar securities and other factors could cause the notes to trade at prices lower than their purchase price or reduce the liquidity of the notes.

BECAUSE OUR QUARTERLY REVENUE AND OPERATING RESULTS ARE LIKELY TO VARY SIGNIFICANTLY IN FUTURE PERIODS, OUR COMMON STOCK PRICE MAY DECLINE.

Our quarterly revenue and income from operations have varied and are likely to continue to fluctuate significantly from quarter to quarter because of the nature of our business and planned product introductions. If our quarterly revenue or operating results fall below the expectations of securities analysts or investors, the price of our common stock may fall substantially. For example, because of our lengthy sales and design processes described above, the effects of failing to be selected by a customer to provide a product may result in significantly lower revenue in subsequent periods, as compared to prior periods with more revenue from earlier design wins. We have experienced fluctuations in quarterly revenue for this reason in the past. In addition, sales of our products for specific customer projects often begin and end abruptly, so revenue may increase rapidly and later decrease just as quickly. The relative timing of the beginning and end of such sales can make our revenue less predictable.

BECAUSE OF DIFFERENCES IN VOTING POWER AND LIQUIDITY BETWEEN THE CLASS A COMMON STOCK AND THE CLASS B COMMON STOCK, THE MARKET PRICE OF THE CLASS A COMMON STOCK MAY BE LESS THAN THE MARKET PRICE OF THE CLASS B COMMON STOCK.

There are more shares of Class B common stock than Class A common stock outstanding. Consequently, the Class B common stock may be more liquid than the Class A common stock. In addition, because the Class B common stock has greater voting power per share for the election and removal of directors than the Class A common stock, some investors may prefer the Class B common stock as a means of investing in our company. Accordingly, the greater potential voting power and liquidity of the Class B common stock may cause the Class B common stock to trade at a higher market price than the Class A common stock.

IF YOU CONVERT ANY NOTES, THE VALUE OF THE CLASS A COMMON STOCK YOU RECEIVE MAY FLUCTUATE SIGNIFICANTLY.

Since our Class A common stock has been publicly traded, the market price has fluctuated significantly and may continue to do so in the future. Significant fluctuations in the market price of our Class A common stock may occur in response to various factors and events, including, among other things:

- the depth and liquidity of the trading market for our Class A common stock;
- variations in actual or anticipated operating results;
- market conditions in the semiconductor and optical components industries;
- announcements and performance by competitors;
- sales of large volumes of our common stock, including by Lucent stockholders who received shares in the spin-off and do not want to hold our common stock;
- regulatory actions; and
- general economic conditions.

USE OF PROCEEDS

We estimate that the net proceeds of this offering will be approximately $396 million after deducting the underwriting discount and our expenses in connection with the offering. We intend to use approximately 50% of the net proceeds to repay a portion of the short-term debt outstanding under our credit facility and the balance for general corporate purposes.

We have a credit facility under which $960 million was outstanding at March 31, 2002. The maturity date of the credit facility is September 30, 2002. If we raise at least $500 million in equity or debt capital markets transactions before September 30, 2002, or approximately $90 million after giving effect to this offering, the maturity date of the credit facility will be extended to September 30, 2004, with the credit facility required to be reduced to $750 million on September 30, 2002 and $500 million on September 30, 2003. The interest rates applicable to borrowings under the credit facility are based on a scale indexed to our credit rating. Based upon our current credit ratings of BB- from Standard & Poor's and Ba3 from Moody's, the interest rate under the facility is the applicable LIBOR rate plus 400 basis points. The only periodic debt service obligation under the credit facility, as amended, is to make

quarterly interest payments.

CAPITALIZATION

The following table sets forth our consolidated capitalization as of March 31, 2002, on an actual basis and on an as adjusted basis to give effect to this offering and the use of approximately 50% of the net proceeds therefrom to repay a portion of the short-term debt outstanding under our credit facility and the repayment of an additional $540 million of the credit facility subsequent to March 31, 2002 as described under "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

The table below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," our financial statements and the notes thereto included elsewhere in this prospectus.

	MARCH 31, 2002	
	HISTORICAL	AS ADJUSTED
	(UNAUDITED) (DOLLARS IN MILLIONS)	
Cash and cash equivalents	$ 1,604	$ 1,293
Debt:		
Credit facility	$ 960	$ 222
Other secured debt	136	163
6.5% Convertible Subordinated Notes due 2009	--	410
Capitalized lease obligations	41	41
Total debt	1,137	836
Stockholders' equity:		
Class A common stock, par value $0.01 per share, 5,000,000,000 shares authorized and 727,431,519 shares issued and outstanding	7	7
Class B common stock, par value $0.01 per share, 5,000,000,000 shares authorized and 908,100,000 shares issued and outstanding	9	9
Additional paid in capital	7,032	7,032
Accumulated deficit	(5,136)	(5,136)
Accumulated other comprehensive loss	(2)	(2)
Total stockholders' equity	1,910	1,910
Total capitalization	$ 3,047	$ 2,746

COMMON STOCK PRICE RANGE AND DIVIDENDS

Our Class A common stock has been listed on the New York Stock Exchange

under the symbol "AGR.A" since March 28, 2001. The following table sets forth, for the indicated periods, the quarterly high and low sale prices of our Class A common stock, as reported on the New York Stock Exchange.

	HIGH	LOW
FISCAL YEAR 2001		
Quarter ended March 31, 2001 (trading began March 28, 2001)	$6.23	$6.01
Quarter ended June 30, 2001	9.50	4.10
Quarter ended September 30, 2001	7.50	3.10
FISCAL YEAR 2002		
Quarter ended December 31, 2001	$6.30	$4.06
Quarter ended March 31, 2002	6.10	3.60
Quarter ended June 30, 2002 (through June 13, 2002)	4.49	2.06

On June 13, 2002, the last reported sales price of our Class A common stock, as reported on the New York Stock Exchange, was $2.45 per share.

Our Class B common stock has been listed on the New York Stock Exchange under the symbol "AGR.B" since June 3, 2002. The high and low sales price of our Class B common stock, as reported on the New York Stock Exchange, through June 13, 2002 is $3.32 and $2.08, respectively. On June 13, 2002, the last reported sales price of our Class B common stock, as reported on the New York Stock Exchange, was $2.47.

As of June 3, 2002 there were approximately 750,000 and 1,488,000 stockholders of record of our Class A and Class B common stock, respectively.

We have not declared or paid any dividends on our Class A or Class B common stock and do not anticipate doing so in the foreseeable future. Under our bank credit facility, we are not permitted to pay any dividends on our common stock other than dividends payable solely in additional shares of our common stock and dividends pursuant to our stockholders' rights plan.

SELECTED FINANCIAL INFORMATION
(DOLLARS IN MILLIONS)

The following table sets forth our selected financial information. The financial information for the six month periods ended March 31, 2002 and 2001 and as of March 31, 2002 has been derived from our unaudited financial statements included elsewhere in this prospectus. The financial information for the years ended September 30, 2001, 2000 and 1999 and as of September 30, 2001 and 2000 has been derived from our audited financial statements included elsewhere in this prospectus. The financial information for the year ended September 30, 1998 and as of September 30, 1999 has been derived from our audited financial statements not included in this prospectus. The financial information for the year ended September 30, 1997 and as of September 30, 1998 and 1997 has been derived from our unaudited financial statements not included in this prospectus. The historical selected financial information may not be indicative of our future performance as a stand-alone company and should be read in conjunction with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and the related notes included elsewhere in this prospectus.

	SIX MONTHS ENDED MARCH 31,		YEAR ENDED SEPTEMBER 30,				
	2002	2001	2001(1)	2000(2)	1999	1998	
	(DOLLARS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)						
STATEMENT OF OPERATIONS INFORMATION:							
Revenue	$ 1,088	$2,553	$ 4,080	$4,708	$3,714	$3,101	$
Gross profit	69	1,021	996	2,153	1,765	1,509	
Purchased in-process research and development	--	--	--	446	17	48	
Amortization of goodwill and other acquired intangibles	37	223	415	189	13	3	
Restructuring and separation -- net	96	47	662	--	--	--	
Impairment of goodwill and other acquired intangibles	176	--	2,762	--	--	--	
Other income (loss) -- net(3)	335	37	35	33	36	67	
Income (loss) before cumulative effect of accounting change	(594)	(148)	(4,612)	(76)	319	303	
Cumulative effect of accounting change (net of provision (benefit) for income taxes of $(2) for the six months ended March 31, 2001, $(2) in fiscal 2001, and $21 in fiscal 1999)(4)	--	(4)	(4)	--	32	--	
Net income (loss)	$ (594)	$ (152)	$(4,616)	$ (76)	$ 351	$ 303	$
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE:(5)							
Income (loss) before cumulative effect of accounting change	$ (.36)	$ (.15)	$ (3.46)	$ (.07)	$ .31	$ .29	$
Cumulative effect of accounting change(4)	--	--	--	--	.03	--	
Net income (loss)	$ (.36)	$ (.15)	$ (3.46)	$ (.07)	$ .34	$ .29	$
Weighted average shares outstanding -- basic and diluted (in millions)	1,635	1,035	1,334	1,035	1,035	1,035	
STATEMENT OF CASH FLOWS INFORMATION:							
Net cash (used in) provided by operating activities	$ (454)	$ 369	$ 269	$ 762	$ 690	$ 524	
Net cash provided by (used in) investing activities	340	(486)	(723)	(829)	(753)	(541)	
Net cash (used in) provided by financing activities	(1,433)	186	3,607	67	63	17	
OTHER FINANCIAL DATA:							
Ratio of earnings to fixed charges(6)	n/a	n/a	n/a	2.4	8.7	12.5	
Deficiency(6)	$ 584	160	$ 4,553	n/a	n/a	n/a	
SUPPLEMENTAL FINANCIAL DATA:							
EBITDA(7)	$ (558)	$ 320	$(3,520)	$ 822	$ 877	n/a	
Adjusted EBITDA(8)	(286)	367	(96)	1,268	894	n/a	

	AT MARCH 31,	AT SEPTEMBER 30,			
	2002(9)	2001(1)	2000(2)	1999	1998
	(DOLLARS IN MILLIONS)				
BALANCE SHEET INFORMATION:					
Working capital	$ 93	$ 156	$ 428	$ 219	$ 409
Total assets	4,291	6,562	7,067	3,020	2,481
Short-term debt	1,111	2,516	14	14	--
Long-term debt	26	33	46	64	--
Stockholders' equity/invested equity	1,910	2,461	5,781	1,962	--

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(1) During fiscal 2001 we received approximately $3,400 million of net proceeds from our initial public offering and recorded a $2,762 million impairment of goodwill and other acquired intangibles related to our acquisitions of Ortel Corporation, Herrmann Technology, Inc., Agere, Inc. and Enable Semiconductor, Inc. We also assumed $2,500 million of debt from Lucent Technologies Inc., consisting of short-term borrowings under a credit facility provided by financial institutions. We did not receive any of the proceeds of this short-term debt.

(2) During fiscal 2000 net goodwill and other acquired intangibles increased by approximately $3,400 million due to the acquisitions of Ortel Corporation, Herrmann Technology, Inc., Agere, Inc. and substantially all the assets of VTC Inc., whose results of operations are included from their respective dates of acquisition.

(3) During the six months ended March 31, 2002, we recognized a gain of $243 million from the sale of our FPGA business.

(4) Effective October 1, 2000, we adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended.

Effective October 1, 1998, we changed our method for calculating the market-related value of plan assets used in determining the expected return-on-asset component of annual net pension and postretirement benefit costs.

(5) Basic and diluted earnings (loss) per common share are calculated by dividing income (loss) by the weighted average number of common shares outstanding during the period. The weighted average number of common shares outstanding on a historical basis includes the retroactive recognition to October 1, 1996 of the 1,035,000,000 shares owned by Lucent prior to our initial public offering.

(6) For purposes of determining the ratio of earnings to fixed charges, "earnings" are defined as income (loss) from continuing operations before income taxes less undistributed earnings of equity investments plus fixed charges less interest capitalized during the period. "Fixed charges" consist of interest expense on all indebtedness and that portion of operating lease rental expense that is representative of the interest factor. "Deficiency" is the amount by which fixed charges exceeded earnings.

(7) EBITDA equals operating income (loss) plus depreciation and amortization expense. EBITDA is not intended to represent cash flow or any other measure of performance or liquidity in accordance with generally accepted accounting principles. EBITDA is included here because we believe that you may find it

to be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly-titled figures for other companies.

(8) The calculation of adjusted EBITDA is shown below:

	SIX MONTHS ENDED MARCH 31,		YEAR ENDED SEPTEMBER 30,		
	2002	2001	2001	2000	1999
	(DOLLARS IN MILLIONS)				
EBITDA	$(558)	$320	$(3,520)	$ 822	$877
Purchased in-process research and development	--	--	--	446	17
Restructuring and separation -- net	96	47	662	--	--
Impairment of goodwill and other acquired intangibles	176	--	2,762	--	--
Adjusted EBITDA	$(286)	$367	$ (96)	$1,268	$894

(9) For the six months ended March 31, 2002, we repaid $1,540 million of the $2,500 million of short-term debt outstanding under our credit facility to reduce the size of the facility to $960 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited financial statements for the six month periods ended March 31, 2002 and 2001 and our audited financial statements for the years ended September 30, 2001, 2000 and 1999, and the notes thereto. This discussion contains forward-looking statements. See "Forward-Looking Statements" and "Risk Factors" for a discussion of the uncertainties, risks and assumptions associated with these statements.

OVERVIEW

We are the world's leading provider of components for communications applications, delivering integrated solutions that form the building blocks for advanced wired, wireless and optical communications networks. We also design and manufacture a wide range of semiconductor solutions for computer- and communications-related devices used by consumers, such as cellular phones, modems and hard disk drives for personal computers and workstations. In addition, we supply complete wireless computer networking solutions through the ORiNOCO(R) product family.

Our business operations are organized into two market-focused groups, Client Systems and Infrastructure Systems, that target the consumer communications and network equipment markets, respectively. Each of these two groups is a reportable operating segment. The segments each include revenue from the licensing of intellectual property related to that segment.

The Client Systems segment includes our wireless data, computer

communications, storage and wireless terminal solutions products. This segment delivers integrated circuit solutions for a variety of end-user applications such as modems, Internet-enabled cellular terminals and hard-disk drives for computers as well as software, systems and wireless local area network solutions through the ORiNOCO product family.

The Infrastructure Systems segment delivers solutions to the high-speed communications systems market and facilitates the convergence of integrated circuit devices and optoelectronic components. We have consolidated research and development, as well as marketing, for both optoelectronic and integrated circuit devices aimed at communications systems. This allows us to design, develop and deliver complete, interoperable solutions to equipment manufacturers for advanced enterprise, access, metropolitan, long-haul and undersea applications.

SEPARATION FROM LUCENT

We were incorporated under the laws of the State of Delaware on August 1, 2000, as a wholly owned subsidiary of Lucent. We had no material assets or activities as a separate corporate entity until the contribution to us by Lucent of its integrated circuits and optoelectronic components businesses. Lucent had previously conducted these businesses through various divisions and subsidiaries. On February 1, 2001, Lucent began the separation of our company by transferring to us the assets and liabilities related to these businesses. The separation was substantially completed, including the transfer of all assets and liabilities other than pension and postretirement plan assets and liabilities, when we completed our initial public offering in April 2001. As of April 30, 2002, Lucent owned 100% of our outstanding Class B common stock and 37 million shares of our outstanding Class A common stock, which represented approximately 58% of the total outstanding common stock and approximately 84% of the combined voting power of both classes of our common stock with respect to the election and removal of directors. On June 1, 2002, Lucent distributed all of these shares to its shareholders, completing our spin-off.

In connection with our separation from Lucent, we entered into several agreements with Lucent regarding, among other things, interim services, intellectual property and product supply. The interim services agreement sets forth charges generally intended to allow the providing company to fully recover the allocated direct costs of providing the services, plus all out-of-pocket costs and expenses. For more

information, see note 19 to our annual financial statements and note 13 to our quarterly financial statements included elsewhere in this prospectus.

Lucent is our largest customer with purchases for the six months ended March 31, 2002 and 2001 representing 13.1% and 15.9%, respectively, and in fiscal 2001, 2000 and 1999 representing 14.9%, 21.3% and 25.7%, respectively, of our revenue. We expect Lucent will continue to represent a significant percentage of our revenue in the foreseeable future.

Our financial statements include amounts prior to February 1, 2001 that have been derived from the financial statements and accounting records of Lucent using the historical results of operations and historical basis of the assets and liabilities of our businesses. We believe the assumptions underlying our financial statements are reasonable. However, our financial statements for periods prior to February 1, 2001 may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had we been a stand-alone company during the periods presented. Because a direct ownership

relationship did not exist among all the various units comprising Agere, Lucent's net investment in us is shown in lieu of stockholders' equity in our financial statements for periods prior to February 1, 2001. For periods prior to February 1, 2001, our financial statements include allocations of Lucent's expenses, assets and liabilities, including allocations for general corporate expenses, basic research, interest expense, pension and postretirement costs, income taxes and cash and receivables, which are discussed in note 1 to our annual and quarterly financial statements included elsewhere in this prospectus.

ACQUISITIONS

During fiscal 1999 and 2000 we completed the acquisitions described below as part of our efforts to broaden our portfolio of product offerings. We did not have any significant acquisitions during the six months ended March 31, 2002 or fiscal 2001.

In June 2000, we acquired Herrmann, a developer and manufacturer of passive optical filters that can be used in conjunction with active optoelectronic components in products such as amplifiers. The purchase price was $432 million in Lucent common stock and options. In connection with this acquisition, certain former stockholders of Herrmann are entitled to receive up to a total of 677,019 additional shares of Lucent common stock based on retention and the achievement of specified milestones, which require the production of two products at improved manufacturing yields within the three-year period following the acquisition. As of September 30, 2001, 200,000 shares of Lucent common stock had been released based on the achievement of milestones, resulting in additional goodwill related to the acquisition. The achievement of additional milestones may also result in additional goodwill.

In April 2000, we acquired Ortel, a developer and manufacturer of semiconductor optoelectronic components used in fiber optic systems for cable television and data communications networks. The purchase price was $2,998 million in Lucent common stock and options.

In April 2000, we acquired Agere, Inc., a developer and supplier of network processor integrated circuits. Network processors control how data is sent over a network. The purchase price was $377 million in Lucent common stock and options.

In March 2000, we acquired substantially all the assets of VTC, a supplier of integrated circuits to computer hard disk drive manufacturers. The purchase price was $104 million in cash. In connection with this acquisition, stockholders of VTC are entitled to receive additional cash consideration of up to $50 million contingent on the delivery of product at specified manufacturing yields and the transfer and qualification of process technology to our manufacturing facilities. As of September 30, 2001, $30 million of the additional cash consideration had been paid, resulting in additional goodwill related to the acquisition. Any future contingent cash consideration paid will also be recorded as additional goodwill.

In March 1999, we acquired Enable, a developer of integrated circuits for local area network equipment. The purchase price was $51 million in cash.

In February 1999, we acquired Sybarus Technologies ULC, a developer of integrated circuits for communications networks. The purchase price was $41 million in cash.

We review our long-lived assets for impairment whenever events or changes in circumstances occur that indicate the carrying amount of the assets may not

be fully recoverable. During fiscal 2001 and the second quarter of fiscal 2002, we performed impairment evaluations of the goodwill and other acquired intangibles from recent acquisitions. The assessments were performed in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," as a result of weakening economic conditions and decreased current and expected future demand for products in the markets in which we operate. We determined the fair value of the acquired entities using a discounted cash flow model based on growth rates and margins reflective of the current decrease in demand for our products, as well as anticipated future demand. Discount rates used were based upon our weighted average cost of capital adjusted for business risks. These assumptions were based on management's best estimate of future results. As a result of the assessments, we determined that an other-than-temporary impairment of goodwill and other acquired intangibles existed. In fiscal 2001, we recorded a charge to reduce goodwill and other acquired intangibles of $2,762 million during fiscal 2001, consisting of $2,220 million, $275 million, $240 million and $27 million related to Ortel, Herrmann, Agere, Inc. and Enable, respectively. During the second quarter of fiscal 2002, we performed additional impairment evaluations of goodwill and other acquired intangibles due to a continued weakening of economic conditions and decreased demand for our products. We recorded a charge to reduce goodwill and other acquired intangibles of $176 million during the second quarter of fiscal 2002, consisting of $113 million and $63 million related to Ortel and Hermann, respectively.

OPERATING TRENDS

During the second quarter of fiscal 2002, the Client segment experienced a 19% increase in revenues for the three months ended March 31, 2002 compared to the three months ended December 31, 2001. This increase was due to improved demand for PC-related components. However, the Infrastructure segment experienced a 14% decrease in revenues for the three months ended March 31, 2002 compared to the three months ended December 31, 2001. This decrease was due to lower demand from network equipment manufacturers, as service providers continue to reduce or defer spending. We would expect these general trends to continue into our third fiscal quarter. However, our ability to forecast future results is limited due to backlog levels that are lower than those experienced in the past and higher than normal order cancellations and reschedules.

Our costs consist primarily of manufacturing overhead, materials and labor. Similar to many semiconductor manufacturers, we have relatively high fixed costs associated with our wafer manufacturing. As a result, our ability to reduce costs quickly in times of decreased demand is limited, which has an adverse effect on margins. Because we anticipated higher revenues as we entered fiscal 2001, our cost structure reflected manufacturing capacity and resources greater than those actually required. In light of the lower revenues we have experienced in recent quarters, we have taken a number of steps to reduce our cost structure, including restructuring activities and reductions in capital spending, and we are considering additional actions to reduce our cost structure in the event that our revenues do not improve.

RESTRUCTURING ACTIVITIES

In fiscal 2001 and the first half of fiscal 2002, we announced a series of restructuring initiatives to reduce our cost structure in light of declining revenues. We recorded net restructuring charges of $91 million and $563 million for the six months ended March 31, 2002 and fiscal 2001, respectively, classified within restructuring and separation expenses -- net. These restructuring initiatives were focused on improving gross profit, reducing expenses and streamlining operations, and include a worldwide workforce reduction, rationalization of manufacturing capacity and other activities.

FISCAL YEAR ENDED SEPTEMBER 30, 2001

The restructuring initiatives announced in fiscal 2001 will result in a workforce reduction of approximately 6,000 employees across various business functions, operating units and geographic regions, and includes both management and occupational employees. We recorded a restructuring charge of $177 million in fiscal 2001 related to approximately 5,500 employees, of which approximately 4,300 employees had been taken off-roll as of September 30, 2001. Of this $177 million charge, $28 million represents termination benefits to certain U.S. employees that will be funded through pension assets. This amount was recognized in accordance with Statement of Financial Accounting Standards No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." Severance costs and other exit costs noted above were determined in accordance with Emerging Issues Task Force No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity."

We recorded a restructuring charge of $386 million in fiscal 2001 relating to the rationalization of under-utilized manufacturing facilities and other restructuring-related activities. We have discontinued manufacturing operations at our chip fabrication plant in Madrid, Spain and have subsequently sold this facility. We are also rationalizing under-utilized manufacturing capacity at our facilities in Orlando, Florida, and in Allentown, Breinigsville and Reading, Pennsylvania. In addition, we are consolidating several satellite-manufacturing sites, as well as leased corporate offices. The restructuring charge for fiscal 2001 includes $37 million related to facility closings, primarily for lease terminations, non-cancelable leases and related costs. It also includes an asset impairment charge of $287 million. All affected assets were classified as held for disposal, in accordance with the guidance on impairment of assets in Statement 121, and depreciation was suspended. The $287 million non-cash impairment charge represents the write-down to fair value, less costs to sell, of property, plant and equipment that was disposed of or removed from operations. The remaining restructuring charge of $62 million relates primarily to contract terminations.

A summary of restructuring charges is outlined as follows:

	YEAR ENDED SEPTEMBER 30, 2001			AT SEPTEMBER 30, 2001
	TOTAL CHARGES	NON CASH CHARGES	CASH PAYMENTS	RESTRUCTURING RESERVE
	(DOLLARS IN MILLIONS)			
Workforce reduction	$177	$ (28)	$(57)	$ 92
Rationalization of manufacturing capacity and other charges	386	(293)	(14)	79
Total	$563	$(321)	$(71)	$171

SIX MONTHS ENDED MARCH 31, 2002

We recorded net restructuring charges of $91 million for the six months ended March 31, 2002, classified within restructuring and separation

expenses -- net. These net restructuring charges are comprised of charges of $177 million, offset by reversals of $86 million. We recorded net restructuring charges of $12 million for the six months ended March 31, 2001, primarily related to contract terminations. The details of the initiatives announced during the first and second quarters of fiscal 2002 are outlined below.

On December 5, 2001, we announced a workforce reduction of 950 positions, which affects primarily management positions within our product groups, sales organizations and corporate support functions located in New Jersey and Pennsylvania.

On January 23, 2002, we announced plans to further improve our operating efficiency by consolidating our facilities. We are consolidating existing manufacturing, research and development, business management and administrative facilities in Pennsylvania and New Jersey. This consolidation is expected to be substantially completed 18 months from the announcement. Additionally, we are seeking a buyer for our wafer fabrication operation in Orlando, Florida. This site has approximately 1,100 employees.

We are moving the majority of our integrated circuits and optoelectrics operations from our sites in Reading and Breinigsville, Pennsylvania, into the Allentown, Pennsylvania campus. In addition, the majority of our assembly and test operations located in these three sites are moving to our assembly and test facilities in Bangkok, Thailand; Matamoras, Mexico; and Singapore. Subsequently, we will discontinue operations at the Reading and Breinigsville facilities and will seek buyers for those properties. We expect that our plans to combine operations from these facilities into Allentown will result in a net headcount reduction of approximately 300 positions.

The following table sets forth our restructuring reserves as of March 31, 2002 and reflects the activity related to the worldwide workforce reductions and the rationalization of manufacturing capacity and other charges affecting the reserves for the six months ended March 31, 2002:

	SEPTEMBER 30, 2001	SIX MONTHS ENDED MARCH 31, 2002			
	RESTRUCTURING RESERVE	RESTRUCTURING CHARGE	RESTRUCTURING REVERSAL	NON-CASH ITEMS	CASH PAYMENTS
Workforce reduction.....	$ 92	$ 56	$(20)	$ (23)	$ (80)
Rationalization of manufacturing capacity and other charges.....	79	121	(66)	(53)	(30)
Total.....	$171	$177	$(86)	$ (76)	$(110)

Worldwide Workforce Reduction

We recorded restructuring charges relating to workforce reductions of $56 million for the six months ended March 31, 2002. The charges include $23 million for the approximately 500 remaining employees associated with the workforce reduction of approximately 6,000 positions announced in fiscal 2001, $24 million relating to approximately 600 employees associated with the December 5, 2001

announcement and $9 million for approximately 100 employees associated with the January 23, 2002 announcement. Of the total workforce reduction charges, $23 million represents non-cash charges for termination benefits to certain U.S. employees that will be funded through pension assets.

During the six months ended March 31, 2002, we recorded a $20 million reversal of the restructuring reserve associated with workforce reductions, resulting from severance and benefit cost termination estimates that exceeded amounts paid during the second half of calendar year 2001. The original reserve included an estimate of termination pay and benefits for occupational employees that was based on the average rate of pay and years of service of the occupational employee pool at risk. Our collective bargaining agreements allow for a period when employees at risk can opt for positions filled by employees with less seniority. When that period ended, a series of personnel moves followed that ultimately resulted in lower severance and benefit payments than originally expected. This was due principally to the termination of occupational employees with fewer years of service and fewer weeks of severance entitlement. These personnel moves were substantially finished at the end of calendar 2001. Severance costs and other exit costs were determined in accordance with Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity."

We have completed the workforce reductions announced in fiscal 2001 with approximately 6,000 employees taken off-roll as of March 31, 2002. We have also made significant progress towards completing the workforce reduction of 950 employees announced on December 5, 2001 with approximately 500 employees taken off-roll by March 31, 2002 and expect to complete this workforce reduction by the end of fiscal 2002. With regard to the facilities consolidation plan announced on January 23, 2002, we expect that this action will result in a net reduction of approximately 300 positions by the end of fiscal year 2003, none of which were off-roll as of March 31, 2002.

Rationalization of Manufacturing Capacity and Other Charges

We recorded restructuring charges of $121 million for the six months ended March 31, 2002, relating to the rationalization of under-utilized manufacturing facilities and other activities. The charges included $69 million related to asset impairments, $40 million for facility closings, and $12 million of other related costs primarily for contract terminations.

The asset impairment charge of $69 million includes the impairment of assets under construction that had not been placed into service and were associated with the facilities consolidation initiative announced on January 23, 2002 to move the majority of our operations in Reading and Breinigsville, Pennsylvania to our Allentown, Pennsylvania campus and the impairment of property, plant and equipment relating to earlier restructuring initiatives for the rationalization of underutilized manufacturing facilities and other activities. All affected assets were classified as held for disposal, in accordance with the guidance on impairment of assets in Statement 121, and depreciation was suspended. These non-cash impairment charges represent the write-down to fair value, less costs to sell, of property, plant and equipment that were disposed of, held for sale, or removed from operations.

The facility closing charge of $40 million consists principally of a non-cash charge of $35 million for the realization of the cumulative translation adjustment resulting from our decision to substantially liquidate our investment in the legal entity associated with our Madrid, Spain manufacturing operations. This charge was recognized in accordance with Emerging Issues Task Force Issue No. 01-5, Issue Summary No. 1, "Application of SFAS No. 52, and Foreign Currency

Translation, to an Investment Being Evaluated for Impairment That Will Be Disposed Of." The $5 million balance of the charge related to the facility closing is primarily for lease terminations and non-cancelable leases and related costs.

We recorded restructuring charge reversals of $66 million for the six months ended March 31, 2002. The restructuring charge reversals include adjustments to estimates of $27 million for asset impairments, a $25 million reversal due to receiving more proceeds from the sale of the assets associated with our Madrid, Spain manufacturing operations than originally estimated, $6 million for contract terminations, a $6 million reversal of a restructuring reserve deemed no longer necessary, and $2 million for facility lease terminations. The asset impairment adjustments were due principally to realizing more proceeds than expected from asset dispositions and from assets that were placed back into service in the second quarter of fiscal 2002.

Restructuring Reserve Balances

We anticipate that substantially all of the $25 million restructuring reserve as of March 31, 2002, relating to the workforce reductions, will be paid by end of fiscal 2002. We anticipate that the restructuring reserve balance of $51 as of March 31, 2002, relating to the rationalization of manufacturing capacity and other charges, will be paid as follows: the majority of the contract terminations of $30 million will be paid by the end of fiscal 2002; the non-cancelable lease obligations of $11 million, due to consolidation of facilities, will be paid over the respective lease terms through fiscal 2005; and the majority of the other related costs of $10 million will be paid by December 31, 2002.

These cash outlays will be funded through cash and cash equivalents on hand. Excluding the facilities consolidation initiative announced on January 23, 2002, we currently estimate future annualized pre-tax savings to be approximately $600 million, of which approximately $120 million is associated with reduced depreciation and $480 million is cash savings resulting from lower employee costs and reduced costs associated with contract and facility lease obligations. The full impact of these savings is expected to be achieved during the third quarter of fiscal 2002. We expect that approximately 75% of these savings will affect gross margin and 25% will affect operating expenses. Our savings in the second quarter of fiscal 2002 were approximately $140 million, resulting from reduced depreciation and lower employee costs and reduced costs associated with contract and facility lease obligations. Of that amount, we estimate that approximately 75% affected gross margin and 25% affected operating expenses.

Facilities Consolidation

In addition to the charges we recorded as restructuring expenses related to our January 23, 2002 announcement concerning our facilities consolidation, we also recorded $17 million of charges within gross margin for the six months ended March 31, 2002, substantially all of which resulted from accelerated depreciation. This accelerated depreciation charge is due to the shortening of estimated useful lives of certain assets in connection with the planned facility closings.

We expect to incur total cash expenditures of approximately $250 million to $350 million associated with the moving of operations and the consolidating of existing manufacturing, research and development, business management and administrative facilities in Pennsylvania and New Jersey. There will also be additional non-cash impacts associated with accelerated depreciation and asset

impairments as we continue to evaluate the property, plant and equipment located at Breinigsville and Reading, which had a combined net book value of approximately $455 million as of March 31, 2002. As part of this evaluation, we are determining which assets will be transferred to other locations, temporarily remain in service until the completion of the facilities consolidation, or be removed from service and disposed of by sale or abandonment. We expect the transfer of equipment and manufacturing capability to be substantially complete within eighteen months from the date of the announcement. Our wafer fabrication operation in Orlando, Florida, for which we are seeking a buyer, had property, plant and equipment with a net book value of approximately $445 million as of March 31, 2002.

Through the consolidation of operations in Pennsylvania and New Jersey, we are reducing our square footage in the two states by about two million square feet, or approximately 50 percent, significantly lowering costs. We expect to realize approximately $100 million annually in cash savings from these actions, commencing in the first quarter of fiscal 2003, driven primarily by a reduction in rent and building infrastructure costs.

SEPARATION EXPENSES

We incurred costs, fees and expenses relating to our separation from Lucent. These costs, fees and expenses were primarily related to legal separation matters, designing and constructing our computer infrastructure, information and data storage systems, marketing expenses relating to building a company brand identity and implementing treasury, real estate, pension and records retention management services. For fiscal 2001 we recorded $99 million of separation expenses. For the six months ended March 31, 2002 we incurred separation expenses of $5 million compared to $35 million for the six months ended March 31, 2001. As we incurred the majority of the necessary expenses related to our separation from Lucent in fiscal 2001, we would expect these expenses to be substantially lower in fiscal 2002.

INVENTORY PROVISION

We recorded inventory provisions, classified within cost of sales, of $66 million and $74 million for the six months ended March 31, 2002 and 2001, respectively, and $409 million in fiscal 2001 compared to inventory provisions of $29 million in fiscal 2000 and $11 million in fiscal 1999. The inventory provisions were calculated in accordance with our inventory valuation policy, which is based on a review of forecasted demand compared with existing inventory levels.

We experienced significant revenue growth over the five years ending September 30, 2000, and this pattern of growth continued through the first quarter of fiscal 2001. In the second quarter of fiscal 2001, we noted softness in customers' demand. However, we did not believe this to be other than temporary, given the recent history of growth. Our belief that the weakness in demand was temporary was supported by the observation that customers were delaying orders to later periods rather than canceling them, and third-party market projections indicating that there could be a rebound in demand in the following months. During the third quarter of fiscal 2001, the decline in the market accelerated. Our customers provided evidence of a longer lasting market decline, both through canceled orders and through direct communications with us. Given our forecast of continuing reductions in demand in the fourth quarter, the majority of the fiscal 2001 inventory charge was recorded in the third quarter. We immediately initiated

discussions with suppliers to modify or cancel supply contracts and in the fourth quarter of fiscal 2001 were able to quantify and record a charge of $15

million for contract cancelation fees, which is included in the fiscal 2001 inventory provision.

Inventory that is determined to be excessive or obsolete is generally disposed of for little or no recoverable value. There are generally no alternative uses for such inventory.

ACCOUNTING POLICIES INVOLVING SIGNIFICANT ESTIMATES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. The following accounting policies are particularly dependent on estimates and assumptions made by management. These estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary. If actual results differ significantly from management's estimates, our financial statements could be materially impacted.

Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market. Our inventory valuation policy is based on a review of forecasted demand compared with existing inventory levels. If our estimate of forecasted demand is significantly different than our actual demand, our inventory may be over- or under-valued.

Long-lived assets, such as goodwill and other acquired intangibles and property, plant and equipment, are reviewed for impairment whenever events such as a significant industry downturn, product discontinuance, plant closures, product dispositions, technological obsolescence or other changes in circumstances indicate that the carrying amount may not be recoverable. When such events occur, we compare the carrying amount of the assets to undiscounted expected future cash flows. If this comparison indicates that there is an impairment, the amount of the impairment is typically calculated using discounted expected future cash flows. If our estimate of an asset's future cash flows is significantly different from the asset's actual cash flows, we may over- or under-estimate the value of an asset's impairment. A long-lived asset's value is also dependent upon its estimated useful life. A change in the useful life of a long-lived asset could result in higher or lower depreciation and amortization expenses. If the asset's actual life is different from its estimated life, the asset could be over- or under-valued.

Restructuring reserves have been recorded in connection with the restructuring initiatives we have announced. These reserves include estimates pertaining to employee separation costs, the settlement of contractual obligations and other matters. Although we do not anticipate significant changes, the actual costs may differ from these estimates, resulting in further charges or reversals of previously recorded charges.

We are subject to proceedings, lawsuits and other claims related to environmental, labor, product, tax and other matters. We are required to assess the likelihood of adverse outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required, if any, for these contingencies is made after careful analysis of each individual issue. The required reserves may change in the future due to new developments in each matter or changes in the approach, such as a change in settlement strategy.

Historically, certain of our operations have been included in Lucent's consolidated income tax returns. Income tax expense in our consolidated and combined statements of operations has been calculated on a separate tax return basis prior to our initial public offering. The asset and liability approach is

used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. A valuation allowance is established, as needed, to reduce net deferred tax assets to the amount for which recovery is probable. If estimates of our future profitability are different than that actually attained, our deferred tax assets could be under- or over-valued.

See footnote 2 to our annual financial statements included elsewhere in this prospectus for a summary of our significant accounting policies.

RESULTS OF OPERATIONS

SIX MONTHS ENDED MARCH 31, 2002 COMPARED TO THE SIX MONTHS ENDED MARCH 31, 2001

The following table shows the change in revenue by operating segment:

	SIX MONTHS ENDED MARCH 31,		CHANGE	
	2002	2001	$	%
	(DOLLARS IN MILLIONS)			
Operating Segment:				
Infrastructure Systems	$ 489	$1,784	$(1,295)	(73)%
Client Systems	599	769	(170)	(22)
Total	$1,088	$2,553	$(1,465)	(57)%

Revenue. Revenue decreased 57%, or $1,465 million, for the six months ended March 31, 2002 as compared to the same period in 2001, due primarily to volume decreases. The decrease of $1,295 million within the Infrastructure segment was due to depressed market conditions and reduced expenditures by communication service providers, which drove volume decreases across the entire segment. The decrease of $170 million within the Client segment was driven primarily by volume decreases across the majority of the segment, except for the personal computer hard-drive market which experienced slight volume growth.

Costs and gross margin. Costs decreased 33%, or $513 million, from $1,532 million for the six months ended March 31, 2001 to $1,019 million for the six months ended March 31, 2002. Gross margin decreased from 40.0% for the six months ended March 31, 2001 to 6.3% for the six months ended March 31, 2002, a decrease of 33.7 percentage points. Gross margin for the Infrastructure segment decreased to (9.6)% in the current period from 44.8% in the prior year period primarily due to lower manufacturing capacity utilization. Gross margin for the Client segment declined to 19.4% in the current period from 28.7% in the prior year period. This decline was primarily due to lower manufacturing capacity utilization in the first quarter of fiscal 2002.

Selling, general and administrative. Selling, general and administrative expenses decreased 41%, or $137 million, from $336 million in the six months ended March 31, 2001, to $199 million in the same period in 2002. The decrease was primarily due to savings realized from our restructuring and cost saving initiatives.

Research and development. Research and development expenses decreased 30%, or $160 million, from $537 million in the six months ended March 31, 2001 to $377 million in the same period in 2002. The decrease was primarily due to savings realized from our restructuring and cost saving initiatives.

Amortization of goodwill and other acquired intangibles. Amortization expense decreased 83%, or $186 million, from $223 million for the six months ended March 31, 2001 to $37 million for the six months ended March 31, 2002. The decrease is due to the impairment of goodwill and other acquired intangibles of $2,762 million that was recognized in the second half of fiscal 2001. These impairments significantly reduced our goodwill and other acquired intangibles and therefore, our current period amortization.

Restructuring and separation -- net. Net restructuring and separation expenses increased $49 million to $96 million for the six months ended March 31, 2002 from $47 million for the six months ended March 31, 2001. Net restructuring expenses increased $79 million to $91 million for the six months ended March 31, 2002 from $12 million for the six months ended March 31, 2001, as we continued to implement our announced restructuring initiatives. Separation expenses decreased 86%, or $30 million, to $5 million in the current period from $35 million in the prior year period, as the separation was mostly completed in fiscal 2001.

Impairment of goodwill and other acquired intangibles. During the six months ended March 31, 2002, we determined that an other than temporary impairment of goodwill and other acquired intangibles existed and recorded a charge of $176 million to reduce goodwill and other acquired intangibles, consisting of $113 million and $63 million related to the acquisitions of Ortel and Herrmann, respectively. No impairment charge was recorded in the prior year period.

Operating loss. We reported an operating loss of $816 million for the six months ended March 31, 2002, compared to an operating loss of $122 million reported for the six months ended March 31, 2001. This change reflects primarily a decline in gross profit, as well as an impairment charge for goodwill and other acquired intangibles, partially offset by expense reductions and a decrease in the amortization of goodwill and other acquired intangibles. Although performance measurement and resource allocation for the reportable segments are based on many factors, the primary financial measure used is operating income (loss) by segment, exclusive of amortization of goodwill and other acquired intangibles, the impairment of goodwill and other acquired intangibles, and net restructuring and separation expenses, which is shown in the following table.

	SIX MONTHS ENDED MARCH 31,		CHANGE	
	2002	2001	$	%
	(DOLLARS IN MILLIONS)			
Operating Segment:				
Infrastructure Systems	$(389)	$213	$(602)	N/M
Client Systems	(118)	(65)	(53)	82%
Total	$(507)	$148	$(655)	N/M

N/M = Not meaningful

Other income -- net. Other income -- net increased $298 million, from $37 million for the six months ended March 31, 2001 to $335 million for the same period in 2002. The increase was primarily due to the sale of our FPGA business to Lattice Semiconductor, which resulted in a $243 million gain, and gains of $41 million from sales of investments.

Interest expense. Interest expense increased $39 million to $73 million for the six months ended March 31, 2002 from $34 million in the prior year period. This increase is due to the interest expense associated with our credit facility being greater than what Lucent allocated to us in the prior year period.

Provision for income taxes. For the first six months of fiscal 2002, we recorded a provision for income taxes of $40 million on a pre-tax loss of $554 million, yielding an effective tax rate of (7.3)%. This rate is higher than the U.S. statutory rate primarily due to the provision for taxes in foreign jurisdictions and the recording of a full valuation allowance of approximately $196 million against U.S. net deferred tax assets. For the first six months of fiscal 2001, we recorded a provision for income taxes of $29 million on a pre-tax loss of $119 million, yielding an effective tax rate of (24.9)%. This rate is higher than the U.S. statutory rate primarily due to non-tax deductible goodwill amortization and separation costs.

FISCAL YEAR ENDED SEPTEMBER 30, 2001 COMPARED TO FISCAL YEAR ENDED SEPTEMBER 30, 2000

The following table shows the change in revenue by operating segment:

	YEAR ENDED SEPTEMBER 30,		CHANGE	
	2001	2000	$	%
	(DOLLARS IN MILLIONS)			
OPERATING SEGMENT:				
Infrastructure Systems	$2,674	$3,059	$(385)	(13)%
Client Systems	1,406	1,649	(243)	(15)
Total	$4,080	$4,708	$(628)	(13)%

Revenue. Revenue decreased 13%, or $628 million, to $4,080 million in fiscal 2001 from $4,708 million in fiscal 2000, primarily due to volume decreases in both segments. The decrease of $385 million within the Infrastructure segment was primarily due to decreased sales of $395 million in integrated circuits, as system providers managed their orders and inventory in light of the reduced capital spending by service providers. This decrease in the Infrastructure segment was partially offset by an increase of $10 million in sales of optoelectronic components. The decrease of $243 million within the Client segment was due to volume decreases across the segment, which were partially offset by strength in the wireless local area networking market.

During fiscal 2001 revenues decreased sequentially each quarter due to declining market conditions compared to sequential revenue growth each quarter in fiscal 2000. Infrastructure revenues declined $708 million, or 70%, to $298 million in the fourth quarter of fiscal 2001 from the peak quarterly revenue level of $1,006 million experienced in the fourth quarter of fiscal 2000. Client revenues declined $181 million, or 37%, to $302 million in the fourth quarter of fiscal 2001 from the peak quarterly revenue level of $483 million experienced in the fourth quarter of fiscal 2000.

Costs and gross margin. Costs increased 21%, or $529 million, to $3,084 million in the current fiscal year from $2,555 million in the prior fiscal year. Gross margin decreased 21.3 percentage points to 24.4% in fiscal 2001 from 45.7% in fiscal 2000, primarily due to lower manufacturing capacity utilization and the impact of inventory provisions of $409 million in fiscal 2001 compared to inventory provisions of $29 million in fiscal 2000. Gross margin for the Infrastructure segment declined to 24.8% in fiscal 2001 from 49.8% in fiscal 2000 primarily due to lower manufacturing capacity utilization, inventory provisions of $378 million in fiscal 2001 compared to inventory provisions of $20 million in fiscal 2000, and a change in product mix, from higher margin components to lower margin components. Gross margin for the Client segment decreased to 23.8% in fiscal 2001 from 38.3% in fiscal 2000 due to lower manufacturing capacity utilization.

Selling, general and administrative. Selling, general and administrative expenses increased 12%, or $62 million, to $597 million in fiscal 2001 from $535 million in fiscal 2000. This was primarily due to increases in general and administrative expenses associated with being a stand-alone company, which were partially offset by lower bonus accruals of approximately $35 million.

Research and development. Research and development expenses increased 15%, or $124 million, to $951 million in fiscal 2001 from $827 million in fiscal 2000. The increase was due to new and ongoing product development expenses, including a full year of expenses associated with acquisitions during fiscal 2000, partially offset by lower bonus accruals of approximately $40 million.

Purchased in-process research and development. Purchased in-process research and development decreased to zero in fiscal 2001 from $446 million in fiscal 2000. This is the result of no significant acquisitions being made in fiscal 2001, while a number of acquisitions were completed in fiscal 2000.

Amortization of goodwill and other acquired intangibles. Amortization expense increased $226 million to $415 million in fiscal 2001 from $189 million in fiscal 2000 due to the recognition in fiscal 2001 of amortization associated with acquisitions completed during fiscal 2000.

Restructuring and separation expenses. Restructuring and separation expenses of $662 million were incurred in fiscal 2001. We recorded $563 million of restructuring charges. We also incurred expenses of $99 million in connection with our separation from Lucent.

Impairment of goodwill and other acquired intangibles. During fiscal 2001, we determined that an other than temporary impairment of goodwill and other acquired intangibles existed and recorded a charge of $2,762 million to reduce goodwill and other acquired intangibles.

Operating income (loss). Operating loss was $4,391 million in fiscal 2001 compared to $156 million of operating income in fiscal 2000. This was driven primarily by the impairment of goodwill and other acquired intangibles, a decline in gross profit, restructuring and separation expenses and an increase

in the amortization of goodwill and other acquired intangibles, partially offset by the absence of purchased in-process research and development costs in fiscal 2001. Although performance measurement and resource allocation for the reportable segments are based on many factors, the primary financial measure used is operating income (loss) by segment, exclusive of purchased in-process research and development costs, amortization of goodwill and other acquired intangibles, restructuring and separation expenses, and impairment of goodwill and other acquired intangibles which is shown in the following table:

	YEAR ENDED SEPTEMBER 30,		CHANGE	
	2001	2000	$	%
	(DOLLARS IN MILLIONS)			
OPERATING SEGMENT:				
Infrastructure Systems	$(377)	$658	$(1,035)	N/M
Client Systems	(175)	133	(308)	N/M
Total	$(552)	$791	$(1,343)	N/M

N/M = Not meaningful

Other income -- net. Other income-net increased 6%, or $2 million, to income of $35 million in fiscal 2001 from income of $33 million in fiscal 2000. The $35 million in fiscal 2001 was comprised primarily of interest income of $69 million from our investment of the proceeds from our initial public offering, income of $42 million from our equity investment in Silicon Manufacturing Partners Pte Ltd., the impairment of $47 million for several non-consolidated investments and foreign exchange losses of $14 million. The $33 million in fiscal 2000 was comprised primarily of gains of $18 million on the sale of investments and foreign exchange gains of $6 million.

Interest expense. Interest expense increased $93 million to $151 million in fiscal 2001 from $58 million in fiscal 2000. This increase is due to interest on the $2,500 million of short-term debt we assumed from Lucent in April 2001.

Provision for income taxes. The effective tax rates were (2.3)% and 158.0% for fiscal 2001 and 2000, respectively. The fiscal 2001 effective tax rate includes the impact of recording a valuation allowance of approximately $553 million for deferred tax assets, and the effects of non-tax deductible goodwill amortization and separation costs. The fiscal 2000 effective tax rate includes the impact of non-tax deductible goodwill amortization and non-tax deductible purchased in-process research and development.

FISCAL YEAR ENDED SEPTEMBER 30, 2000 COMPARED TO FISCAL YEAR ENDED SEPTEMBER 30, 1999

The following table shows the change in revenue by operating segment:

YEAR ENDED

	SEPTEMBER 30,		CHANGE	
	2000	1999	$	%
	(DOLLARS IN MILLIONS)			
OPERATING SEGMENT:				
Infrastructure Systems	$3,059	$2,290	$769	34%
Client Systems	1,649	1,424	225	16
Total	$4,708	$3,714	$994	27%

Revenue. Revenue increased 27%, or $994 million, to $4,708 million in fiscal 2000 from $3,714 million in fiscal 1999, primarily due to volume increases in both segments. The increase of $769 million in the Infrastructure segment was driven by volume increases across the segment and led by increased sales to existing customers of optoelectronic components used in high-speed transport and submarine network applications. The increase of $225 million in the Client segment was led by strengthening in the wireless local area networking and personal computer hard-drive markets. This increase in the Client segment was negatively impacted by a missed design win with a large customer in 1999 for wireless terminal devices, which resulted in not generating sales from a generation of that customer's mobile telephones.

Costs and gross margin. Costs increased 31%, or $606 million, to $2,555 million in fiscal 2000 from $1,949 million in fiscal 1999, primarily due to increased sales volume. Gross margin decreased 1.8 percentage points to 45.7% in fiscal 2000 from 47.5% in fiscal 1999. Gross margin for the Infrastructure segment was 49.8% in fiscal 2000 and 52.0% in fiscal 1999. The decrease in Infrastructure gross margin was primarily due to lower average revenues per unit for integrated circuits and a change in product mix, partially offset by volume growth in the sale of optoelectronics components, which resulted in a more efficient utilization of manufacturing capacity for optoelectronic components. Gross margin for the Client segment decreased to 38.3% in fiscal 2000 from 40.3% in fiscal 1999. The decrease in Client gross margin was primarily due to a change in product mix, from higher margin components to lower margin components.

Selling, general and administrative. Selling, general and administrative expenses decreased 7%, or $38 million, to $535 million in fiscal 2000 from $573 million in fiscal 1999. This decrease was primarily due to lower costs associated with the implementation of our advanced logistics and planning systems. These systems were primarily implemented and paid for in fiscal 1999.

Research and development. Research and development expenses increased 21%, or $144 million, to $827 million in fiscal 2000 from $683 million in fiscal 1999. This increase was primarily due to new and ongoing product development expenses including $50 million added during the year as a result of our acquisitions.

Purchased in-process research and development. Purchased in-process research and development increased $429 million, to $446 million in fiscal 2000 from $17 million in fiscal 1999. This increase was due to the fiscal 2000 acquisitions of Ortel, Agere, Inc., Herrmann and substantially all the assets of VTC, which resulted in charges of $307 million, $94 million, $34 million and $11 million, respectively.

Amortization of goodwill and other acquired intangibles. Amortization expense increased $176 million, to $189 million in fiscal 2000 from $13 million in fiscal 1999. This increase reflects amortization of goodwill associated with the acquisitions of Ortel, Herrmann and Agere, Inc. during fiscal 2000.

Operating income (loss). Operating income decreased 67%, or $323 million, to $156 million in fiscal 2000 from $479 million in fiscal 1999. This was driven primarily by purchased in-process research and development costs, an increase in the amortization of goodwill and other acquired intangibles and an increase in research and development cost, partially offset by an increase in gross profit. Performance measurement and resource allocation for the reportable segments are based on many factors. The primary financial

measure used is operating income by segment, exclusive of purchased in-process research and development costs and amortization of goodwill and other acquired intangibles, which is shown in the following table:

	YEAR ENDED SEPTEMBER 30,		CHANGE	
	2000	1999	$	%
	(DOLLARS IN MILLIONS)			
OPERATING SEGMENT:				
Infrastructure Systems	$658	$478	$180	38%
Client Systems	133	31	102	N/M
Total	$791	$509	$282	55%

N/M = Not meaningful

Other income -- net. Other income-net decreased 8%, or $3 million, to $33 million in fiscal 2000 from $36 million in fiscal 1999. The $33 million in fiscal 2000 was comprised primarily of gains on sales of investments of $18 million, $4 million of equity income and a $6 million gain on foreign currency transactions. The $36 million in fiscal 1999 was comprised primarily of gains on sales of investments of $32 million, a $20 million equity loss and a $9 million gain on foreign currency transactions.

Provision for income taxes. The effective tax rates were 158.0% and 33.1% for fiscal 2000 and 1999, respectively. The increase in effective tax rates was due to the fiscal 2000 write-offs of purchased in-process research and development costs that are not deductible for tax purposes. Excluding the impact of non-tax deductible purchased in-process research and development expenses and amortization of goodwill and other acquired intangibles expenses, the effective tax rates were 27.8% and 32.2% for fiscal 2000 and 1999, respectively. The decrease was primarily due to the tax impact of non-U.S. activity and increased research tax credits.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2002, our cash in excess of short-term debt was $493 million, which reflects $1,604 million in cash and cash equivalents less $960 million of short-term debt under our credit facility, $136 million in other secured debt related to our accounts receivable securitization transaction and $15 million from the current portion of our capitalized lease obligation.

Net cash used in operating activities was $454 million for the six months

ended March 31, 2002, compared with $369 million of net cash provided by operations for the six months ended March 31, 2001. The decline in the cash flow from operations for the six months ended March 31, 2002, compared with the same period last year, was driven primarily by an increase in our operating losses, as a result of less favorable market conditions.

Net cash provided by investing activities was $340 million for the six months ended March 31, 2002 compared with cash used in investing activities of $486 million for the six months ended March 31, 2001. The increase in cash flow from investing activities is primarily due to proceeds of $250 million from the sale of the FPGA business, proceeds of $115 million from the sale of property, plant and equipment, proceeds of $55 million from the sale of investments and a reduction of capital expenditures in the current period. Capital expenditures decreased $405 million to $80 million for the six months ended March 31, 2002, from $485 million for the six months ended March 31, 2001. We are seeking to limit our capital expenditures principally to projects critical to winning new business, keeping customer commitments and the completion of a new office facility adjacent to our current headquarters.

Net cash used in financing activities was $1,433 million for the six months ended March 31, 2002, compared with cash provided by financing activities of $186 million for the six months ended March 31, 2001. The largest portion of the decrease was the result of our repayment of $1,000 million under our credit facility in connection with the amendment of the facility on October 4, 2001. Subsequent to the

amendment of the facility, we further reduced the amount outstanding under the facility by $540 million to $960 million at March 31, 2002, as discussed below.

As of September 30, 2001, our net cash position was $636 million, which reflects $3,152 million in cash and cash equivalents less $2,516 million of short-term debt, including a $16 million current portion of capitalized lease obligations. The $636 million of net cash is primarily the result of our receipt of $3,448 million of net cash proceeds from our initial public offering, offset by $2,500 million of short-term debt we assumed from Lucent at that time. We did not receive any of the proceeds of this debt and Lucent was relieved of all obligations related to this debt.

Net cash provided by operating activities was $269 million in fiscal 2001 compared to $762 million for fiscal 2000. The decrease in fiscal 2001, compared with fiscal 2000, reflects a reduction in revenues during a period in which we increased our manufacturing capacity and infrastructure in anticipation of higher revenues. The adverse impact on cash caused by our fiscal 2001 net loss was offset by a $413 million reduction in accounts receivable and a $243 million increase in accounts payable.

Net cash provided by operating activities was $762 million in fiscal 2000 compared to $690 million for fiscal 1999. The improvement was primarily the result of increases in net income, excluding the non-cash impact associated with depreciation and amortization and purchased in-process research and development. In fiscal 2000 our cash provided by operating activities reflects an increase in receivables of $237 million as a result of increased revenue. In fiscal 1999 our cash provided by operating activities reflects a pre-payment of certain costs in connection with the expansion of our non-U.S. integrated circuits operations.

Net cash used in investing activities was $723 million in fiscal 2001 compared to $829 million and $753 million in fiscal 2000 and 1999, respectively. Capital expenditures and acquisitions of businesses have historically been the primary components of our investing activities. Capital expenditures were $723

million, $672 million and $656 million in fiscal 2001, 2000 and 1999, respectively. Our capital spending has been used primarily in support of our manufacturing facilities. Capital spending also includes expenditures for information technology, including computer servers and networking capability.

In fiscal 2001 we invested $96 million on the construction of a new office facility adjacent to our current headquarters and invested $24 million in capital expenditures related to our separation from Lucent. The remainder of our capital expenditures supported on-going business requirements. In light of current business conditions, we are limiting our capital expenditures principally to projects critical to winning new business or keeping customer commitments. Our capital investment needs are expected to be significantly lower in fiscal 2002 than in fiscal 2001, resulting from the current downturn in our markets.

Net cash provided by financing activities was $3,607 million in fiscal 2001 compared to $67 million and $63 million in fiscal 2000 and 1999, respectively. The increase in fiscal 2001 was primarily the result of the receipt of the net cash proceeds from the sale of our common stock in our initial public offering. Prior to our initial public offering, we relied on Lucent to provide financing for our operations.

The $2,500 million credit facility that we assumed from Lucent at the time of our initial public offering was a 364-day facility that was to mature on February 21, 2002. On October 4, 2001, this credit facility was amended. In connection with the amendment, we repaid $1,000 million, thereby reducing the facility to $1,500 million. We also paid $21 million in fees in connection with the amendment, which we are amortizing over the life of the facility. The facility is comprised of term loans and revolving credit loans and is secured by our principal domestic assets other than the proceeds of our initial public offering. The maturity date of the facility was extended from February 22, 2002 to September 30, 2002. In addition, if we raise at least $500 million in equity or debt capital markets transactions before September 30, 2002, or $90 million after giving effect to this offering, the maturity date of the facility will be extended to September 30, 2004, with the facility required to be reduced to $750 million on September 30, 2002 and $500 million on September 30, 2003. The debt is not convertible into any other securities of the company.

The interest rates applicable to borrowings under the facility are based on a scale indexed to our credit rating. Our credit ratings have declined from BBB- from Standard and Poor's and Baa3 from Moody's at the time of our initial public offering to BB-, with a negative outlook, from Standard & Poor's

and Ba3, with a negative outlook, from Moody's currently. Based on these credit ratings, the interest rate under the facility is the applicable LIBOR rate plus 400 basis points. Unless our credit ratings change, this rate will remain in effect for the life of the facility. Any further decline in our credit rating would increase the interest rate under the facility by 25 basis points per year, which would increase our annual interest expense by approximately $2.4 million, assuming $960 million was outstanding. Following the reduction in the size of the facility, $500 million of the facility is now a revolving credit facility with the remainder considered a term loan. The only periodic debt service obligation under the amended credit facility is to make quarterly interest payments.

Under the agreement, we must use 100% (50% if the size of the facility is $500 million or less) of the net cash proceeds of liquidity raising transactions to reduce the size of the facility. Liquidity raising transactions are dispositions of assets (other than sales of inventory and ordinary course disposals of excess or obsolete property) including, among other things,

receivables securitizations and sale-leaseback transactions, in each case outside the ordinary course of business. The agreement also provides that 50% of the net cash proceeds of the first $500 million and 75% (50% if the size of the facility is $500 million or less) of the net cash proceeds greater than $500 million from most sales of debt or equity securities in public or private transactions be applied to reduce the credit facility. Notwithstanding the foregoing, we must apply 100% of net cash proceeds over $1,000 million from the issuance of debt securities that are secured equally with the credit facility to reduce the size of the credit facility.

On January 18, 2002, we completed the sale of certain assets and liabilities related to our FPGA business to Lattice Semiconductor Corporation for $250 million in cash. The net cash proceeds from the sale were used to repay amounts outstanding under our credit facility. We believe that the sale of the FPGA business will not have a material impact on our future results of operations.

On January 24, 2002, Agere Systems Inc. and certain of its subsidiaries entered into a securitization transaction relating to certain accounts receivable. As part of the transaction, Agere Systems Inc. and certain of its subsidiaries irrevocably transfer accounts receivable on a daily basis to a wholly-owned, fully consolidated, bankruptcy remote subsidiary. When we say that the subsidiary is bankruptcy remote, we mean that it is unlikely that it will be voluntarily placed into bankruptcy proceedings by us. In the event we were to be the subject of bankruptcy proceedings, it is unlikely that our creditors would have a claim on the subsidiary's assets, even though the subsidiary is wholly owned by us. This is because we have taken a number of steps, including the appointment of an independent director and the requirement of unanimous board approval to commence bankruptcy proceedings, that we believe under current law will result in the assets of this subsidiary not being available to our creditors until the claims of the subsidiary's creditors are satisfied. The subsidiary has entered into a loan agreement with certain financial institutions, pursuant to which the financial institutions agreed to make loans to the subsidiary secured by the accounts receivable. The financial institutions have commitments under the loan agreement of up to $200 million; however, the amount that we can actually borrow at any time depends on the amount and nature of the accounts receivable that we have transferred to the subsidiary. The loan agreement expires on January 21, 2003. As of March 31, 2002, $136 million was outstanding under this agreement.

Subsequent to the October 4, 2001 repayment discussed above and through March 31, 2002, we reduced the amount outstanding under the credit facility by $540 million to $960 million at March 31, 2002. The amounts used to make these repayments resulted from the following transactions: $250 million from the sale of our FPGA business, $136 million from our accounts receivable securitization, $67 million from the sale of our manufacturing facility and related equipment located in Spain, $55 million from the sale of investments, and $32 million from various sale-leaseback and other transactions.

Subsequent to March 31, 2002, we repaid an additional $540 million of borrowings under the credit facility to reduce the balance to $420 million as of June 7, 2002. This $420 million is all a term loan. In addition, we have $500 million of availability under the revolving credit portion of the facility. The amounts used to make the $540 million repayment came from the following sources: $509 million from cash on hand and $31 million from the accounts receivable securitization and other capital raising transactions. As a result of the additional borrowings under the accounts receivable securitization, the balance outstanding under that agreement was increased to approximately $163 million.

The credit facility contains financial covenants that require us to: (1) maintain a minimum level of liquidity, (2) achieve a minimum level of earnings before interest, taxes, depreciation and amortization computed in accordance with the agreement each quarter, (3) maintain a minimum level of net worth, computed in accordance with the agreement and (4) limit capital expenditures. Other covenants restrict our ability to pay cash dividends, incur indebtedness and invest cash in our subsidiaries and other businesses. The accounts receivable securitization has the same four financial covenants and covenant levels as the credit facility; however, a violation of these covenants will not accelerate payment or require an immediate cash outlay to cover amounts previously loaned under the accounts receivable securitization, but will end our ability to obtain further loans under the agreement.

As a result of a significant decline in market demand for telecommunications infrastructure products, we have been experiencing losses and have been using cash in our operations for several quarters. In response to market conditions, we have announced a number of restructuring and consolidation actions to reduce our losses and use of cash.

On January 23, 2002, we announced plans to consolidate existing manufacturing, research and development, business management and administrative facilities in Pennsylvania and New Jersey. The consolidation is expected to be substantially completed 18 months from the announcement date. We anticipate the cash required for this consolidation to be between $250 million and $350 million. We plan to discontinue operations and seek buyers for our Reading and Breinigsville facilities. Through this consolidation we will reduce our square footage in the two states by about two million square feet, or approximately 50%, significantly lowering cost. We expect to realize approximately $100 million annually in cash savings from these actions, driven primarily by a reduction in rent and building infrastructure costs. In addition, we are seeking a buyer for our wafer fabrication operation in Orlando, Florida.

Our primary source of liquidity is our cash and cash equivalents. If this offering is completed, we believe that our cash and cash equivalents will be sufficient to meet our cash requirements for the next 12 months, including repayment of borrowings under the credit facility if its maturity is not extended, the cash requirements of the facilities consolidation described above and the other announced restructuring activities.

If this offering is not completed, we believe that our cash and cash equivalents, together with additional amounts that may be borrowed under the accounts receivable securitization, will be sufficient to meet our cash requirements for the next 12 months, including repayment of borrowings under the credit facility if its maturity is not extended, the cash requirements of the facilities consolidation described above and the other announced restructuring activities. If we lose access to the accounts receivable securitization or generate less cash in our business than what our plans contemplate, we would consider further cash conserving actions to enable us to meet our cash requirements for the next 12 months. These actions would include the elimination of employee bonuses, the acceleration of already planned expense reductions, further limits on capital spending and the retiming of certain restructuring initiatives. We cannot assure you that these actions will be feasible at the time or prove adequate. In any event, we intend to pursue other financing transactions in addition to this offering, although we have no committed financing transactions at this time. In addition, we are restricted in our ability to issue stock in order to raise capital due to conditions related to our spin-off from Lucent. This discussion of our liquidity requirements does not take into consideration an extension of the credit facility, an extension of the accounts receivable securitization, any funds that we may receive as a result of selling our Orlando, Florida operations or the Reading and Breinigsville, Pennsylvania facilities or any other financing transactions.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The following table aggregates our contractual obligations and commitments with definitive payment terms which will require significant cash outlays in the future. The commitment amounts are as of September 30, 2001, with the exception of the credit facility, which has been adjusted for subsequent

repayments and reflects the balance through June 7, 2002, and other secured debt, which is the amount outstanding under the accounts receivable securitization as of June 7, 2002.

		YEAR ENDING SEPTEMBER 30,					
	TOTAL	2002	2003	2004	2005	2006	LATER YEARS
		(DOLLARS IN MILLIONS)					
CONTRACTUAL OBLIGATIONS AND COMMITMENTS							
Credit facility	$420	$420	$ --	$ --	$ --	$ --	$ --
Other secured debt	163	--	163	--	--	--	--
Capital leases	55	17	22	16	--	--	--
Operating leases	331	142	106	50	29	4	--
Total	$969	$579	$291	$ 66	$ 29	$ 4	$ --

We also have potential contractual obligations which are contingent upon certain events and do not have definitive payment terms. Such obligations may require cash outlays by us in the future. The obligations are discussed below.

In December 1997, we entered into a joint venture, called Silicon Manufacturing Partners Pte Ltd, or SMP, with Chartered Semiconductor, a leading manufacturing foundry for integrated circuits, to operate a 54,000 square foot integrated circuit manufacturing facility in Singapore. We own a 51% equity interest in this joint venture, and Chartered Semiconductor owns the remaining 49% equity interest. We have an agreement with SMP under which we have agreed to purchase 51% of the production output from this facility and Chartered Semiconductor has agreed to purchase the remaining 49% of the production output. If we fail to purchase the required commitments, we will be required to pay SMP for the fixed costs associated with the unpurchased wafers. Chartered Semiconductor is similarly obligated with respect to the wafers allotted to it. The agreement may be terminated by either party upon two years' written notice, but may not be terminated prior to February 2008. The agreement may also be terminated for material breach, bankruptcy or insolvency. Based on forecasted demand, we believe it is unlikely that we would have to pay any significant amounts for underutilization in the near future. However, if our purchases under this agreement are less than anticipated, our cash obligation to SMP may be significant.

In July 2000, we and Chartered Semiconductor entered into an agreement committing both parties to jointly develop manufacturing technologies for future generations of integrated circuits targeted at high-growth communications markets. We have agreed to invest up to $350 million over a five-year period. As part of the joint development activities, the two companies are staffing a new research and development team at Chartered Semiconductor's Woodlands campus in Singapore. These scientists and engineers are working with Company teams located

in the United States, as well as with Chartered Semiconductor's technology development organization. The agreement may be terminated for breach of material terms upon 30 days' notice or for convenience upon six months' notice prior to the planned successful completion of a development project, in which case the agreement will terminate upon the actual successful completion of that project.

We have also entered into an agreement with Chartered Semiconductor whereby Chartered Semiconductor will provide integrated circuit wafer manufacturing services to us. Under the agreement, we provide a demand forecast to Chartered Semiconductor for future periods and Chartered commits to have manufacturing capacity available for our use. If we use less than a certain percent of the forecasted manufacturing capacity, we may be obligated to pay penalties to Chartered Semiconductor. We are currently in discussions with Chartered Semiconductor concerning shortfalls in purchase commitments.

PURCHASED IN-PROCESS RESEARCH AND DEVELOPMENT

In connection with the acquisitions of Agere, Inc., Herrmann, Ortel and substantially all the assets of VTC in fiscal 2000, and the acquisitions of Enable and Sybarus in fiscal 1999, a portion of each purchase price was allocated to purchased in-process research and development. In analyzing these acquisitions, we made decisions to buy technology that had not yet been commercialized rather than develop the technology internally. We relied on factors such as the amount of time it would take to bring the

technology to market in making these decisions. We also considered Lucent's Bell Laboratories' resource allocation and its progress on comparable technology, if any. Our management expects to use a similar decision process in the future.

We estimated the fair value of in-process research and development for the above acquisitions using an income approach. This involved estimating the fair value of the in-process research and development using the present value of the estimated after-tax cash flows expected to be generated by the purchased in-process research and development, using risk-adjusted discount rates and revenue forecasts as appropriate. The selection of the discount rate was based on consideration of Lucent's weighted average cost of capital, as well as other factors known at the time, including the projected useful life of each technology, profitability levels of each technology, the uncertainty of technology advances and the stage of completion of each technology. We believe that the estimated in-process research and development amounts so determined represented fair value and did not exceed the amount a third party would have paid for the projects.

Core technology is a product, service or process that exists at the date of the acquisition and may contribute to the value of any product resulting from in-process research and development. We deducted an amount representing the estimated value of any core technology's contribution from the estimated cash flows used to value in-process research and development. At the date of acquisition, the in-process research and development projects had not yet reached technological feasibility and had no alternative future uses. Accordingly, the value allocated to these projects was capitalized and immediately expensed at acquisition. If the projects are not successful or completed in a timely manner, management's product pricing and growth rates may not be achieved and we may not realize the financial benefits expected from the projects.

Set forth below are descriptions of the major acquired in-process research and development projects and our original assumptions in connection with our significant acquisitions, followed by a current status of the projects. Due to

significant changes in economic, industry and market conditions, particularly in the latter half of fiscal 2001, the original assumptions at the time of acquisition, for some of our acquisitions, vary materially from our current estimates as noted below.

AGERE, INC.

On April 20, 2000, we completed the acquisition of Agere, Inc., which was a developer and supplier of integrated circuits solutions used in network processors, which control how data is sent over networks. At the acquisition date, Agere, Inc. was conducting development and qualification activities related to the development of a programmable network processor for various protocols for 2.5 gigabits per second transmission speeds. A protocol is a set of procedures for the formatting and timing of data transmission between two pieces of equipment. A gigabit is a unit of measurement of data and is equal to roughly one billion bits. The allocation to purchased in-process research and development of $94 million represented its estimated fair value using the methodology described above.

Agere, Inc.'s in-process research and development projects were approximately 65% complete at the time of acquisition. The projects were expected to be completed in November 2000 after approximately two years of research and development effort. Following completion, the projects were expected to begin generating economic benefits. Revenue attributable to the resulting products was estimated to be $21 million in fiscal 2001 and $65 million in fiscal 2002. Revenue was expected to peak in fiscal 2007 and decline thereafter through the end of the product's life, which was expected to be in fiscal 2009, as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 205% in fiscal 2002 to 5% in fiscal 2007 and be negative for the remainder of the projection period. At the acquisition date, costs to complete Agere's in-process research and development were expected to total approximately $3.4 million. Projected future net cash flows attributable to Agere's in-process research and development, assuming successful development, were discounted to net present value using a discount rate of 30%.

Agere, Inc.'s in-process research and development projects related to first generation network processors were completed in the fourth quarter of fiscal 2000. The second generation processors were

completed in the first quarter of fiscal 2001. Actual costs related to completing these projects were $13 million. A third generation is expected to be completed in the first quarter of fiscal 2003 at an estimated cost of $2.4 million. Actual revenues for fiscal 2001 were $4 million, consisting primarily of sales of development systems and models, which are used by customers for system evaluations and qualifications. Changing conditions in the targeted market areas for these network processors have led to a revised revenue forecast for these parts, which is lower than originally anticipated. Fiscal 2002 revenues are currently projected to be about $13 million, with growth in excess of 50% over the next two years expected to decrease to a long-term growth rate of 8% by 2011.

ORTEL CORPORATION

On April 27, 2000, we completed the acquisition of Ortel, which was a developer and manufacturer of semiconductor-based optoelectronic components used in fiber optic systems for data communications and cable television networks. At the acquisition date, Ortel was conducting development, engineering and testing activities associated with high-speed optical transmitters, receivers and

transceivers.

Ortel's in-process research and development projects ranged from 50% to 75% complete at the time of acquisition. Ortel's in-process research and development projects were expected to be completed during the period from June 2000 to April 2001 after approximately two to three and a half years of research and development effort. Following completion, the projects were expected to begin generating economic benefits. The allocation to purchased in-process research and development of $307 million represented its estimated fair value using the methodology described above. The $307 million was allocated to the following projects, which are explained below.

- 10G New Products -- $61 million;

- 10G OC-192 Receiver/Daytona Products -- $105 million;

- 980 Products -- $95 million;

- 1550 Products -- $27 million; and

- CATV Products -- $19 million.

Projected net cash flows attributable to Ortel's in-process research and development, assuming successful development, were discounted to net present value using a discount rate of 25%.

Revenue attributable to the 10G New Products was estimated to be $5 million in fiscal 2001 and $30 million in fiscal 2002. 10G New Products are receivers that incorporate new packaging technologies for high-speed transport and metropolitan network applications at speeds of 10 gigabits per second. Revenue was expected to peak in fiscal 2009 and decline thereafter through the end of the products' life as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 447% in fiscal 2002 to 8% in fiscal 2009, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the products were expected to be $3 million.

Most of the 10G New Products were completed in fiscal 2001 as anticipated at a cost of $2 million. One product remains in development and is expected to be completed in fiscal 2002 at an estimated cost of $1 million. There were no revenues attributable to the 10G New Products in fiscal 2001. Management has revised its estimated revenue for fiscal 2002 to be $1 million with a long-term growth rate of 15%.

Revenue attributable to the 10G OC-192 Receiver/Daytona Products was estimated to be $16 million in fiscal 2001 and $33 million in fiscal 2002. 10G OC-192 Receiver/Daytona Products are directly modulated lasers and receivers used for high-speed transport and metropolitan network applications at speeds of 10 gigabits per second. Revenue was expected to peak in fiscal 2009 and decline thereafter through the end of the products' life as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 166% in fiscal 2003 to 8% in fiscal 2009, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the product were expected to be $1 million.

The 10G OC-192 Receiver/Daytona Products were completed in fiscal 2001. Actual revenues in fiscal 2001 were $40 million and are currently projected to decrease to $8 million for fiscal 2002. Revenues are

expected to grow annually at a rate of 10% until fiscal 2008 when a decline in growth is anticipated. Actual project costs were materially consistent with management's original estimates.

Revenue attributable to the 980 Products was estimated to be $44 million in fiscal 2001 and $108 million in fiscal 2002. 980 Products are pump lasers operating at 980 nanometers wavelength. A nanometer is a unit of measurement of distance and equals one billionth of a meter. Revenue was expected to peak in fiscal 2008 and decline thereafter through the end of the products' life as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 143% in fiscal 2002 to 17% in fiscal 2008, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the 980 Products were expected to be $1 million.

The 980 Products were in development and therefore did not yield any revenues in fiscal 2001. Currently, all design efforts on the 980 products have been discontinued and there are no expected revenues in fiscal 2002 or any future period.

Revenue attributable to the 1550 Products was estimated to be $2 million in fiscal 2001 and $63 million in fiscal 2002. 1550 Products are transmitters and lasers operating at 1550 nanometers wavelength. Revenue was expected to peak in fiscal 2008 and decline thereafter through the end of the products' life as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 33% in fiscal 2003 to 17% in fiscal 2008, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the 1550 Products were expected to be $2 million.

The 1550 Products had four distinct product lines. Of these product lines, one has been completed, one has been cancelled and two are still in-process. It is anticipated that the in-process research and development for the uncompleted projects will be finalized in the third quarter of fiscal 2002. Product development costs for the 1550 products since acquisition have been $1.5 million and it is anticipated that an additional $0.5 million will be incurred to complete the products. There were no revenues attributable to these products in fiscal 2001. Management has lowered its estimate of revenues to be $3 million in fiscal 2002 with a 10% annual growth rate projected through fiscal 2008 with negative growth thereafter.

Revenue attributable to the CATV Products was estimated to be $28 million in fiscal 2001 and $58 million in fiscal 2002. CATV Products are receivers and return path products for cable television network applications. The return path allows cable system operators to offer Internet and telephone services, in direct competition with network services providers. Revenue was expected to peak in fiscal 2004 and decline thereafter through the end of the products' life as new product technologies were expected to be introduced by us. Revenue growth was expected to decrease from 107% in fiscal 2002 to 4% in fiscal 2004 and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the CATV Products were expected to be $1 million.

The CATV Products were completed in fiscal 2001 at a cost of $2 million. Actual revenues in fiscal 2001 were $44 million. Revenue attributable to these projects is currently estimated to be $35 million in fiscal 2002 with minimal to no growth anticipated in future years.

HERRMANN TECHNOLOGY, INC.

On June 16, 2000, we completed the acquisition of Herrmann, which was a

developer and supplier of passive optical filters that can be used in conjunction with active optoelectronic components in products such as amplifiers. The allocation to in-process research and development of $34 million represented its estimated fair value using the methodology described above. The $34 million was allocated primarily to the development of manufacturing processes.

Revenue attributable to the products using these manufacturing processes was estimated to be $59 million in fiscal 2001 and $91 million in fiscal 2002. Revenue was expected to peak in fiscal 2005 and decline thereafter through the end of the products' life as new technologies were expected to be introduced by us. Revenue growth was expected to decrease from 54.7% in 2002 to 0.7% in fiscal 2005, and be negative for the remainder of the projection period. At the acquisition date, costs to complete the research and development efforts related to the processes were expected to be $0.5 million.

Herrmann's in-process research and development projects ranged from 20% to 60% complete at the time of acquisition. Herrmann's in-process research and development projects were expected to be completed during the period from August 2000 to June 2001 after approximately two to six years of research and development effort. Following completion, the projects were expected to begin generating economic benefits. In total, costs to complete Herrmann's in-process research and development were expected to equal approximately $1.8 million. Projected future net cash flows attributable to Herrmann's in-process research and development, assuming successful development, were discounted to net present value using a discount rate of 27.5%.

Hermann's in-process research and development projects were either completed by July of 2001 or discontinued due to market conditions. Actual costs to complete the projects were $1.3 million. Actual revenue in fiscal 2001 attributable to these products was significantly lower than anticipated at $3 million. Management has revised the estimated revenue attributable to these projects to be $6 million in fiscal 2002 with minimal to no growth anticipated in future years.

ENVIRONMENTAL, HEALTH AND SAFETY MATTERS

We are subject to a wide range of laws and regulations relating to protection of the environment and employee safety and health. We are currently involved in investigations and/or cleanup of known contamination at eight sites either voluntarily or pursuant to government directives. There are established reserves for environmental liabilities where they are probable and reasonably estimable. Reserves for estimated losses from environmental remediation are, depending on the site, based primarily upon internal or third party environmental studies, estimates as to the number, participation level and financial viability of all potential responsible parties, the extent of contamination and the nature of required remedial actions. Although we believe that the reserves are adequate to cover known environmental liabilities, it is often difficult to estimate with certainty the future cost of such matters. Therefore, there is no assurance that expenditures that will be required relating to remedial actions and compliance with applicable environmental laws will not exceed the amount reflected in the reserves for such matters or will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

LEGAL PROCEEDINGS

From time to time we are involved in legal proceedings arising in the ordinary course of business, including unfair labor charges filed by our unions

with the National Labor Relations Board, claims before the U.S. Equal Employment Opportunity Commission and other employee grievances. We also may be subject to intellectual property litigation and infringement claims, which could cause us to incur significant expenses or prevent us from selling our products.

On October 3, 2000, a patent infringement lawsuit was filed against Lucent, among other optoelectronic components manufacturers, by Litton Systems, Inc. and The Board of Trustees of the Leland Stanford Junior University in the United States District Court for the Central District of California (Western Division). We anticipate we may be named a defendant in the suit. The complaint alleges that each of the defendants is infringing a patent related to the manufacture of erbium-doped optical amplifiers. The patent is owned by Stanford University and is exclusively licensed to Litton. The complaint seeks, among other remedies, unspecified monetary damages, counsel fees and injunctive relief. This matter is in its early stages. Because of the decline in demand for erbium-doped optical amplifiers over the last 12 months, which we expect to continue for the remaining life of the patent, we currently believe that this suit, if determined adversely to us, would not have a material adverse effect on our financial position, results of operations or cash flows.

An investigation was commenced on April 4, 2001, by the U.S. International Trade Commission based on a request of Proxim, Inc. alleging patent infringement by 14 companies, including some of our customers for wireless local area networking products. Proxim alleges infringement of three patents related to spread-spectrum coding techniques. Spread-spectrum coding techniques refers to a way of transmitting a signal for wireless communications by spreading the signal over a wide frequency band. We believe we

have valid defenses to Proxim's claims and have intervened in the investigation in order to defend our customers. Proxim seeks relief in the form of an exclusion order preventing the importation by our customers of specified wireless local area networking products, including some of our products, into the United States. If Proxim were able to obtain an exclusion order, we believe that the order would likely apply to 802.11(b) card products and access point products containing such cards for our customers named in the complaint, and possibly all 802.11(b) card products and access point products containing such cards imported by us. We believe that any order would not exclude importation of 802.11(b) chipsets, or impact any potential 802.11(a) products. While it is possible that an exclusion order, if granted, could affect products from which we derive a material amount of revenue, we believe that we could restructure our operations to minimize the impact of such an order on our business. One of our subsidiaries, Agere Systems Guardian Corp., filed a lawsuit on May 23, 2001, in the U.S. District Court in Delaware against Proxim alleging infringement of three patents used in Proxim's wireless local area networking products.

If we are unsuccessful in resolving these proceedings, as they relate to us, our operations may be disrupted or we may incur additional costs. Other than as described above, we do not believe there is any litigation pending that should have, individually or in the aggregate, a material adverse effect on our consolidated financial position, results of operations or cash flows.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." Statement 142 provides guidance on the financial accounting and reporting for acquired goodwill and other intangible assets. Under Statement 142, goodwill and indefinite lived intangible assets will no longer be amortized. Intangible assets with finite lives will continue to be amortized over their useful lives

which will no longer be limited to a maximum life of forty years. The criteria for recognizing an intangible asset have also been revised. As a result, we will need to re-assess the classification and useful lives of our previously acquired goodwill and other intangible assets. Statement 142 also requires that goodwill and indefinite lived intangibles be tested for impairment at least annually. The goodwill impairment test is a two step process that requires goodwill to be allocated to reporting units. In the first step, the fair value of the reporting unit is compared to the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value of the reporting unit, a goodwill impairment may exist, and the second step of the test is performed. In the second step, the implied fair value of the goodwill is compared to the carrying value of the goodwill and an impairment loss will be recognized to the extent that the carrying value of the goodwill exceeds the implied fair value of the goodwill. Statement 142 is effective for Agere in fiscal year 2003, although earlier application is permitted. We plan to adopt Statement 142 effective October 1, 2002 and are currently evaluating the potential effects of implementing this standard on our financial condition and results of operations.

Also in July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations." Statement 143 addresses financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and their associated retirement costs. In accordance with Statement 143, retirement obligations will be recognized at fair value in the period they are incurred. When the liability is initially recorded, the cost will be capitalized by increasing the asset's carrying value, which is subsequently depreciated over its useful life. Statement 143 is effective for us in fiscal year 2003, with earlier application encouraged. We plan to adopt Statement 143 effective October 1, 2002, and are currently evaluating the potential effects of implementing this standard on our financial condition and results of operations.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Statement 144 primarily addresses financial accounting and reporting for the impairment or disposal of long-lived assets and also affects certain aspects of accounting for discontinued operations. Statement 144 is effective for us in fiscal year 2003, with earlier application encouraged. We plan to adopt Statement 144

effective October 1, 2002, and are currently evaluating the potential effects of implementing this standard on our financial condition and results of operations.

EUROPEAN MONETARY UNION -- EURO

Several member countries of the European Union have established fixed conversion rates between their sovereign currencies and the Euro, and have adopted the Euro as their new single legal currency. The legacy currencies remained legal tender in the participating countries for a transition period between January 1, 1999 and January 1, 2002. During the transition period, cash-less payments were permitted to be made in the Euro. Beginning on January 1, 2002, the participating countries introduced Euro notes and coins. The participating countries withdrew all legacy currencies by February 28, 2002, and they are no longer available. The Euro conversion may affect cross-border competition by creating cross-border price transparency. We will continue to evaluate issues involving introduction of the Euro as further accounting, tax and governmental legal and regulatory guidance is available. Based on current information and our current assessment, it is not expected that the Euro conversion will have a material adverse effect on our business or financial

condition.

RISK MANAGEMENT

We are exposed to market risk from changes in foreign currency exchange rates and interest rates that could impact our results of operations and financial position. We manage our exposure to these market risks through our regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. We use derivative financial instruments as risk management tools and not for speculative purposes. In addition, derivative financial instruments are entered into with a diversified group of major financial institutions in order to manage our exposure to nonperformance on such instruments. Our risk management objective is to minimize the effects of volatility on our cash flows by identifying the recognized assets and liabilities or forecasted transactions exposed to these risks and appropriately hedging the risks.

We use foreign currency forward contracts, and may from time to time use foreign currency options, to manage the volatility of non-functional currency cash flows resulting from changes in exchange rates. Foreign currency exchange contracts are designated for recorded, firmly committed or anticipated purchases and sales. The use of these derivative financial instruments allows us to reduce our 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, 2001, our primary net foreign currency market exposures included Singapore dollars and British Pounds Sterling.

The fair value of foreign currency exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments and results of operations. The financial instruments included in our sensitivity analysis are foreign currency forward contracts. These contracts generally have a duration of three to six months and are primarily used to hedge firmly committed and anticipated transactions. The sensitivity analysis excludes the values of foreign currency denominated receivables and payables because of their short maturities. To perform the sensitivity analysis, we assess the risk of loss in fair values from the effect of a hypothetical 10% change in foreign currency exchange spot rates assuming no change in interest rates. For contracts outstanding as of March 31, 2002, a 10% appreciation in foreign currency exchange rates against the U.S. dollar from the prevailing market rates would have increased our pre-tax earnings by approximately $2 million. Conversely, a 10% depreciation in these exchange rates from the prevailing market rates would have decreased our pre-tax earnings by approximately $2 million. Consistent with the nature of the economic hedge of foreign currency exchange contracts, these gains or losses would be offset by corresponding decreases or increases, respectively, of the underlying instrument or transaction being hedged.

The model assumes a parallel shift in all foreign currency exchange spot rates. Exchange rates, however, rarely move in the same direction. The assumption that all exchange rates change in a parallel

manner does not necessarily represent the actual changes in fair value we would incur under normal market conditions because all variables other than the specific market risk are held constant.

Effective October 1, 2000, we adopted Statement 133 and its corresponding amendments under Statement 138. The adoption of Statement 133 resulted in a

cumulative effect of an increase in our net loss of $4 million, net of a tax benefit of $2 million in fiscal 2001. The increase in our net loss is primarily due to derivatives not designated as hedging instruments. For the six months ended March 31, 2002 and 2001, and the fiscal year ended September 30, 2001, the change in fair market value of derivative instruments was recorded in other income-net and was not material.

While we hedge certain foreign currency transactions, a decline in value of non-U.S. dollar currencies may adversely affect our ability to contract for product sales in U.S. dollars because our products may become more expensive to purchase in U.S. dollars for local customers doing business in the countries of the affected currencies.

As of March 31, 2002, we had $1,096 million of short-term variable rate debt outstanding. To manage the cash flow risk associated with this debt, we may, from time to time, enter into interest rate swap agreements. There were no interest rate swap agreements in effect during the six months ended March 31, 2002, fiscal 2001 or fiscal 2000. As of March 31, 2002, a variation of 1% in the interest rate charged on this short-term variable rate debt would result in a change of approximately $11 million in annual interest expense.

Our investment portfolio consists of equity investments accounted for under the cost and equity methods. We do not hedge equity price risk.

BUSINESS

GENERAL

We are the world's leading provider of components for communications applications, delivering integrated solutions that form the building blocks for advanced wired, wireless, and optical communications networks. We also design and manufacture a wide range of integrated circuit solutions for computer- and communications-related consumer devices such as cellular phones, modems, and hard disk drives for personal computers and workstations. In addition, the company supplies complete wireless computer networking solutions through the ORiNOCO(TM) product line.

Our business operations are organized into two market-focused groups, Client Systems and Infrastructure Systems, that target the consumer communications and network equipment markets respectively. Each of these two groups is a reportable operating segment. The segments each include revenue from the licensing of intellectual property related to that segment.

The Client Systems segment includes our wireless data, computer communications, storage and wireless terminal solutions products. This segment delivers integrated circuit solutions for a variety of end-user applications such as modems, Internet-enabled cellular terminals and hard-disk drives for computers as well as software, systems and wireless local area network solutions through the ORiNOCO product family.

The Infrastructure Systems segment delivers solutions to the high-speed communications systems market and facilitates the convergence of integrated circuit devices and optoelectronic components. We have consolidated research and development, as well as marketing, for both optoelectronic and integrated circuit devices aimed at communications systems. This allows us to design, develop and deliver complete, interoperable solutions to equipment manufacturers for advanced enterprise, access, metropolitan, long-haul and undersea applications.

Integrated circuits, or chips, are made using semiconductor wafers imprinted with a network of electronic components. They are designed to perform various functions such as processing electronic signals, controlling electronic system functions and processing and storing data. Optoelectronic components, including both active and passive components, transmit, process, change, amplify and receive light that carries data and voice traffic over optical networks.

We sell our products primarily through our direct sales force, but we also utilize distributors, resellers and electronic commerce. Of our total revenue of $4,080 million in the fiscal year ended September 30, 2001, $1,406 million, or 34%, was generated by our Client Systems segment and $2,674 million, or 66%, was generated by our Infrastructure Systems segment. Approximately 45% of our revenue was generated in the United States and 55% internationally during fiscal 2001. For the six months ended March 31, 2002, $599 million of our revenue, or 55%, was generated by our Client Systems segment and $489 million of our revenue, or 45%, was generated by our Infrastructure Systems segment. Approximately 33% of our revenue was generated in the United States and 67% internationally during the six months ended March 31, 2002. See note 17 to our annual financial statements included elsewhere in this prospectus for further information about our Client Systems and Infrastructure Systems segments.

As of March 31, 2002, we employed approximately 11,700 people worldwide. We have major research and development and manufacturing sites in the United States, Mexico, Singapore and Thailand.

OUR STRATEGY

We intend to maintain and enhance our position as the leading global provider of communications components. To accomplish this goal, we are pursuing the major strategies described below.

- Focus on Future Growth and Profit Opportunities within the Communications Components Industry. We are focusing resources on segments of the market for integrated circuits and optoelectronics where we can leverage our existing technical skills, manufacturing capabilities and customer

relationships, and where we believe there is long-term market growth and profit potential. We will particularly focus on the markets for network communications equipment and wireless local area networking products.

- Expand and Develop New Customer Relationships. We seek to capitalize on our status as a stand-alone company to increase our sales by being selected to develop and supply components for our customers' new products. We seek to expand our engagements with existing and potential customers who have been reluctant to buy from us because they are competitors of Lucent.

- Execute on Management Realignment and Restructuring. We have realigned our management structure to focus on the communications infrastructure and client systems markets. We will continue to implement a series of announced restructuring initiatives focused on reducing expenses and streamlining operations within these segments, which are intended to reduce our fixed costs and enable us to more closely match our costs to the level of the demand from our customers.

- Extend Product and Technical Leadership. We are building on our product and technical leadership by continuing to work closely with our customers and making appropriate investments in research and development. Specific initiatives include:

1. Integrated Solutions. We will continue to leverage our extensive communications systems experience and extensive product portfolio to provide integrated solutions for our customers. Our integrated solutions will provide customers with components and software for entire functions and subsystems so that customers can design and market higher performance and lower cost products more quickly. We also support customers with technical product and systems understanding to help them use our products.

2. Combined Integrated Circuit and Optoelectronic Solutions. We believe that customers will increasingly demand combined integrated circuit and optoelectronic solutions in order to reduce the time and expense necessary to develop communications equipment. We will take advantage of our extensive experience, systems understanding and broad product portfolio in both integrated circuits and optoelectronics to capitalize on this market opportunity.

CLIENT SYSTEMS

We sell integrated circuits for use in products that allow users to access communications networks through a variety of different methods. We offer our customers solutions that include integrated circuits and software. In addition, we offer integrated circuits for computer hard disk drives and equipment for wireless local area networking which facilitates data communication between computers and networks without the use of wires.

Many of our products convert analog signals into digital signals and vice versa. Analog refers to a transmission technique employing a continuous signal that varies in amplitude, frequency or phase of the transmission. Digital refers to a method of transmitting, storing and processing data that uses distinct electronic or optical pulses to represent the binary digits 0 and 1.

COMPETITIVE STRENGTHS

We believe the primary reasons why customers select our client systems components are:

- price;

- breadth of product line and ability to offer integrated solutions;

- manufacturing capacity, as measured by ability to satisfy orders;

- performance, as measured by speed, power requirements and reliability; and

- compatibility of products with other products and communications standards used in communications networks.

PRODUCTS AND APPLICATIONS

Storage Products

We sell integrated circuits for use in hard disk drives. As applications used on computers and communications equipment become more complex, we expect an increased demand for higher storage capability. Within the storage products area we sell read channels, disk controllers and pre-amplifiers, or preamps. Read channels convert an analog signal that is generated by reading the stored data

on the hard disk into digital signals. Preamps are used to amplify the initial signal from the hard disk so the signal can be processed by the read channel. Together, these are key components that are critical to determining the overall performance of a hard disk drive. We also develop and sell disk drive controllers, which are used to control signal processing and communications functions within the disk drive. When a read channel and a disk controller are integrated into a single solution, this is referred to as a "super chip." We design and sell hard disk drive super chips to several leading disk drive manufacturers.

Wireless Local Area Networking Products

We sell integrated circuits and equipment for wireless networks, along with associated software. We offer our ORiNOCO products for wireless local area networking.

Our wireless local area networking products comprise a complete wireless local area network system that provides broadband network access through mobile and fixed data devices. We offer the software and equipment necessary to create and support wireless local area networks, which are typically referred to as wireless LANs. Our wireless local area network solution currently supports data transmission speeds of over 10 megabits per second. We sell a complete solution for wireless networking that facilitates mobile Internet connectivity to the end user in an enterprise, home or public space, such as an airport lounge or hotel lobby.

We sell wireless local area network solutions to network services providers and to customers that sell to enterprises and home users under the ORiNOCO brand. We also sell our wireless local area networking products to personal computer manufacturers that integrate them into their products.

Computing Connectivity Devices

Modem Products. We primarily sell our integrated circuits for modem products directly to leading manufacturers of personal computers, modems and other electronic equipment. We also offer integrated circuits and software for use in digital telephony products. Digital telephony products access and interface with merged voice and data networks. We sell our digital telephony solutions to manufacturers of business telephone equipment.

Input/Output Products. Input/output refers to the transfer of data within and between computers, peripheral equipment, such as printers, scanners and digital cameras and data networks. We sell input/output products primarily to manufacturers of computers, peripheral equipment and communications equipment. A majority of our sales are customized solutions that combine our intellectual property with that of our customers in the design of our integrated circuits. Our products support Universal Serial Bus, or USB, and IEEE-1394 industry standards, which are both established connectivity and transmission standards.

Bluetooth Solutions. We sell integrated circuit solutions and supporting software for the new market of Bluetooth technology applications. Bluetooth is an open standard for short-range radio transmission of digital voice and data that facilitates a wireless personal area network. Bluetooth technology also makes it easier for data synchronization of mobile computers, mobile telephones and handheld devices. Bluetooth uses radio waves that can pass through walls and other non-metal barriers to create a personal area network.

We have started to sell a two-component Bluetooth solution and supporting software. Our solution facilitates a wireless personal area network which supports data transmission speeds of up to 1 megabit per

second for devices within an approximately 30-foot radius. We sell our Bluetooth products to manufacturers of communications and computer equipment.

Mobile Terminal Devices

We sell integrated circuits for use in digital mobile telephones, and other wireless data and voice communications products. We also offer supporting software as part of our comprehensive integrated circuit wireless product solutions. These solutions include:

- digital signal processors for speech compression and encoding and transmission of voice and data;

- conversion signal processors to convert signals between frequencies used in digital signal processors and frequencies used for radio transmission; and

- software that controls the communication process.

We also license hardware and software designs for mobile telephones that use our integrated circuits.

Most of our wireless products operate on the Global Systems for Mobile Communications, or GSM, standard. We also sell products that support General Packet Radio Service, or GPRS, that provide enhanced data transmission capabilities for GSM mobile phones.

INFRASTRUCTURE SYSTEMS

We offer integrated circuits and optoelectronic components for use in a broad range of communication networks applications. Our products are used primarily in the following types of equipment:

- network communications equipment, which facilitates the transmission, switching and management of data and voice traffic within communications networks;

- network access equipment, such as data communications equipment and cable television infrastructure equipment, which allow equipment to connect to communications and cable television networks; and

- wireless infrastructure equipment, such as cellular base stations, which transmit and receive data and voice communications through radio waves.

COMPETITIVE STRENGTHS

Our infrastructure products are engineered to work together in optical, wireline and wireless networks. We often sell integrated solutions that combine multiple components into a single product. We believe our integrated solutions allow our customers to reduce the size and costs of their network equipment and reduce their time to develop new products. We also believe these solutions allow our customers to rely on a smaller number of suppliers and improve the performance of their products. As a result, our customers are able to meet the requirements of their end users more quickly and effectively.

We have dedicated engineering groups that develop manufacturing technology, common design methodology and commonly used product design elements for use across our Infrastructure Systems segment. By using common core technologies, we simplify our design methods, create reusable intellectual property and achieve manufacturing efficiencies.

We believe the primary reasons why customers select our products are:

- breadth of product offerings and product design capabilities, including the ability to deliver integrated solutions;

- performance, as measured by speed, power requirements and reliability;

- feature set;

- price;

- quality and automation of optoelectronic manufacturing processes;

- flexibility, which refers to the ability to design products using our intellectual property, our customers' intellectual property or a combination of both; and

- compatibility with other products and communications standards used in communications networks.

We focus our product development and sales efforts to address the customer considerations listed above. The relative importance of these factors may vary depending on the product group or the particular customer's requirements. For example, the ability to deliver integrated solutions may be a primary concern of a smaller company with relatively few equipment design resources. It may also be very important to a more established company that needs to bring new products to market quickly. On the other hand, high-performance products or the best feature set may be the most important factor to some customers that have specialized needs in a particular market segment.

PRODUCTS AND APPLICATIONS

Our infrastructure systems product offerings support four primary applications:

- processing, aggregation and switching;

- optical core and metro networks;

- optical access and transport; and

- networking.

We offer integrated circuits and optoelectronic components that facilitate the transmission and switching of data and voice signals within communications networks, including optical, wireline and wireless networks.

We sell integrated circuit solutions that include physical layer devices, integrated circuits supporting SONET/SDH communication standards, multi-service switching fabrics and network processing devices and broadband access devices, each of which is described below.

Our optoelectronic components are utilized in optical networks. Optical networks transmit information as pulses of light, or optical signals, through optical fibers, which are hair-thin glass strands. An optical network utilizes a number of interdependent active optoelectronic and passive optical components. An active component is a device that has both optical and electronic properties. A passive component is a device that functions only in the optical domain. We

primarily offer active optical components, including lasers, modulators, transmitters and amplifiers, each of which is described below.

Processing, Aggregation and Switching Devices

Multi-Service Switching Fabrics and Network Processing Devices. Switching devices guide data to different local area networks and wide area networks based on the intended destination. Multi-service switching devices support the transmission of voice and video signals as well as data. We sell switch fabrics and network processors to communications equipment manufacturers. A switch fabric directs the data within a switching device. A network processor is a component that controls how data is sent over a network or over a switch fabric such that the data retains its quality of service without interfering with other data traffic. We also offer supporting software with our switching products. In addition, our customers sometimes add their own supporting software to switch fabrics and network processors that they purchase from us to produce complete switching equipment.

We currently offer switching products for asynchronous transfer mode, or ATM. We are developing switching products for the Internet protocol standard. These products are being sampled by some customers but further design work is required before they will be available for sale in commercial quantities. Asynchronous transfer mode and Internet protocol refer to different procedures for the

formatting and timing of data transmission between two pieces of equipment. Our switching integrated solutions reduce the number of required integrated circuits needed in a switching device.

Broadband Access Devices. Broadband is a general term which refers to high-speed data transmission. Our broadband access integrated circuits, or mappers, support data transport between central offices and enterprise sites by aggregation and termination. Aggregation refers to the combining of many low-speed, or tributary, data signals from enterprises into higher speed, or trunk, data signals for transmission to a central office. Termination refers to the separation of trunk data signals into lower-speed, tributary data signals.

Our products support data transport for T-carrier data transport in North America. T-carrier is a digital transmission service from a common carrier. We support similar services worldwide which are referred to as J-carrier in Japan and E-carrier in Europe. T-carrier services such as T1 and T3 lines are widely used to create point-to-point networks for use by enterprises. T1 and T3 lines refer to different levels of T-carrier service which transmit data at 1.5 megabits per second and 44.7 megabits per second, respectively. A megabit is a unit of measurement for data and is equal to one million bits.

Wireless Infrastructure Devices. We sell integrated circuit solutions used in wireless infrastructure products, which are primarily cellular base stations and cellular base transceiver stations. These devices include digital signal processors for speech compression and encoding and transmission of voice and data. We also are beginning to sample to some customers radio frequency devices to transmit and receive signals.

Optical Core and Metro Networks Devices

Our optical core and metro networks devices address several market segments. We offer a variety of highly reliable, ultrastable components designed to withstand the rigors of terrestrial and undersea transmission. Customers for our submarine products are manufacturers of undersea communications equipment.

In addition, our products support high-speed, long-haul transmission of optical signals at speeds of 2.5 or 10 gigabits per second. We also have 40 gigabits per second modulators and receivers that are currently being sampled by customers. Our high-speed transport products can send multiple optical signals for distances up to 720 kilometers without amplification, and much further when used in conjunction with optical amplifiers. Customers for our high-speed transport products are manufacturers of communications equipment who sell to network services providers that operate long-distance communications networks. Finally, we sell optoelectronic components that are used in optical networks in metropolitan areas to carry information between central offices of network services providers or between large enterprises and central offices. The information transmitted within these networks is carried for shorter distances, generally 40 kilometers or less, and at lower speeds than those used in high-speed transport network applications. We sell products designed for metropolitan communications networks to manufacturers of communications equipment, which sell to service providers that operate local exchanges and to manufacturers of network equipment for enterprises.

Lasers. We offer a variety of lasers for use in high-speed transport, metropolitan and submarine network applications. Higher power lasers can transmit light greater distances than lower power lasers. A single laser is required for each channel in a dense wavelength division multiplexing, or DWDM, system, which is a system that transmits two or more signals over a single optical fiber. Communications equipment manufacturers use different types of lasers depending on the needs of the specific network application.

Modulators. Modulation can be achieved directly by turning a laser on and off or by external modulators that transmit or interrupt a continuous optical signal to achieve the same on and off effect. Long-distance and submarine networks typically use high power lasers and external modulators, while short-distance networks use direct modulation. Our lithium niobate modulators are used in high-speed transport and metropolitan network applications, and our lithium niobate polarization controllers are used in high-speed transport network applications.

Amplifiers. During transmission, an optical signal must be periodically renewed because it loses its strength as it travels within the network. Optical amplifiers increase the strength of an optical signal without converting it back into an electronic signal. Optical amplifiers represent a major cost efficiency, as network services providers can reduce the number of costly optical-to-electronic-to-optical conversions. We offer erbium doped fiber amplifiers and raman amplifiers in high-speed transport and metropolitan network applications.

High Performance Transmitters. We offer cooled laser transmitters for high-speed transport and metropolitan network applications, and tunable laser transmitters for high-speed transport network applications that are designed to enable flexible and reconfigurable optical networks.

MEMS Devices. We have introduced optical cross connects and dynamic gain equalizers, which are our first optical micro electro-mechanical systems, or MEMS, devices. MEMS are small mechanical products that perform a variety of optical functions which include optical switching, dynamic gain equalization and add-drop multiplexing. An optical cross connect is an optical switching device that maintains the optical signal as light from input to output, without converting it into electronic form. A dynamic gain equalizer is an optical device that optimizes transmissions in an optical network by equalizing the amplitude of specific wavelengths of light within the optical fiber. These products are being sampled by some customers but further design and

manufacturing process development is required before they will be available for sale in commercial quantities.

Thin Film Optical Filters. Thin film optical filters are designed to allow only selected wavelengths of light to pass through them. Our filters are manufactured by depositing many thin layers on a base of specially made glass. Thin film optical filters are incorporated into multiplexing and demultiplexing modules that are used in dense wavelength division multiplexing, or DWDM, systems, which are systems that transmit two or more signals over a single fiber. They can also be used to correct the amplitude of the signal coming from an optical amplifier.

Silicon Waveguides. We have started to sample optical dynamic gain equalizers, which are our first silicon waveguide products. We believe our experience in silicon-based integrated circuit manufacturing processes is an important factor in our ability to manufacture these products. These silicon-based processes will permit production of these products in high volumes. In addition, silicon-based technology allows active components such as transmitters and receivers to be integrated with silicon waveguides, permitting reductions in size and cost of integrated modules.

Optical Access and Transport Devices

Physical Layer Devices. High-speed physical layer devices are key elements in the conversion between optical signals and electronic signals in communications networks. High-speed physical layer devices accept the output from an optical receiver and convert it into a digital data signal that can be used in communications switching and processing functions. Our products include a set of six integrated circuit components for physical layer devices that provide a complete product offering for 10 gigabits per second transmission. We offer our customers physical layer device components either separately or together with optoelectronic components. In particular, we sell a transponder which combines our physical layer device components together with our optoelectronic components in a single module.

SONET/SDH Network Devices. Synchronous optical networks, which are typically referred to as SONET, and synchronous digital hierarchy standard networks, or SDH, carry data, voice and video traffic through a network by combining lines carrying traffic at slower speeds with lines carrying traffic at higher speeds. This process is known as multiplexing, and involves directing traffic from the individual lines into designated time slots in the higher speed lines, and those lines into still higher speed lines. The SONET/ SDH equipment that handles the directing of traffic into slower speed and faster speed lines is the add-drop multiplexor, or ADM. Add-drop multiplexors handle the addition and removal of traffic from a SONET/SDH communication transmission. We offer single-chip integrated circuit solutions, or framers, for add-drop multiplexing of data and voice traffic. In addition, our framers are used in high-speed routers within an optical network. A router is an interface, or link, between two networks.

Transponders. Our transponders offer both integrated circuits and optoelectronic components in one combined unit, or module. This module combines a transceiver with a multiplexor/demultiplexor into a unified product. A multiplexor is an electronic device that allows two or more signals to be combined for transmission over one communications circuit. A demultiplexor separates two or more signals previously combined by compatible multiplexing equipment. Our transponders are capable of multiplexing 16 electronic signals into one optical signal. Our transponders are also capable of demultiplexing one optical signal into 16 electronic signals. We sell 2.5 gigabits per second transponders in commercial quantities to customers and recently introduced 10

gigabits per second transponders.

We offer a variety of lasers for use in cable television and data network applications. Communications equipment manufacturers use different types of lasers depending on the needs of the specific network application. Lasers used in optical access markets generally support lower data rates and shorter transmission distances than the types of lasers used for optical core and metro networks. We also offer transmitters, receivers and transceivers. We offer uncooled laser transmitters for metropolitan network applications. Our positive intrinsic negative, or PIN, receivers are used for high-speed transport, metropolitan and cable television network applications. Our avalanche photo detector, or APD, receivers are used for high-speed transport and metropolitan network applications. We also offer combined transmitters and receivers, which are called transceivers.

Our optical access devices support cable television and data communications applications. Over the past ten years, cable system operators have upgraded their systems to add optical fiber to their networks. Our cable television optoelectronic components provide a high-speed return path from the consumer's home to the cable system operator. This return path allows cable system operators to offer Internet and telephone services, in direct competition with network services providers. Customers for our cable television optoelectronic components are manufacturers of cable television transmission equipment.

Our products are also used in high-speed local area data communications. A local area network links data devices such as servers, computers and printers in the same localized area to facilitate Internet access and to share files and programs. As bandwidth and transmission distance requirements of enterprises have increased, it has become more practical to utilize the superior transmission capabilities of optical networks to build high-speed local area networks. These networks require transceivers to convert electronic signals into optical signals and back into electronic signals at high speeds. Customers for our data communication optoelectronic components are manufacturers of network equipment for enterprises.

Networking Devices

Customized Solutions. The majority of our revenue from our networking devices is derived from the manufacture of customized integrated circuits for our customers. These integrated circuits incorporate our intellectual property or combine our intellectual property with our customers' intellectual property to create a customized solution for these customers. For some customers, we design and manufacture the integrated circuit while the key intellectual property belongs solely to our customers. We draw our intellectual property from the various product areas within the Infrastructure Systems segment in order to meet our customers' specific requirements.

Our systems-level knowledge allows us to turn our customers' design concepts into a systems solution quickly and effectively. Our intellectual property gives our customers the flexibility to customize their products to meet their individual cost and performance objectives.

Analog Line Card and Analog Telephone Products. Traditional voice telephone equipment uses technology in which voice communications are transmitted as analog signals until they reach a network services provider's central office, where analog line cards are located. Analog line cards convert analog voice signals into digital signals to be transmitted through the communications network and convert the digital signal coming from the network back to analog in order to complete the telephone call. Our customers also use our products in telephone interfaces, or lines, located closer to an end user in devices such as television set-top boxes, broadband gateways and integrated access devices. Broadband gateways and integrated access devices combine a

variety of communications technologies such as analog and digital

subscriber line in the end user's premises onto a single telephone line for transmission to the network. We sell our analog line card and telephone solutions to manufacturers of communications equipment for use worldwide.

Traditional Voice Systems. We provide integrated circuits to telecommunications equipment manufacturers for use in traditional voice telephone networks and integrated services digital network, or ISDN, systems. These networks are not as advanced as newer voice and data networks that manufacturers of communications equipment currently offer. We expect sales for these systems to decline rapidly over the next several years.

CUSTOMERS, SALES AND DISTRIBUTION

CUSTOMERS

We have a globally diverse base of customers, consisting primarily of manufacturers of communications and computer equipment. We generally target as customers the leaders in the market segments in which our products are used as well as the companies we believe will be future leaders in these segments. In fiscal 2001, we directly sold our products to approximately 250 end customers and indirectly, through distributors, to approximately 1,000 end customers. For some end customers, we deliver the product to, and are paid by, a third party associated with the customer, such as their contract manufacturer. Our top 20 end customers in fiscal 2001, based on revenue, accounted for approximately 70% of our revenue and our top 10 end customers in fiscal 2001, based on revenue, accounted for approximately 53% of our revenue. Our top ten end customers in fiscal 2001 were:

Apple Computer, Inc.	Lucent Technologies Inc.
Alcatel	Maxtor Corp.
Avaya Inc.	Nortel Networks Corp.
Cisco Systems, Inc.	Seagate Technology, Inc.
Globespan Inc.	Tycom (US) Inc.

All of the customers listed above purchased integrated circuits from us. Alcatel, Avaya, Cisco Systems, Lucent, Nortel and Tycom also purchased optoelectronic components from us. Our sales to Lucent represented 13.1% of our revenue for the six months ended March 31, 2002 and 14.9%, 21.3% and 25.7% of our revenue for fiscal 2001, 2000 and 1999, respectively. No other customer accounted for 10% or more of our revenue in any of these periods, except for Maxtor which accounted for 10.8% of our revenue for the six months ended March 31, 2002.

SALES AND DISTRIBUTION

We have a worldwide sales organization with approximately 500 employees as of March 31, 2002, located in 9 domestic and 14 international sales offices. We sell our products globally primarily through our direct sales force. To complement our direct sales force, we also sell our products through distributors, which represented approximately 8% of our revenue in fiscal 2001.

When selling both our integrated circuits and optoelectronic components, we aim to have our customers incorporate our products into the end products they design and develop. Typically, manufacturers of communications and computer equipment conduct a competitive process to select suppliers for the parts that

they will include in their end products. Our sales, marketing and technical personnel work with customers to demonstrate our products' ability to satisfy any specific requirements. We call winning the competitive process a design win. A design win is important because it allows us to establish a long-term relationship with the customer, at least through the life-cycle of the product. We generally do not, however, enter into written agreements with our customers after achieving a design win. A customer could terminate our relationship or discontinue developing the product. Most of our revenue originates from sales that are the result of design wins.

After we achieve a design win and negotiate the terms of the sale, we deliver our products to our end customers in a number of ways. Our end customers typically have us ship our products to their facilities

directly. In some instances, however, our customer uses a contract manufacturer to manufacture and assemble their end product. When our product is being incorporated into an end product being manufactured by a contract manufacturer, we often ship our product directly to the contract manufacturer and receive payment from that contract manufacturer. To determine our sales to particular customers, however, we recognize this type of transaction as a sale to, and revenue from, the end customer. Sometimes a customer for which we have achieved a design win will have us sell that product to a distributor or trading company from which they buy our product. We recognize these transactions as indirect sales.

MANUFACTURING AND SUPPLIES

MANUFACTURING

Our Operations support organization is responsible for the supply chain management and manufacturing activities of both integrated circuits devices and optoelectronics components and brings a full-systems perspective to our manufacturing processes. As of March 31, 2002, we had approximately 6,000 employees devoted to manufacturing and related support activities.

INTEGRATED CIRCUIT MANUFACTURING

We had six facilities located in three countries devoted to manufacturing integrated circuits as of March 31, 2002. These sites utilized approximately 2.3 million square feet of space dedicated to manufacturing. As of March 31, 2002, our company-owned and joint venture wafer fabrication operations were in the United States and Singapore, while our assembly and test operations were in the United States, Singapore and Thailand. In January 2002, we announced our intention to consolidate our integrated circuit manufacturing operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Restructuring Activities."

Currently, we manufacture most of our integrated circuits in facilities that we either own or operate through a joint venture. We also have third-party manufacturing relationships to improve our manufacturing efficiency and flexibility and to allow us to focus on manufacturing and developing leading products. We entered into a joint venture, called Silicon Manufacturing Partners, with Chartered Semiconductor Manufacturing Ltd. in December 1997 to open an integrated circuit manufacturing facility in Singapore. Under the terms of our agreement with Chartered Semiconductor, we agreed to purchase 51% of the production output from this facility and Chartered Semiconductor agreed to purchase the remaining 49% of the production output. For more information regarding our joint venture with Chartered Semiconductor, please see "-- Strategic Relationships -- Manufacturing Joint Venture." In the future, we expect to increase the amount of integrated circuits we buy at market prices,

whether through our relationship with Chartered Semiconductor or other strategic relationships.

We have implemented sophisticated logistics and planning systems and manufacturing processes that allow us to manufacture and deliver our integrated circuits more quickly and reliably. The sophisticated internal systems we are implementing allow us to start manufacturing a customer's specific order for some integrated circuits within hours of receipt. Today, we believe we are able to manufacture silicon wafers faster than most of our competitors. However, as we increase our percentage of wafer fabrication manufactured through strategic relationships, we may not be able to maintain our wafer manufacturing cycle times. We assemble, test and ship our integrated circuits, on average, in approximately two and a half days. We intend to continue performing these activities for substantially all of our integrated circuits in the future and to maintain our assembly and test cycle times.

OPTOELECTRONIC COMPONENT MANUFACTURING

We had six facilities located in the United States and one facility located in Mexico devoted to manufacturing optoelectronic components as of March 31, 2002. These sites utilized approximately 500,000 square feet. Currently, we manufacture substantially all of our optoelectronic components internally. A small percentage of our components, however, are sent to sub-assembly manufacturers. These

are manufacturers that add some pieces to the unfinished product and send the unfinished product back to us. In these cases, we complete the manufacturing of the final product and deliver the product to our customers. In January 2002, we announced our intention to consolidate our optoelectronic manufacturing operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Restructuring Activities."

We intend to explore opportunities to increase our manufacturing capabilities through joint ventures or strategic relationships with third parties. If we form these ventures or develop these relationships, we will seek to ensure consistent quality so that neither our customers nor our customers' end users can differentiate between products that are manufactured in-house and those that are not. Additionally, we have started to manufacture some of our silicon-wafer-based optoelectronic components in our integrated circuit facilities to capture economies of scale. This allows us to apply our extensive experience in integrated circuit manufacturing to the high-volume manufacturing of optoelectronic components.

We have automated the manufacturing of core technologies used in our optoelectronic components. In particular, we have automated our optical sub-assembly manufacturing process, which is the core technology used in all of our laser-based optoelectronic products. The benefits of automation include:

- greater volume;

- improved quality and reliability;

- reduced costs; and

- improved speed in responding to customer demands.

SUPPLIES

At times, the integrated circuits and optoelectronic components industries

have been supply constrained, meaning that demand for components is greater than the ability of most manufacturers of integrated circuit and optoelectronic components products, including us and our competitors, to supply products. In early fiscal 2001, we experienced shortages in supplies of parts for our products and in the equipment needed to increase the capacity of our manufacturing plants, although by the end of fiscal 2001, we were not experiencing shortages. Also, there is a limited number of qualified engineers with the talent to develop and manufacture new products as quickly as desired. A significant price increase from our suppliers may cause our gross profit to decline if we cannot pass the increase to our customers. The loss of a significant supplier or the inability of a supplier to meet performance and quality specifications or delivery schedules may cause our revenue to decline.

We currently purchase several different parts that are used in our optoelectronic components for which there is only one qualified manufacturer of each part. Some of these single source suppliers also are competitors of ours. These parts are included in our optical amplifiers, pump lasers used in submarine networks, lithium niobate modulators and PIN and APD receivers. The number of qualified alternative suppliers for our single source parts and processes is limited and the process of qualifying new suppliers requires a substantial lead time. Although we have not experienced any significant difficulties in obtaining the above parts or manufacturing processes, we are currently looking for alternative sources of these parts and processes, either through internal development or alternative suppliers.

COMPETITION

We sell infrastructure and client products designed for the communications and computer applications industries. These market segments are intensely competitive, and are characterized by:

- rapid technological change;

- evolving standards;

- short product life cycles; and

- price erosion.

The number of competitors has risen in the past few years. We expect the intensity of competition in the market segments we serve to continue to increase in the future as existing competitors enhance and expand their product offerings and as new participants enter these market segments. Increased competition may result in price reductions, reduced revenues and loss of market share. We cannot assure you that we will be able to compete successfully against existing or future competitors. Some of our customers and companies with which we have strategic relationships also are, or may be in the future, competitors of ours.

The size and number of our competitors vary across our product areas, as do the resources we have allocated to the segments we target. Therefore, many of our competitors have greater financial, personnel, production capacity and other resources than we have in a particular market segment or overall. Competitors with greater financial resources may be able to offer lower prices, additional products or services or other incentives that we cannot match or offer. These competitors may be in a stronger position to respond quickly to new technologies and may be able to undertake more extensive marketing campaigns. They also may adopt more aggressive pricing policies and make more attractive offers to potential customers, employees and strategic partners. These competitors may make strategic acquisitions or establish cooperative relationships among

themselves or with third parties to increase their ability to gain market share. Further, some of our competitors are currently selling commercial quantities of products that we are sampling to our customers, that are still in the initial stages of development or that we may develop in the future. By being able to offer these products in commercial quantities before we do, our competitors can establish significant market share, acquire design wins in customer equipment programs and create a market position that we may be unable to overcome once we have completed development and testing of that product. Because we have a unionized workforce and many of our main competitors are not unionized to the same extent or at all, our product costs may be higher. As a result, our competitors may be more profitable or may be able to compete for customers more effectively based on price. In the event of a union work stoppage at our facilities, we may be adversely affected.

Our primary competitors within our Client product areas are listed in the table below.

STORAGE	WIRELESS LOCAL AREA NETWORKING	COMPUTING CONNECTIVITY	WIR
IBM Corp.	BreezeCOM Ltd.	Broadcom Corp.	Conexan
Infineon Technologies AG	Cisco Systems, Inc.	Conexant Systems, Inc.	Koninkl Elect
LSI Logic Corp.	D-Link Systems, Inc.	Infineon Technologies AG	Motorol
Marvell Communications Corp.	Intersil Holding Corp.	Koninklijke Philips Electronics AG	QUALCOM
STMicroelectr	Proxim, Inc.		