ANNUAL REPORT 2003

ALCATEL

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PROFILE

ALCATEL DEVELOPS LEADING-EDGE TECHNOLOGIES AND PROVIDES INNOVATIVE COMMUNICATION SOLUTIONS FOR TELECOM OPERATORS, INTERNET ACCESS PROVIDERS, AND COMPANIES, ENABLING THEM TO DELIVER THE VALUE-ADDED VOICE, DATA AND VIDEO COMMUNICATIONS SERVICES THEIR CUSTOMERS NEED IN A BROADBAND WORLD.

IN FIXED LINE NETWORKS, THE COMPANY HAS REINFORCED ITS POSITION AS WORLD LEADER IN BROADBAND ACCESS (DSL, OPTICAL FIBER). IN MOBILE NETWORKS, ALCATEL CONTINUES TO INCREASE ITS MARKET SHARE THANKS TO GSM/GPRS SOLUTIONS AND OFFERS A WELL-RECOGNIZED UMTS SOLUTION. IN BOTH FIXED AND MOBILE, ALCATEL DEVELOPS HIGH ADDED-VALUE MULTIMEDIA SOLUTIONS SUCH AS VIDEO, ONLINE GAMING, AND MMS.

NEARLY ONE THIRD OF ALCATEL'S BUSINESS IS DEVOTED TO THE DEVELOPMENT OF END-TO-END TELECOMMUNICATION SOLUTIONS FOR ENTERPRISES, INDUSTRIES, AND THE PUBLIC AND PRIVATE SECTOR WHO MAKE THEM AVAILABLE TO THEIR CUSTOMERS, EMPLOYEES AND THE PUBLIC.

WITH SALES OF EURO 12.5 BILLION IN 2003 AND A WORKFORCE OF 60,000 EMPLOYEES, ALCATEL OPERATES IN 130 COUNTRIES.

CHAIRMAN'S MESSAGE

Dear Shareholders

After two years of an unprecedented crisis in the telecommunications industry, 2003 was a year of contrasts for Alcatel.

On the one hand, the market continued to shrink and our sales further declined by 22%. But on the other hand, we succeeded in recovering a positive operating income of 332 million euros, or 3% of sales. This results from our cost-reduction measures within the Group, which included the regrettable but necessary added reduction of our workforce, and also from our efforts to streamline the Company's processes to improve productivity.

The restructuring – from 78,000 employees at year-end 2002 to 60,000 at year-end 2003 – today fully reserved, accounts for the major portion of our net loss of 1,944 million euro in 2003. It is important to note that, despite these departures, we have succeeded in preserving the internal cohesion of our company, in nurturing our employees' team spirit and in not compromising the future by maintaining a high level of R&D at 13% of our sales.

We have also strengthened our balance sheet thanks to another substantial reduction of our working capital. Our net cash position at year-end was positive at 976 million euros, compared to 326 million euros the year before. The financial markets have applauded this performance, resulting in a significant increase in our share price, as have the credit rating agencies, one of which recently improved its rating of our debt.

Our objective for 2004 is clear: to resume growth and return to net income profitability before goodwill amortization.

In a market which is showing some signs of recovery, and despite the adverse impact of a weak dollar, we are convinced that Alcatel has the strengths to gain market share and to strengthen its competitive positioning. We are starting to experience the benefits of the strategic repositioning we announced in January 2003, which consisted of evolving from being a traditional telecommunications equipment vendor to becoming a creator of high value-added communications solutions.

We are leveraging our products, software and traditional service expertise, and adding a new dimension in order to implement after its integration new applications. This positioning is completely in line with today's evolution of the telecommunications market:

- Networks are becoming broadband, transforming the way we live thanks to new services made possible by high-speed, interactivity and ubiquity – there were about 100 million broadband subscribers worldwide at the end of 2003;
- These services must be accessible everywhere, over all types of networks. Users must no longer be dependent on one or another technology: they want the benefits any time, anywhere, at the best price, with any device (PC, television, cellular phone, PDA, gaming console) and in the most simple manner possible.
- Inversely our customers, whether they are service providers, enterprises, institutions or municipalities, are confronted with the growing complexity of networking and the services that they offer or use. They are in search of partners rather than suppliers to help them transform their network depending on their challenges, their strategy and their competitive environment. Some of them are even considering outsourcing their operations, which represents a substantial opportunity for Alcatel.
- Finally, technology is commoditizing and has become subject to intense pricing pressure, especially from new entrants from the Far East. We must differentiate ourselves through innovation, by offering our customers high value-added services and solutions capable of generating new revenue streams or optimizing the cost of running their networks. Alcatel's advanced, high-end offering will be the differentiator compared to these new challengers.

The commitment to growth and profitability in 2004 is based on solid and differentiated leadership:

- We are **the world leader in broadband access** and we strengthened our position in 2003. Today, the end-user's access connection is the bottleneck in the network and is, therefore, a strategic area of investment for our customers. Alongside DSL, which remains the dominant high-speed access mode, we have widened the portfolio of access technologies to, for example, fiber to the user – an escalating market in the US – or satellite – indispensable in isolated areas. We are also widening our offering toward content providers: beyond networks we propose modular integration of solutions such as video servers that combine television and legacy telephony over copper. Such technology opens a wide range of services applied to e-education, e-health or e-government above and beyond the world of entertainment which immediately springs to mind and which is now, in early 2004, already becoming a reality in several Asian, European and North American countries.

■ We also have **the world's largest installed base of telephone lines** with close to 350 million terminations. What was in recent years a weakness with the decline of this mature market could prove to be a strength in the future. These networks will converge and migrate to IP–based architectures, especially to accommodate the demand for broadband. We offer appropriate migration paths for each or our customers who desire to evolve progressively towards next-generation networks: the acquisition of TiMetra, a specialist in intelligent IP services, in mid-2003 rounded out this strategy.

■ Despite the collapse of the optics market, we have deliberately decided to continue investing selectively because, as I have often said, **optics will be the future telecommunications revolution.** We have built a particularly competitive portfolio of data-aware optics solutions and, as the world leader, we observe, with satisfaction, that this market is starting to move.

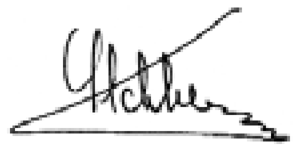
■ In a few years we have become a recognized player in **mobile networking** thanks to our particularly competitive and profitable radio access portfolio combining excellent performance and a highly efficient cost structure. We had 12% of the worldwide GSM market in 2003 and even more in the emerging country deployments, which gives us the leadership there. We are now extending our expertise into software applications and have taken significant positions in multimedia messaging, payment chain and video applications. Thanks to our expertise developed in partnership with Fujitsu we have an optimal solution for the evolution to third generation networks and services.

■ Finally we stand out by the vigor and success of our approach to enterprises large or small, communication-intensive vertical markets, institutions and municipalities. Today they represent close to one third of our sales and contribute significantly to our profitability. We apply the technical expertise developed with carriers and augment it with an appropriate service offering which can include integration and management if need be.

This review would be incomplete without a summary of what I consider to be a fundamental strength: our Chinese strategy and the establishment two years ago of Alcatel Shanghai Bell. This unique combination, bringing together commercial strength and technology transfer, makes Alcatel a formidable player in the Chinese telecommunications market, equipped with the latest technologies in fixed networks with broadband and mobile networks with 3G. Beyond China, Alcatel Shanghai Bell reinforces Alcatel's positions in many other countries.

With this letter I wish to strengthen your trust in our company. Alcatel has overcome the crisis, affirmed its personality, and shown its uniqueness. We are ready in 2004, with a team that has preserved its spirit, to reap the rewards of the profound transformation our company has undergone. You can count on our total commitment in that regard.

Serge Tchuruk



KEY FIGURES

In a still difficult market for telecommunications equipment makers in 2003, primarily because of restricted capital spending by operators, Alcatel succeeded in implementing a restructuring program designed to lower costs and to optimize the Group's operations while maintaining significant research activities. Commercially, Alcatel consolidated its market share in several key segments, such as broadband access, wireless infrastructures, and IP telephony. The 2003 results particularly reflect improved operational profitability.

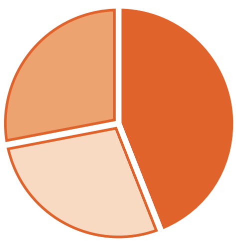
The Group's healthy position means that it will be able to take advantage of any future rebound in business.

HIGHLIGHTS BY SEGMENT (AS A %)

44% Fixed communications

28% Mobile communications

28% Private communications



Fixed communications, which strengthened its leadership positions in 2003, particularly in broadband access, represented 44% of sales revenues. The balance of sales was divided between mobile and private communications (corporations, local authorities).

SALES REVENUES BY GEOGRAPHIC REGION (AS A %)

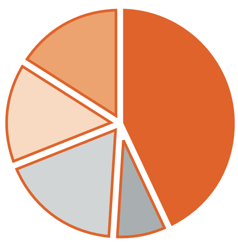
43% Western Europe

8% Eastern Europe

18% Asia

15% North America

16% Rest of the world



Europe represented half the sales. Asia's share has increased strongly in recent years, while North America has remained stable.

CONTRIBUTION OF THE SEGMENTS TO OPERATING INCOME

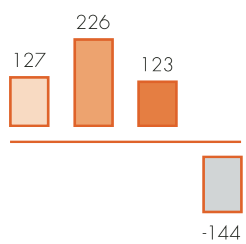
Fixed communications

Mobile communications

Private communications

Other

(in millions of euros)



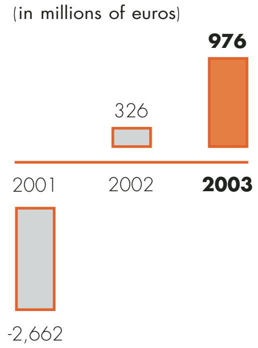
As a result of continued restructuring and a sharp decrease in costs in a context of lower sales revenues, the Group as a whole, as well as each of its business segments, posted a positive income from operations in 2003.

SUMMARY THREE-YEAR INCOME STATEMENTS

(in millions of euros)	2003	2002 restated [1] (unaudited)	2002 published	2001
Net sales	12,513	16,014	16,547	25,353
Income (loss) from operations	332	(606)	(727)	(361)
Net income (loss)	(1,944)	(4,745)	(4,745)	(4,963)
Earnings per share in euros	(1.46)	(3.99)	(3.99)	(4.33)
Earnings per ADS in $ [2]	(1.84)	(5.03)	(5.03)	(5.46)

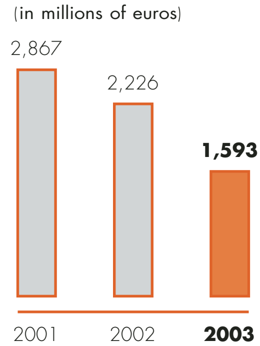
[1] See note 2 to the consolidated financial statements.
[2] Earnings per ADS were calculated on the basis of the euro/dollar buy exchange rate of USD 1.26, published by the New York Federal Reserve Bank at noon on December 31, 2003.

CHANGE IN NET CASH



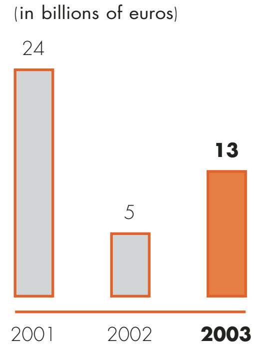
Fiscal year 2003 closed with positive net cash three times higher than at the end of 2002.

CHANGE IN R&D EXPENDITURE



In 2003, R&D expenditures represented 13% of sales, as in 2002.

CHANGE IN MARKET CAPITALIZATION



The growth in Alcatel's market capitalization reflects Alcatel's efforts in 2003 to maintain a healthy financial position, develop its product portfolio, gain market share, as well as renewed market confidence in technological stocks.

COMPANY MANAGEMENT AND CONTROL

Members of the board of directors

Serge Tchuruk
Chairman and Chief Executive Officer

Philippe Germond
President and Chief Operating Officer

Daniel Bernard
Independent Director
Chairman and Chief Executive Officer of Carrefour

Philippe Bissara
Independent Director
Representative of ANSA (National Association of Joint Stock Companies)

Frank W. Blount
Independent Director
Chairman of JI Ventures Inc.

Jozef Cornu
Director
Adviser to the Chairman of Alcatel

Jean-Pierre Halbron
Director

David Johnston
Independent Director
President of the University of Waterloo (Canada)

Daniel Lebègue
Independent Director
President of the French Institute of Board Directors

Pierre-Louis Lions
Independent Director
Professor, Collège de France

Thierry de Loppinot
Director
Corporate Lawyer at Alcatel HQ

Peter Mihatsch
Independent Director
Chairman of the Supervisory Board of Giesecke and Devrient Munich

Bruno Vaillant
Director
Engineer, Alcatel Space

Marc Viénot
Independent Director
Honorary Chairman and Director of Société Générale

Antoine Courteault
Secretary to the Board of Directors

Members of the strategy committee

Serge Tchuruk, Chairman

Pierre-Louis Lions

Peter Mihatsch

Members of the nominating and compensation committee

Daniel Bernard, Chairman

Philippe Bissara

Frank W. Blount

Members of the audit committee

Daniel Lebègue, Chairman

Daniel Bernard

David Johnston

Marc Viénot

Auditors

Deloitte Touche Tohmatsu
Represented by Alain Pons

Barbier Frinault et Autres
Represented by Christian Chiarasini

Alcatel deeply regrets the death early in 2004 of Mr. Jean-Pierre Brunet, General Director of Compagnie Générale d'Electricité - Alcatel from 1982 to 1984, and the death of Mr. Helmut Werner, member of the Alcatel Board from 1997 to 2003.

MANAGEMENT

Serge Tchuruk
Chairman and Chief Executive Officer

Philippe Germond
President and Chief Operating Officer

Jean-Pascal Beaufret
Chief Financial Officer

Jacques Dunogué
Executive Vice President of Alcatel
and President of Alcatel Europe and South

Thomas Edig
Senior Vice President of Alcatel,
Corporate Human Resources

Étienne Fouques
Executive Vice President of Alcatel
and President of Mobile Communications Group

Olivier Houssin
Executive Vice President of Alcatel
and President Private Communications Group

Mike Quigley
Senior Executive Vice President of Alcatel;
President of Alcatel North America
and President of Fixed Communications Group

Niel Ransom
Chief Technology Officer

Christian Reinaudo
Executive Vice President of Alcatel
and President of Alcatel Asia-Pacific

Ronald Spithill
Executive Vice President of Alcatel
and Chief Marketing Officer

Mr. Christian Tournier was a member of the Executive Committee until July 2003.

HUMAN RESOURCES

Successful Adaptation

For three years, following the brutal collapse of the telecommunications market, Alcatel has been engaged in a program intended to adapt its organization to the new economic realities and to redirect the Group toward vectors for growth. This effort continued in 2003 in a difficult context marked by a 22% decline in sales revenues on a like from like basis over 2002.

Each time the opportunity arose, Alcatel gave priority to redeployment, disposals, and outsourcing of operations based on subcontracting agreements. When job cuts were inevitable, Alcatel negotiated plans to save jobs that included mechanisms to assist employees with retraining and reclassification.

Restructuring has continued in the framework of an ongoing dialogue both at Group and local levels. The various employee representative bodies, the European Committee for Information and Dialogue (ECID), the Group Committee, and the Works Committees were informed and consulted, as needed, on the implementation of solutions to take account of the changed economic circumstances.

In addition to these restructuring efforts, the need to adapt to changes in the market led to both the development of new internal skills and the acquisition of new companies.

Thus, a major effort was initiated in 2003 to adapt existing qualifications to the new needs. Alcatel acquired the companies TiMetra, PacketVideo and iMagic TV to strengthen its expertise in certain technologies linked to IP routers and video. The growth in delegated network management (outsourcing of operator networks) also resulted in the arrival of new staff within the Group.

Today, with a work force of approximately 60,000 employees, Alcatel has been able to adapt its cost structure to market conditions, while preserving the key skills required for the growth of the Group.

"One Company"– a Group-wide campaign

By reorganizing into market segments early in 2003, Alcatel took an important step in enhancing its response to the needs of its customers.

Also during 2003, the Group launched the "One Company" campaign, an additional step in the major effort to transform the organization, designed to adapt the Group to its new environment. The "One Company" project is designed to turn Alcatel into a more homogeneous and coherent corporation, and is a continuation of the restructuring efforts implemented in recent years.

A renewed vision of human resources

The "HR vision for one Company" program defines the Human Resources strategy and action plan for the coming years. One of the essential components of this plan is the implementation of Human Resources processes and systems shared by all Group employees. In particular, Alcatel plans to deploy a single performance management system and to generalize the setting-up and follow-up of a professional development plan for each employee. As a result of the efforts to provide training via the Intranet (e-learning), each employee will eventually be responsible for more effectively designing his or her own development plan.

In 2003, Alcatel also pursued its career development policy by exploiting the Group's diversity both in terms of geographic locations and businesses. In particular, the international mobility program was intensified and, despite the significant reduction in the work force, the relative number of employees benefitting from an international mobility contract increased.

In line with its policy to offer attractive compensation packages, Alcatel has implemented stock option plans for several years that are competitive with practices in the high-tech sector. In March 2003, 23,650 employees received stock options as part of the annual allotment. In addition, Alcatel granted stock options to all employees who subscribed to the 2000 and 2001 stock purchase plans reserved for employees.

Adoption of a Social Charter

The development of a social charter was one of the priority projects of 2003. It enhances Alcatel's statement on business practices by defining the Group's socially responsible business practices and will be the subject of a major communications campaign in 2004. In addition to compliance with local laws and regulations, the Group undertakes to "protect human rights," "ensure health and safety at work," and to uphold "freedom of thought, opinion and expression". Alcatel prohibits any discrimination as well as any abusive disciplinary practice. The social charter also confirms the Group's commitment to training and professional development.

RESEARCH AND DEVELOPMENT

A MAINTAINED R&D PROGRAM

The research and development of innovative technologies are essential in the telecommunications sector where new solutions are often complex and require several years to reach excellency. This is why, despite the severe downturn in the telecommunications market, Alcatel has maintained a substantial R&D program in this area. In 2003, R&D spending totaled €1,600 million representing 13% of the Group's sales revenues with more than 14,500 engineers employed worldwide.

Laboratories and development centers worldwide

600 scientists and engineers work in the Group's six research labs around the globe: Dallas (United States), Ottawa (Canada), Marcoussis (France), Stuttgart (Germany), Antwerp (Belgium), and Shanghai (China), which opened in 2002. Specializing in one or more fields of expertise, these laboratories conduct research programs for the entire Group.

In addition, to meet the needs of its three market segments, Fixed, Mobile and Private Communications, 22 development centers conduct projects in direct liaison with customers' needs and refine products and networks.

Alcatel continues to develop research partnerships with universities, manufacturers and governments to explore new technological avenues and to anticipate the future of networks and communications solutions. In 2003, two new universities joined the Alcatel research program: the University of Technology of Sydney (UTS) and the Centre Inter Université de Microélectronique (IMEC) in Belgium, again expanding the network of more than 50 universities and research institutions that are already partners to the Group.

In addition, Alcatel has been a leader in the creation of a new European EUREKA program dedicated to telecommunications known as CELTIC (Cooperation for European sustained Leadership In Telecommunications). The goal of this program is to develop cooperation among European manufacturers in the sector of new end-to-end telecommunications solutions in a number of areas, such as convergence between fixed and wireless networks, multimedia services, or network management systems.

Research and development directed toward products with added value for customers

Alcatel devoted 50% of its R&D budget to applications, services and new-generation technologies for operator networks.

In association with the reorganization of the Group, R&D focused on the development of communications solutions that will allow operators to reduce their costs and increase their revenues. This is the case in the areas of application software for broadband networks integrating video, the convergence of fixed and wireless networks, or migration to total IP infrastructures.

At the same time, Alcatel continued to invest to maintain its leading edge in the technologies in which the Group is already a leader. For instance, research allowed the Group to develop global mobility solutions, to increase capacities, and to extend the reach of optical solutions right up to the end user. Research continues to invent products that users will need in the future, and is working on post-3G for mobile communications, new solutions for very high speed fixed and wireless access, the next generation of IP networks, or the evolution of interactive communications.

Effective research

The speed at which a new technology is brought to market, the quality, reliability and cost of products are major challenges for Alcatel's R&D. Improved effectiveness is a constant goal, implemented in 2003 through an optimization program designed to control development costs and ensure that research projects match customer needs.

In 2003, Alcatel achieved more than ten world firsts or records, primarily in the radio and optics spheres, where Alcatel is reinforcing its technological leadership. For instance, the research teams have pushed forward the limits on transmission speeds to 40 gigabytes per second over fiber, by achieving 4 terabytes per second over a distance of 6,240 kilometers. This work will lead to the preparation of new generation transmission systems at 40 Gb/s. As a further example, Alcatel achieved a world record in 2003 by repairing submarine cable on the high seas at depths descending to 9,400 meters through the use of remote-controlled robots.

Alcatel's portfolio of patents is proof of the strength of its research effort and, in 2003, generated revenue growth of 8% over 2002. 750 new patents were filed in 2003 in a variety of areas, including IP, wireless infrastructures and fixed or wireless solutions.

NETWORKS FOR TOMORROW'S WORLD

FIXED COMMUNICATIONS

Activities

- Design, supply and install access and long-haul fixed communications infrastructure (voice, data and video) for operators
- Propose value-added applications software

MOBILE COMMUNICATIONS

Activities

- Design, supply and install mobile infrastructure (voice, data and video) for operators
- Supply broadband solutions, favoring multimedia services
- Offer extensive applications portfolio linked to mobility

PRIVATE COMMUNICATIONS

Activities

- Design, supply and install voice-data enterprise networks and provide associated applications and services
- Design and supply satellite-based solutions in voice-data communications for enterprises and operators
- Design, supply and install signalling and communication networks for operators of urban and rail transportation systems
- Network integration and service offerings
- Outsourcing for operator networks

Solutions

- Wireline telephone networks
- Broadband access networks (DSL, FTTH)
- Optical networks (terrestrial and submarine)
- IP networks, high speed Internet access
- Intelligent networks
- Applications development (video over DSL, multimedia…)

Key Figures

€ 5.7 billion in sales in 2003

- No.1 worldwide for ADSL, 15.8 million lines shipped in 2003 [1]
- No.1 worldwide in optical networks, 15.4% market share in 2003 [2]
- World market leader in multiservice WAN with 17% market share in 2003 [3]
- 345.8 million circuit switched lines installed [4]

1. Source : Dell'Oro (February 2004), 2. Source : RHK (February 2004), 3. Source : SRG (February 2004), 4. Source : RHK (February 2004).

Solutions

- GSM/GPRS, EDGE and 3G/UMTS networks and infrastructure
- Mobile solutions for multimedia, video and messaging services
- Applications for mobile services: payment system, positioning system
- Over-the-air transmission networks
- Integration services for application platforms and networks
- Wi-Fi solutions
- Mobile terminals

Key Figures

€ 3.5 billion in sales in 2003

- Over 300 customers in more than 130 countries [1]
- 12% market share in GSM infrastructure [2]
- A world leader (24% market share) for the supply of wireless transmission solutions [3]

1. Source : Current Analysis Website (November 2003), 2. Source : Alcatel 3. Source : Skylight Research.

Solutions

- Solutions for voice-data convergence
- IP Telephony
- Multimedia call centers
- Satellite-based systems for telecoms, navigation, meteorology, earth observation and science
- Integrated solutions in signalling and management of urban and rail networks
- Value-added services, operation, maintenance and management of operator and enterprise networks
- Sector-specific applications and solutions (banking, distribution, energy, administration, etc.)

Key Figures

€ 3.6 billion in sales in 2003

- No.1 worldwide for enterprise IP communication systems (IP-PBX) [1]
- A worldwide market leader in multimedia call centers (No.1 in the North American and Asia Pacific regions) [2]
- A world leader in telecommunications satellites (20% market share in 2003) [3]
- A major player in railway management (ETCS, European Train Control System)

1. Source : Dell'Oro (February 2004), 2. Source : Frost & Sullivan (October 2003), 3. Source : Alcatel.

FIXED COMMUNICATIONS

World market leader in broadband access, optical networks and circuit-switched voice systems, Alcatel is advancing in applications software solutions and next-generation Internet Protocol (IP) networking equipment. Its extensive portfolio of products and solutions, and its network integration know-how, enable Alcatel to supply solutions, tailored to the needs of operators for generating new revenue streams, while reducing their costs, a winning combination for honing their competitive edge.

Towards growth

In 2003, constant growth in broadband access was the hallmark of the fixed communications marketplace. In addition, new value-added IP services emerged as well as a trend to migrate traditional networks to solutions that enable the implementation of broadband multimedia services.

At the end of 2003, there were 100 million broadband subscribers worldwide. This marketing arena presents an opportunity for operators to provide value-added services, which represent new revenue streams. For instance, consumer offerings now include services, such as television and video on demand, online gaming, music downloads, and more. For enterprise offerings, there is the promise of productivity gains, thanks to customized services, for instance, instant messaging and video conferencing, hosted on operator networks.

In this context, it is increasingly important for operators to work with telecom solutions providers, and not just equipment suppliers. This way, operators are sure to bring value-added services to their users, without jeopardizing the profitability of their networks. These are the broad strokes that define Alcatel's strategy today.

Leading and innovating in access

Access is a key strategic factor in networking, because it defines the conditions for the supply of revenue-generating services to end users. Furthermore, growth in broadband network access can drive national economic growth. Ultimately, broadband is set to become the foremost technology for network access everywhere.

Alcatel is the world market leader in broadband access, with an installed base of nearly 40 million DSL lines shipped, at the end of 2003. According to data from Dell'Oro Group, that is a cumulative market share of 37%. This volume of business allows Alcatel to realize economies of scale that contribute to its competitive edge. In 2003, thanks to a two-fold increase in the number of lines shipped, Alcatel has installed more than four times as many lines as that of its closest competitor, since the arrival of DSL technology.

Alcatel access systems equip the networks of 110 customers in 53 countries. Alcatel has the widest range of access network management systems and products. Innovation is at the heart of Alcatel's strategy in access, as illustrated by the launch in 2003 of the fifth generation of its DSL platform, the Alcatel 7301 ASAM, which enables the provision of value-added services to residential and enterprise subscribers. Alcatel also confirmed its presence in the market for Fiber-To-The-Subscriber (FTTx) and signed a four-year agreement with the American national operator, SBC.

Migration of voice networks

In the circuit-switched voice marketplace, Alcatel has an installed base of 345.8 million lines, deployed in 177 countries, meaning Alcatel systems handle more than one in five voice connections worldwide. Today, operators are paying close attention to the move from voice networking to the supply of new IP applications. The Alcatel Open Path to Enhanced Networking (OPEN) program is designed to enable operators to migrate progressively to next-generation networking, which features voice, data and video convergence.

Alcatel OPEN solutions allow for a seamless transition in service to broadband applications (Voice over IP, multimedia services, etc.). The wealth of network management systems and products from Alcatel makes it possible for operators to migrate their networks, regardless of existing infrastructure, which limits migration costs, compared with solutions that require the construction from scratch of new infrastructure. Over 20 operators worldwide have already chosen Alcatel's solutions, and some 40 more customers are currently testing them.

Optical networks: confirmed world market leadership

During another year of turmoil in this marketplace, Alcatel pursued its twin objectives of improving the features and functionalities of its products, while restructuring its activities, with the effects set to be fully felt in 2004. In 2003, for the third year in a row, Alcatel was number one worldwide in optical networks (source: RHK). The Group also improved its position in China, one of the world's most dynamic marketplaces for fiber optics. For instance, it signed a contract with China Telecom to supply a network spanning 2,177 km linking the west and the south of the country.

Optical networking is a critical transmission technology in the development of new broadband access services and mobile communications. For this purpose, optical equipment is increasingly present in solutions for data services, an arena where Alcatel pioneers with its range of optical multiservice nodes (OMSN). Alcatel offers complete solutions to operators for terrestrial and submarine networks, benefitting from synergies in research and development between the two applications.

In an added push to optimize its optics business, Alcatel sold its optronics activity in optoelectronic components to the American firm, Avanex, which becomes a world industry leader, with Alcatel holding a 26.2% share interest.

IP networking: an enhanced offering

The IP networking solutions market, which continues to grow strongly, was characterized by a significant change in routers. Until now, routers had been designed for applications centered mainly on data packet processing speed, primarily for e-mail traffic and Internet connections. Today, the next generation of IP routers is set to implement much more complex applications, which are at the heart of new service offerings from operators, such as virtual private networks. These next-generation devices are called service routers.

Alcatel enhanced its portfolio in this area through its acquisition of TiMetra, a company in California (USA), specialized in service routing. Following this deal, Alcatel brought to market its 7750 Service Router, one of the first platforms available, which integrates, without degrading routing speed, the service management capabilities necessary for operators to generate new revenues. Ten customers are already deploying this solution in their networks.

Similarly, the Alcatel 7670 Router Switching Platform (RSP) for multiservice IP networking delivers the reliability, scalability and performance necessary to operators, who want choice in enriching their service offerings. Alcatel gives operators the chance to add new services to their existing infrastructure, enabling them to keep their current significant revenue-generating service offerings, and at the same time allowing them to upgrade their networks to meet the very strong growth in IP traffic.

Fixed solutions: intelligent networks and video services

Starting from a single platform, Alcatel develops complete solutions in response to new market opportunities opening up to operators. These networking services rely on Alcatel's intelligent networking platform and its multimedia capabilities, which allow operators to provide more online content and services.

As part of this strategy, Alcatel acquired iMagicTV and the key assets of Thirdspace, to enable operators to deliver TV and multimedia interactive services over broadband networks. Alcatel's ambition is to make inroads into this secure value-added service market: audiovisual entertainment, online gaming, distance learning, e-commerce, etc. Thanks to Alcatel's software portfolio, operators can now deliver services to their subscribers, such as digital television and video on demand, over their existing broadband networks. This solution, already the choice of several operators, thus protects the networking investments they have already made.

MOBILE COMMUNICATIONS

Alcatel now has a structure dedicated to serving the world's 500 mobile telephony operators. This organization allows Alcatel to benefit from all the synergies between infrastructure needs, applications and services, further reinforcing the company's presence with operators. Alcatel brings to market an extended range of mobile solutions (UMTS, GSM, radio and microwave links and Wi-Fi) and applications (video, m-commerce, intelligent networking…), which empower operators to quickly deploy services for connectivity and content, key success factors in retaining their own customers. In networking infrastructure integration, as in the development of applications for operators, Alcatel is one of the world's major players in mobile telephony applications.

Global multimedia mobile solutions

While the voice mobile telecommunications market has reached maturity in developed countries, multimedia data exchange is now pushing third-generation (3G) mobile technology. In pursuit of this evolving market, Alcatel entered into partnership with Fujitsu and, as a result, benefits already from Fujitsu three years of significant commercial use of the technology in Japan, a factor which attracts numerous European operators.

With the soaring of broadband mobile systems, subscribers expect to enjoy the same services – Internet, news, gaming, video, music, etc. –, whenever they want and wherever they are. Alcatel deploys a complete offering, which assists operators in building customer loyalty, by enabling them to offer customers a rich bouquet of diversified content and the possibility to communicate simply while using all the resources of the new multimedia messaging services. It is in this context, for instance, that Alcatel acquired in 2003 the Network Solutions division of the American company, PacketVideo, which is known for its innovative video technology in the mobile telecommunications industry. In fact, PacketVideo was the first to bring to market video on mobile terminals, using the standard, MPEG 4. This acquisition is an important step in Alcatel's strategy, as the Group aims to become the leader in high-speed video transmission solutions.

Moreover, Alcatel already practices a strategy of regularly renewing its equipment offerings, which enables it to deliver to operators infrastructure and solutions ever more competitive in the marketplace, even for mature technologies, such as GSM.

In 2003, thanks to this strategy, Alcatel grew its market share in an otherwise contracting market for mobile infrastructure.

Mobile networking: increased market share

Alcatel fields complete mobile networking solutions (base stations, network controllers, and network core systems), which guarantee operators continuity from one generation of infrastructure to the next.

Alcatel benefits from its advance, compared with many other competitors, in 3G technologies. This is chiefly due to its experience in Japan with DoCoMo, through Evolium, its joint venture with Fujitsu. Deployed over the last two years in Japan, Evolium 3G technologies have proven fully reliable. In 2003, Orange in France and in the UK, tele-ring in Austria, and Telecom Portugal have all chosen 3G technologies from Alcatel.

At the same time, Alcatel increased its market share in second-generation (2G) infrastructure, thanks to the performance of its Evolium GSM/GPRS solutions, on which Alcatel has continued to innovate in parallel to its development of 3G mobile telephony. Among the market's most competitive offerings, these solutions equip 25% of new networks, deployed in 2003, in East Europe, Asia Pacific, Africa and the Middle East.

Mobile solutions: the multimedia bonanza

In 2003, Alcatel adapted its offering to the operators' business models. Alcatel brings to market a suite of applications software packages that enable mobile operators of all sizes to quickly launch services, which currently drive market growth: multimedia messaging, provision of video content, information services, remote payment and billing, etc.

Alcatel's technology solutions are among the most advanced in the marketplace, namely for Multimedia Messaging Services (MMS), where Alcatel is a world record holder for performance.

Alcatel's software solution suite already enables operators to present a complete offering to their subscribers: video messaging, gaming, and live coverage of sporting events. Other services are under development: portable Web cam, TV kiosk functions, and video mailbox.

Microwave: successful migration to the next generation

Alcatel is a recognized market leader in microwave. Its extensive offering complies with European and American standards. During the last five years, Alcatel installed over 300,000 microwave systems in over 150 countries. With some 100 customers already deploying its point to multipoint radio systems around the world, Alcatel is a world market leader in this business. With its new range of products, launched in 2003, Alcatel further reinforces its competitive edge in this area.

Terminals: extremely user-friendly

In 2003, demand for new handsets equipped with digital cameras drove the market in developed countries. In the developing ones, growth in the number of new subscribers was the dominant trend.

Alcatel brings to market terminals that meet the needs of both these marketplaces: from the entry-level One Touch 320 handset to the very compact color One Touch 735 handset, featuring a digital camera, multimedia messaging functions and gaming in 3D. In 2003, 7.6 million mobile terminals were sold. It was also the year in which Alcatel launched four new terminals, to the acclaim of the specialized press, which notably cited the One Touch 715 and the One Touch 525 for the quality of their designs. Meanwhile, Alcatel announced its intention to find a solution that would allow it to reduce its exposure in this primarily consumer-oriented business activity.

PRIVATE COMMUNICATIONS

Alcatel's private networks business develops solutions for enterprises of all sizes, public service agencies and administrations, which require their own telecommunication systems. Service (consulting, integration and outsourcing) is one of the key elements of this business segment, whose mission is to place Alcatel's entire portfolio of technologies as well as those of its partners at the service of customers. This way, Alcatel makes available, to companies and other organizations, innovative solutions (DSL, optical networks, 3G, and applications), which have been proven with operators. To better serve these customers, Alcatel has organized this business segment along vertical market lines by integrating enterprise telecommunication networks, satellite telecommunication systems or rail transportation signalling, so as to create global end-to-end telecommunication systems tailored to the needs of each market.

Strength in the provision of integration and services for vertical markets

Alcatel is one of those rare, worldwide, telecommunications groups, which can draw upon solutions dedicated to widely diverse communities of customers: fixed and mobile network operators, as well as public administrations, local government, and enterprises of all sizes.

Whether it be enterprises in the energy business (the petroleum industry, for instance) for which intranet telecommunications are of strategic importance, whether it be health-care, e-government or transportation where security and customer service are primary concerns, or whether it be insurance companies or retailers where the quality of customer service relies on effective call centers, Alcatel is able to bring to market products adapted to the needs of each.

Enterprise solutions: growth in IP technologies

Although the market for traditional enterprise solutions (PABX) is decreasing, the market for telephony over IP is booming. Alcatel delivered more than 16% of its PABXs configured for IP, a market where the company is the world leader [(1)].

Alcatel has positioned itself to benefit from stronger growth in the marketplace for communications software, integrated messaging, and customer contact centers, through the global product offering from Genesys, designed to manage an enterprise's contacts with its customers. In this area, Alcatel's new solutions are among the most innovative in the marketplace.

Data

In the data networking marketplace, Alcatel offers a range of products that benefit from the reliability and quality of service, normally provided to operators.

Satellites: return to growth in orders

In 2003, the satellite industry returned to growth, both in the marketplace for telecom operators, and the one for institutional customers, for whom ambitious programs have been launched. In the commercial satellite business, Alcatel signed contracts for the supply of four new satellites: Eutelsat/HotBird, Rascom, Koreasat 5 and Worldsat 3, as well as a major extension to the program, StarOne in Brazil, and five payloads.

Satellite-based communication offers an efficient, competitive response to the need for broadband access, and offers an answer to how isolated communities around the globe can bridge the digital divide. With its all-encompassing solutions and its telecommunications experience, Alcatel is well positioned in the access marketplace in both the developed and least developed countries, as demonstrated by the Rascom project in Africa, and the different proposals for the solution, "DSL in-the-Sky", from Alcatel.

In 2003, Alcatel also increased its market share among institutional customers. Alcatel is a member of the consortium, Galileo-Industrie which is at the service of the major European initiative for navigation by satellite, Galileo. Alcatel is also working on a military satellite telecommunications system for the French General Delegation for Armaments (the Syracuse system).

Solutions for the transportation sector: a growing activity

Alcatel develops telecom solutions for signalling in the urban and rail transportation businesses. This activity, which is growing strongly throughout the world, fulfils two key requirements: to improve the safety and efficiency of pas-

(1) Sources: Dell'Oro (February2004).

senger and freight movements. The significance of infrastructure investment in this area makes it necessary to achieve maximum efficiency in operations. A pioneer in the deployment of solutions that meet new European traffic regulation standards (ETCS, or European Train Control System), Alcatel has signed in 2003 numerous equipment contracts with Europe's railways. Several major equipment contracts were also signed for metropolitan networks, notably in New York (USA), London (UK) and Guangzhou (China).

Integration and services: growing trend in outsourcing of operators' networks

Drawing upon its technological skills, its experience of network systems, and its global reach, Alcatel has decided to vigorously develop its service activity in two directions with strong growth potential. Firstly, Alcatel is proposing systems integration services to provide end-to-end telecommunications solutions for vertical markets. In this area, numerous new contracts in Europe were signed in 2003: the railways in Spain, electricity in Romania, and petroleum in Pakistan. Secondly, many fixed and mobile network operators are outsourcing the management of their infrastructure. Alcatel's offering responds to operators who have expressed more and more the need and desire to concentrate their own resources on developing services for their customers. Alcatel, a pioneer in this field, recorded in 2003 significant orders in New Zealand and Austria.

Components: divestment of the batteries business

Alcatel also manages an activity for the development and sale of industrial components. In January 2004, Alcatel finalized its sale of SAFT, a world specialist in batteries, but whose activity was too far removed from Alcatel's core business.

CONSOLIDATED FINANCIAL STATEMENTS

FINANCIAL REPORT

Because of the sale of the optical components and batteries businesses announced in May and October 2003 respectively, the 2002 income statements have been restated in order to ensure comparability. The figures provided and discussed in relation to the income statement are stated after accounting for these businesses as "activities sold or being sold".

Introduction

Following 2001 and 2002, fiscal year 2003 was hit by a further downturn in the markets for communications equipment and solutions. Group sales declined 22% from €16,014 million in 2002 to € 12,513 million in 2003. The Group was able to maintain or increase its market share in most of its businesses but was not, however, able to offset the decline in the markets which, valued in euros, was intensified by the continued decline in the U.S. dollar. As a result, 2003 Group sales at constant exchange rates and on a like-for-like basis fell only 16% compared to 2002.

The length and exceptional severity of the crisis in telecommunications have forced Alcatel to implement intensive restructuring programs over the last few years. The first benefits began to flow through in 2003 leading to an operating profit of € 332 million in 2003, up from an operating loss of € 606 million in 2002. Alcatel was profitable in all business segments in which it operates: fixed, mobile and private communications. The Group did not relax its efforts to continue to adapt and streamline its operations based on market conditions and, as a result, recorded major restructuring costs during the year. The net loss of € 1,944 million posted by the Group in 2003 primarily reflects these charges (€ 1,314 million) and the charges related to goodwill impairment (€ 578 million).

Consolidation and principal changes in structure

The principal changes in consolidation in 2003 are the result of the following events:

– in February 2003, Alcatel exercised its option to sell to Thomson its 50% stake in their joint venture Atlinks, as stipulated in the original agreement signed in 1999 with Thomson. Alcatel received € 68 million. Atlinks was consolidated under the equity method and the sale had no significant impact on the financial statements of the Alcatel Group.

– at the end of April 2003, Alcatel finalized the acquisition of iMagic TV Inc, a Canadian company that develops software allowing service providers to create, deliver and manage digital television and multimedia services over broadband networks, in which Alcatel held a 16% stake. The remaining 84% was purchased for 3.5 million Alcatel ADS (American Depositary Shares), representing an acquisition price of € 26 million. This company was consolidated as from May 1, 2003. This acquisition has not had a significant impact on the financial statements of the Alcatel Group;

– in May 2003, Alcatel announced an agreement with Avanex for the sale of its optical components operations, which was completed on July 31, 2003. Under the agreement, Avanex also acquired certain assets of Corning's photonics activities. In consideration for its contribution of assets, Alcatel received 28% of the capital of the new entity, which is consolidated under the equity method. The financial results and financial position of the optical components activity have been recorded as disposed of or a discontinued operation;

– in June 2003, Alcatel signed an agreement that ended its partnership and settled its dispute with Loral and the latter's subsidiary, Space Systems Loral Inc. Under the terms of this agreement, Alcatel bought the shares held by Loral in Europe*Star, which increased Alcatel's holding to 95%. This company, which was previously consolidated proportionately at 51%, is now fully consolidated with effect from July 1, 2003. The impact of this change in consolidation method was an increase of € 111 million in financial debt. There was no other significant impact on the consolidated financial statements. On July 15, 2003, Loral was placed under "Chapter 11" protection in the United States. Although it is not possible at this time to determine the consequences of this event, Alcatel believes that the impact should not have a significant effect on its consolidated financial position;

– in July 2003, Alcatel finalized the acquisition of TiMetra Inc., a Californian company that specializes in IP/MPLS service routing at the network edge. All of TiMetra Inc.'s shares were purchased for 18 million Alcatel ADS, representing an acquisition price of € 145 million. This company was consolidated with effect from August 1, 2003;

– on October 20, 2003, Alcatel announced that it had signed an agreement with Doughty Hanson (a private European investment company specializing in the acquisition and development of industrial companies) to sell SAFT, an Alcatel subsidiary specializing in batteries, for € 390 million. The financial results and financial position of Alcatel's battery business have been recorded as a disposed of or discontinued operation (see notes 5 and 34 to the financial statements). The sale of this business was finalized on January 14, 2004.

Accounting principles

Since January 1, 1999, Alcatel's consolidated financial statements including its subsidiaries (the "Group") have been prepared in accordance with the "principles and accounting methodology relative to consolidated financial statements" approved by decree dated June 22, 1999 that ratified Regulation 99-02 of the "Comité de la Réglementation Comptable".

Since January 1, 2002, Alcatel has applied Regulation 00-06 on liabilities adopted by the "Comité de la Réglementation Comptable". The application of this regulation as of January 1, 2002 did not have a significant material impact on shareholders' equity.

Net sales

Group net sales came in at € 12,513 million in 2003, down 22% from € 16,014 million in 2002.

By business segment, net sales were down 27% in fixed communications (€ 5,708 million in 2003 compared with

€ 7,826 million in 2002), 22% in mobile communications (€ 3,539 million in 2003 versus € 4,542 million in 2002), and 12% in private communications (€ 3,627 million in 2003 compared with € 4,109 million in 2002). Other activities and inter-segment eliminations totaled € 361 million (€ 463 million in 2002).

In 2003, Western Europe accounted for 43% of sales (43% in 2002), the rest of Europe 8% (7% in 2002), North America 15% (17% in 2002), Asia-Pacific 18% (17% in 2002) and the rest of the world 16% (16% in 2002).

Operating income

The gross margin for the Group improved in 2003 over 2002, increasing from 27% in 2002 to 33% in 2003. Research and development costs totaled € 1,593 million in 2003, down from € 2,155 million in 2002, or 13% of 2003 revenues (13% in 2002), reflecting the extent of the financial effort made to prepare the Group's future. Administrative and selling expenses of € 2,173 million in 2003, down from € 2,757 million in 2002, illustrate the continued restructuring and optimization efforts in these areas. Along with the improvement in the gross margin, these efforts resulted in operating income of € 332 million for the Group, compared with an operating loss of € 606 million in 2002.

Each of the Group's segments also posted positive operating results: € 127 million in fixed communications (losses of € 784 million in 2002), € 226 million in mobile communications (profits of € 204 million in 2002), and € 123 million in private communications (profits of € 115 million in 2002). Losses from non-operational activities amounted to € 144 million (losses of € 141 million in 2002).

Financial income

The net financial loss amounted to € 242 million compared with a loss of € 1,008 million in 2002. The improvement was primarily due to the fact that the Group did not have to write down financial receivables as significantly as in 2002 (€ 39 million in 2003, down from € 669 million in 2002). The improvement was also due to a decline in interest costs (€ 102 million in 2003 compared with € 151 million in 2002) related partially to a reduction in the Group's gross debt, which dropped from € 5,783 million at December 31, 2002 to € 5,293 million at December 31, 2003 and partially to the June 12, 2003 issue of € 1,022 million in OCEANEs, which allowed the Group to extend the overall maturity of its debt and benefit from an interest rate reduction of 4.75% lower than the Group's average rate at the time of the issue.

Consolidated net income (loss) before amortization of goodwill

The consolidated net loss before amortization of goodwill amounted to € 1,346 million (a loss of € 4,195 million in 2002), primarily reflecting, in addition to the net financial loss described above, restructuring expenses of € 1,314 million (€ 1,379 million in 2002), other revenue of € 120 million (compared with other expense of € 737 million in 2002), and a loss of € 113 million in 2003 (€ 513 million in 2002) related to the Group's share in net income of equity affiliates and disposed of or discontinued operations.

Net income (loss)

The net loss was € 1,944 million (€ 4,745 million in 2002) after goodwill amortization of € 578 million (€ 532 million in 2002).

Earnings per share

Diluted earnings per share amounted to a loss of € 1.46 (compared with a loss of € 3.99 in 2002).

Analysis by business segment

See the analysis of the business segments.

Statement of cash flows

Net cash used by operating activities before changes in working capital amounted to € 673 million in 2003 (€ 1,872 million in 2002) and includes the cash outflows on the major restructuring operations implemented by the Group. The decrease in working capital did, however, allow the Group to post a positive net cash flow from operating activities of € 444 million (€ 2,723 million in 2002). The net cash flow from investing activities was a positive € 443 million in 2003 versus a negative cash flow of € 429 million in 2002. This improvement reflects a program of tangible asset sales (€ 457 million received in 2003, up from € 280 million in 2002), but also a reduction of € 207 million in loans made in 2003, compared with an increase of € 839 million in 2002 that was related to the buy-back of certain financial receivables owing from customers with payment difficulties. Finally, the cash flow from financial activities was a negative € 564 million, due primarily to a repayment of € 1,580 million of gross debt and the issue of € 1,022 million in convertible bonds (OCEANE). Thus, cash and cash equivalents for the Group excluding listed securities totaled € 6,225 million at December 31, 2003 versus € 6,065 million at December 31, 2002.

Balance sheet

Group shareholders' equity amounted to € 3,030 million at December 31, 2003 compared with € 5,007 million at year-end 2002. Shareholders' equity, minority interests and other equity totaled € 4,038 million at December 31, 2003 (€ 5,995 million at December 31, 2002). Net operating working capital declined from € 1,548 million at December 31, 2002 to € 104 million at December 31, 2003. Net cash for the Group, being all cash and cash equivalents and marketable securities (including listed securities) less financial debt, increased from € 326 million in 2002 to € 976 million at December 31, 2003.

Parent company

Alcatel, the Group's parent company, has no operating activity. It is the direct and indirect holding company for all Group companies. Its principal activities are as follows:

- centralized treasury management,
- pooling of Group resources to finance R & D expenditure and intellectual property,
- granting of guarantees on behalf of subsidiaries in respect of certain bank borrowings and operating contracts,
- management of the French tax group.

Principal financial investments

Alcatel's principal interests in companies accounted for under the equity method are as follows:

- Thalès (9.5%)
- Avanex (26.2%)

The holding in Thalès did not change in 2003. Alcatel retained its position as the largest private shareholder in Thalès, with three directors on the Board.

The clause in the 1998 shareholders' agreement between the two industrial partners of Thalès (Alcatel and the industrial group Marcel Dassault), which prohibited the transfer of the shares received in consideration for their contributions for a period of five years, expired on June 30, 2003.

In the sale of its optical components business to Avanex, Alcatel received 28% of Avanex in consideration for the assets contributed and owned 26.2% of the company as of December 31, 2003.

In addition, in February 2003, Alcatel exercised its option to sell to Thomson its 50% interest in their joint venture Atlinks. Atlinks was consolidated under the equity method until the date of sale.

Finally, Alcatel owns 15% of Nexans. The shares are classified in marketable securities, as it is not intended to hold them for the long term.

Contractual and off-balance sheet commitments

Contractual off-balance sheet commitments relate to future payment obligations including operating lease contracts, firm orders to purchase fixed assets and other firm purchase orders. Minimum future payments for the coming years in respect of these commitments totaled € 1,078 million, € 427 million of which will fall due in less than one year.

In the context of its ongoing operations, the Group may make commitments guaranteeing the completion of contracts. The potential maximum amount of these commitments (excluding intra-group commitments, i.e. commitments made by the Group's holding companies in respect of their subsidiaries' contracts) amounted to € 2,106 million at December 31, 2003. This amount does not include sums that the Group may recover in legal actions or under counter-guarantees received. Nor does it take into account that most of the performance bonds granted are insured. The other commitments made as part of normal operations are primarily guarantees given to banks under the Group's cash pooling arrangements to cover the maximum daily drawdown allowed to the Group's subsidiaries, which totaled € 652 million at December 31, 2003.

In addition, Alcatel has specific commitments related to operations such as the vendor financing securitization program and the sale of a carry-back receivable. The principal features of these financing commitments are described in note 30 to the consolidated financial statements.

Alcatel does not use any special purpose vehicle designed to deconsolidate its risks.

Risk factors in Alcatel's markets

Alcatel serves both the market for telecommunications operators and the markets for enterprises and large institutions.

The market for telecommunications systems and solutions for operators, in which Alcatel holds a leading position, is a cyclical market, even though worldwide demand for telecommunications systems is far from being satisfied. As such, investments in telecommunications systems and solutions fluctuate widely, both in terms of total budget and types of technologies. Overall, the year 2003 was characterized by a further decline in capital expenditures by world telecommunications operators, even though demand remained very steady for certain solutions such as ADSL, in which Alcatel is the world leader.

Thanks in part to this prudent investment policy during 2003, the Group's major telecoms operator customers have now improved their financial position, as demonstrated by their cash flows. In this context, a recovery in Group sales will depend primarily on the speed with which the operators decide to expand and modernize their fixed and mobile telecommunications networks to meet customer demand for new services, and on the technologies that will be selected for this purpose.

In addition to equipment sales, Alcatel pursued its strategy in 2003 to increase sales of software and value-added services, which are less mature markets offering very high growth potential. Finally, in terms of customers, Alcatel has reorganized to strengthen its offer for businesses and private operators, which deploy telecommunications networks for internal use, without subscribers. This very dynamic sector consists of customers operating in the transport industry, the energy and defense sectors, local authorities and others.

In addition to the risks inherent to the telecommunications sector, the Group's markets are exposed to risks resulting from the increased globalization of economies, including currency risks and international competition (between operators and between suppliers of telecommunications solutions). In addition, there are risks related to the economic and political situation of certain countries in which the Group operates, or possibly to the financial position of some customers. To deal with this situation, Alcatel implements a prudent policy to manage risks and to diversify its exposure to various markets and customers. To the extent possible, the Group also seeks to secure project financing from the financial community or export credit agencies whenever this is desirable.

Country risks

Alcatel operates in more than 130 countries. Some countries are more exposed than others to political or economic risks, such as budget deficits, growth rate, inflation or interest rates. These items may affect the Group's business and profitability in certain countries. However, Alcatel has an active policy of hedging interest rate and currency risks (see note 26 to the consolidated financial statements). In addition, the broad geographic diversity of the Group's operations limits the risks related to any one country.

Risks covered by the Group

Alcatel proactively manages business risks of all subsidiaries in which the Group has a 50% or more interest. A centralized team coordinates the risk prevention policy and defines the Group's policy for insurance. This policy, which is implemented through Alcatel's consolidated reinsurance subsidiary, provides for the retention at Group level of normal claims risk and only insures major risks on the global insurance/reinsurance market.

Following the market's sharp deterioration since September 11, 2001, the Group's policy has enabled the pooling of risks among its subsidiaries thereby limiting the impact of increases in insurance premiums, while maintaining external insurance for major risks, including during the renewal of the principal "integrated" program as of January 1, 2004.

Customer concentration

No Alcatel customer accounted for more than 10% of net sales in 2003. Alcatel's top ten customers, representing 29% of 2003 net sales, are located in Europe, North America, Asia and Latin America.

Competition

Alcatel has one of the most extensive portfolios of products and services in the sector of communications solutions. The extent of the competition is therefore very broad and includes among others the very large companies such as Avaya, Cisco, Ericsson, Huawei, Lucent, Motorola, Nokia, Nortel and Siemens. A very large number of smaller companies also compete with Alcatel in one area or another.

In an environment in which operators and businesses have reduced investments, competition has intensified, leading some players in Alcatel's markets to withdraw from certain technologies or geographic regions and other players to emerge to find growth vectors outside their traditional product portfolios. In addition, in the high-tech area, new players can benefit from a technological breakthrough and rapidly gain market share.

Outlook

Even if the market remains uncertain, in view of the book to bill ratio exceeding one for the two previous quarters, we expect Alcatel should resume growth in 2004, at a constant exchange rate. The growth should gradually accelerate during the year following a seasonally low first quarter, which is expected to be almost flat year over year, at a constant exchange rate. We anticipate a positive EPS (pre-goodwill amortization) for the full year, with the seasonally weak first quarter being already close to breakeven.

Subsequent events

On January 14, 2004, Alcatel, pursuant to its announcement in October 2003, finalized the sale of its battery operations to Doughty Hanson for € 390 million. The battery operations have been recorded as a discontinued operation for the year through December 31, 2003 (see note 2 to the consolidated financial statements).

On February 10, 2004, Alcatel and Draka Holding N.V., a Dutch cable and cable system company, announced their plan to combine their communications cable and optical fiber operations within a new entity in which Draka would hold 50.1% and Alcatel 49.9%. This company will be a leading player in China, as well as in Europe, and a major supplier in North America.

As a result, Alcatel intends to record the optical fiber businesses under the equity method on the date the agreement is finalized.

On March 10, 2004, Standard & Poor's, the credit rating agency, raised its rating for Alcatel's long-term debt from B+ to BB-, with a stable outlook. Standard & Poor's decision was largely a reflection of the continuous improvement in the Group's financial results and financial structure. The rating for short-term debt of B was confirmed.

On March 17, 2004, Alcatel launched an offer to exchange bonds in a strategy primarily to lengthen its average debt maturity. On March 30, 2004, Alcatel announced that bonds with a nominal value of € 365 million, coming from Alcatel's 7% bond issue of € 1.2 billion, due 2006, had been exchanged by the holders for new euro bonds having a nominal value of € 412 million, due 2014. The new bonds bear interest at 6.375% per annum and produce a return of 6.49%. As a result, including additional bonds having a nominal value of € 50 million that were issued at the same time, the total nominal value of the new issue, due 2014, amounts to € 462 million.

Principal differences between generally accepted accounting principles in France and the United States

Because Alcatel lists its shares in the United States, the Group prepares its financial statements in accordance with United States generally accepted accounting principles (U.S.GAAP), and files a "Form 20-F" with the Securities and Exchange Commission (SEC) showing the financial statements published in France, as well as a statement reconciling net income and shareholders' equity prepared in accordance with French accounting principles to the equivalent figures under U.S. GAAP. These reconciliations relate to the Group's consolidated financial statements.

The primary differences between these two accounting practices with respect to the income statement and shareholders' equity relate to the following:

Accounting for business combinations

Some acquisitions of the Group (DSC, Genesys, Newbridge, Kymata, Telera and TiMetra) have been recorded at book value in the French financial statements in accordance with the pooling of interests method (Article 215 of Regulation 99-02). Under U.S. GAAP, these same transactions resulted in accounting for goodwill and goodwill impairment, whereas these items are charged to shareholders' equity in France.

Accounting for restructuring provisions

The publication of the new American financial accounting standard SFAS 146 applicable to restructuring plans initiated in 2003 results in new differences with French accounting principles. First, early retirement plans can be accrued under American accounting principles when the rights are granted to the employees, whereas under French accounting principles they are accrued when announced. Second, for restructuring plans announced in 2003, some may be accounted for under SFAS 146 only in 2004 because of more restrictive criteria for recognizing liabilities under American principles than under French principles. Finally, certain costs classified as restructuring costs under French accounting principles are reclassified as cost of sales under U.S. standards (particularly inventory write-downs following restructuring).

Valuation and accounting for financial instruments

According to the rules applied in France, gains and losses from instruments qualified as hedges, which enable the Group to reduce its exposure to the risk of fluctuations, especially in interest and exchange rates, are recorded in the same period as the item hedged. The U.S. financial accounting standard SFAS 133, effective as of January 1, 2001, recommends recording as an asset or a liability all derivatives valued at their fair value, whatever the period covered, including underlying assets or liabilities not recognized in the period.

Changes in the value of these instruments are accounted for as income if they cannot be considered as a hedge according to the definition used by SFAS 133. However, if certain criteria for the effectiveness of the hedge are met, it is then possible to charge the result of the hedge against the gain or loss realized on the underlying asset or liability.

Valuation of shares available for sale and negotiable on a recognized market

Shares available for sale are accounted for in the French financial statements at the lower of historical cost or market value, and unrealized losses, if any, are recognized in income. According to U.S. financial accounting standard SFAS 115, such shares are automatically valued at market value, and positive or negative differences compared to historical values are directly charged to shareholders' equity, net of tax, with no effect on income for the period.

Under French accounting principles, goodwill is generally amortized over 20 years. Under U.S. accounting principles (SFAS 142), goodwill with an indefinite life is no longer amortized, but tested for impairment at least once a year. The impairment test is based on market value, and any impairment is irreversible.

The application of U.S. accounting principles can lead to recording as personnel costs the granting of shares, stock options and stock purchase plans to employees of the company.

Certain sale and leaseback transactions during the year must be restated under U.S. accounting principles in accordance with SFAS 13, which requires the gain realized on the sale to be amortized over the term of the accompanying lease. This gain is posted to income for the year under French accounting principles, if the lease is an operating lease under market conditions.

In addition, the presentation of the income statement and the balance sheet differs under French and U.S. accounting principles.

The documents filed with the SEC are available on the SEC website (www.freeedgar.com), and on the Group's website for the "Form-20F" statements (address: www.alcatel.com or www.alcatel.fr – shareholders/investors). The "Form-20F" document for the year ended December 31, 2003 should be available in April 2004.

Changeover to IFRS

Fully aware of the challenges involved in the changeover to IFRS (International Financial Reporting Standards) in 2005, Alcatel has set up a Steering Committee and a special team to:

- define the timetable for the changeover to IFRS;
- evaluate the impacts;
- determine the training needs; and
- adapt the information systems.

The Steering Committee, chaired by the Group's Chief Financial Officer, brings together the managers of the consolidation, financial control and financial communication teams, who may be assisted by managers from internal audit, treasury, taxation and human resources depending on the topic. A team permanently dedicated to this issue directs the more detailed work related to standards governing tangible assets, long-term contracts (construction contracts), research and development costs, accounting for convertible bonds or bonds redeemable for shares, goodwill and business combinations, financial instruments, pensions and other employee benefits, share-based payments, off-balance sheet commitments and securitization plans, provisions for restructuring and other liabilities, and the presentation of financial statements. The Auditors are closely associated in this process.

Timetable for the changeover to IFRS

The application of IFRS is mandatory for companies of the European Union with effect from fiscal year 2005. Alcatel, which publishes financial statements on a quarterly basis, intends to provide consolidated financial statements prepared under the accounting and valuation principles of IFRS as of the publication of its financial statements for the first quarter of 2005. Comparative information for the previous period, restated using the same accounting rules as those used in 2005, will also be provided.

Impact of IFRS

The work to evaluate the impacts on both valuation and presentation is under way. In addition, a certain number of standards have not yet been finalized to date, or have been only recently, or have not yet been approved by the European Commission. These are primarily standards governing business combinations and financial instruments. The IASB has undertaken that only standards published at the end of March 2004 will be mandatory as of January 1, 2005. Detailed interpretations or recommendations on the application of the standards are not yet available and vary substantially from one expert to another. Some standards, if they had been applied earlier, would have led the Group to conduct certain transactions differently. Thus, although they have an impact on the past, they do not predict the possible accounting impacts of future transactions. Finally, certain other standards applicable as of 2005 will not be applied retroactively to evaluate the opening balance sheet in accordance with standard IFRS 1 on first time adoption of IFRS. Therefore, the following information is only very preliminary and does not predict future financial statements.

IAS (International Accounting Standards) will be applied in conjunction with IFRS. They will take the name IFRS when they have been reviewed and amended.

Property, plant and equipment

The application of IAS 16, related primarily to the valuation, accounting and depreciation of property, plant and equipment, and IAS 36 on the impairment of assets, should not have a significant impact on the Group's financial statements. The rules governing depreciation methods (determination of the estimated useful life of the asset, residual value, etc.) are already applied by the Group, without any major impact foreseen for the opening balance sheet. In effect, because of the unprecedented crisis that the Group has experienced in recent years, impairment tests of property, plant and equipment were performed in 2002 and 2003 using methods very comparable to those described in the standard, and significant impairments were recognized as indicated in note 11 b to the consolidated financial statements.

The fixed assets used in the context of financial leasing contracts are already booked as assets in the consolidated statements in accordance with the criteria defined in IAS 17 (leasing contracts).

Construction contracts (long-term contracts)

IAS 11 governing construction contracts (accounting for long-term contracts) is very close to the principles already used by the Group to account for this type of contract. The methods for recognizing provisions for penalties (changes are recorded in contract revenues under IFRS and in contract costs in the Group's current financial statements) and accounting for the financial impacts of deferred payments in net sales when they are material, may possibly have an impact on the presentation of the income statement under IFRS, but no major impact on the operating income of the Group and opening shareholders' equity. Changes in the method of presenting construction contracts in the balance sheet are also possible.

Research and development costs

Under IAS 38 (Intangible assets), intangible assets relating to development costs must be capitalized if certain criteria are met.

As indicated in note 1e to the consolidated financial statements, research and development costs are currently expensed within the Alcatel Group. The application of the principles defined by IAS 38 will, therefore, lead the Group to recognize certain intangible assets generated internally, when this was not previously the case. This will have the effect of increasing intangible assets and shareholders' equity of the Group in the IFRS opening balance sheet for an amount that is currently being evaluated.

Assuming a constant level of growth, recording internally generated intangible assets in accordance with IAS 38 should not have a material impact on the Group's income.

Convertible bonds or bonds redeemable for shares

The implementation of IFRS will have the effect of stating convertible bonds or bonds redeemable for shares within shareholders' equity (increase in shareholders' equity).

The convertible bonds (OCEANE) and bonds redeemable for shares (ORANE) issued by the Group in 2002 and 2003 are compound financial instruments (according to IAS 32) that include a debt component and an equity component. The ORANEs are currently recorded in other equity and the OCEANEs in financial debt (convertible bonds).

Goodwill and business combinations

The initial application of IFRS will not affect the accounting of past business combinations and goodwill. Consequently, in accordance with the options offered by IFRS1, the Group plans not to restate business combinations prior to January 1, 2004.

As indicated in the notes to the consolidated financial statements (note 1b and f and note 9), the Group in the past has used the special exemption of Article 215 of Regulation 99-02, in which the difference between the price of the business acquired and the corresponding share of net assets is written off directly to Group shareholders' equity.

Therefore, no significant adjustment in shareholders' equity in this respect is anticipated at this stage.

With respect to goodwill recorded at December 31, 2003 (see note 9 to the consolidated statements), the use of an impairment test based on the criteria defined in IAS 36 is not expected to result in a significant reduction in the opening balance sheet. As described in note 1f to the consolidated financial statements, since 2002, the Group already assesses the value of existing goodwill at least once a year based on methods similar to those described in the Exposure Draft ED 3 published in 2003. The proposed revisions to IAS 36 contained in this exposure draft are currently being validated and it is not possible, at this stage, to determine their impact, if any, on the financial statements before the publication of the definitive standard.

Financial instruments

Securities held for sale will have to be recorded at fair value under the new standard (and no longer at "historical cost").

Since the Group has few listed investments, and because of the valuation rules used by the Group (see note 1s for securities) the impact on shareholders' equity can only be positive but should not be material. In addition, the market values of unconsolidated listed securities are already indicated in notes 13 and 18 to the consolidated financial statements.

Accounting for trade receivables sold will be covered by new rules that define the criteria for derecognition of assets. With respect to customer receivables sold without recourse by the Group (see note 14 to the consolidated financial statements), the Group does not expect a major restatement of these receivables with the changeover to IFRS. A review of all contracts concerned is in progress to verify this.

In accordance with the provisions of IAS 39 on financial instruments, derivatives will be recorded at fair value. Most of the interest rate derivatives represent fair value hedges, and the changes in their value should be largely offset in income by revaluations of the underlying debt. Currency derivatives are also primarily used to hedge future cash flows or firm commitments, except for those derivatives hedging commercial bids, whose changes in fair value impact income.

The date for the first application of IAS 39 (January 1, 2004 or January 1, 2005) has not yet been decided. The impact of the implementation of IAS 39 on the opening balance sheet, in particular shareholders' equity, is currently under review.

Retirement and other employee benefits

The methods for determining and recording pension and retirement obligations and other post-retirement benefits, as described in notes 1i and 23 to the consolidated financial statements, are very similar to those required by IAS 19 (Employee Benefits). Specific features related to collective trade union agreements applied in France, particularly with respect to long-service awards, are currently under review.

Payment in the form of stock options for the purchase or subscription of shares

The application of standard IFRS 2 (Share-based Payments), published in February 2004, will modify the method for accounting for stock options granted by the Group to its employees. Only plans issued after November 7, 2002, under which the rights to exercise the options before January 1, 2005 are not yet vested, will have to be restated. Therefore, this will affect the 2003 plans as described in note 20 c to the consolidated financial statements and the plans related to business combinations completed after November 2002 under which the stock options are still valid at December 31, 2003 (see notes 2 and 20 c to the consolidated financial statements).

The impact on 2004 net income, restated in accordance with IFRS, will be the compensation cost related to these plans. The impact, as currently estimated, should not be very significant. Applying this standard should not impact shareholders' equity in the opening IFRS balance sheet.

Off-balance sheet commitments and securitization plan

The Group's off-balance sheet commitments are described in note 30 to the consolidated financial statements. The securitization programs are described in detail in the same note. As of December 31, 2003, the Group participates in two structured securitization programs (the SVF program and a customer receivables securitization program). The special purpose vehicle used in the SVF program will be consolidated as of January 1, 2004 and the impact on the consolidated financial statements is described in note 30 to the financial statements. The impact on the IFRS opening balance sheet should be similar. The special purpose entity used in the customer receivables securitization program is already consolidated at December 31, 2003 and the application of IFRS should not, therefore, have a material impact on the consolidated financial statements. In addition, the carry-back receivable sold in 2002, as explained in note 30, could be recorded as an asset in the IFRS opening balance sheet.

Reserves for restructuring and other liabilities

CRC Regulation 00-06 on liabilities has been applied by the Group since January 1, 2002. As it is very similar to IAS 37, the Group does not anticipate a material impact on the IFRS opening balance sheet for reserves for restructuring and other liabilities provided IAS 37 remains unchanged. Because of proposals for convergence with U.S. GAAP on this point, certain reserves recorded at December 31, 2003 could be restated in the IFRS opening balance sheet and recorded in 2004.

Presentation of financial statements

The application of IAS 1 (as revised December 2003) and, to a lesser extent, the application of IAS 7 (Cash Flow Statements), IAS 14 (Segment Reporting), IAS 35 (Discontinuing Operations) and ED 4 (Disposal of Non-current Assets and Presentation of Discontinued Operations) will have significant consequences on the manner of presenting the financial information.

The balance sheet will be presented based on a classification between current items/non-current items, which does not correspond to the current presentation based on the liquidity of assets and liabilities. In addition, certain specific rules governing offsets between assets and liabilities may result in reclassifications compared to current practice.

The disappearance of the notion of extraordinary income or loss in the IFRS will mean the reclassification in operating income or financial income of certain revenues and expenses currently recorded by the Group in other revenue (expense) (see notes 1m,n,o and note 6 to the consolidated financial statements). The extent of the changes in presentation will be such that the Group envisages presenting the effect of the changeover to IFRS in its 2005 financial statements by indicating, first, the 2005 and 2004 income statements under IFRS and, second, the 2004 and 2003 income statements under French GAAP.

Other standards

The other IAS/IFRS do not require any specific comment and the Group does not currently anticipate any major impact on the IFRS opening balance sheet as a result of applying these other standards. Moreover, some standards are already applied, as is the case for IAS 33 (Earnings Per Share) and IAS 24 (Related Party Disclosures).

Training

Group operational and financial staff will be trained in the new accounting standards in 2004. In this respect, the members of the Group's Audit Committee and Executive Committee were made aware in 2003 of the challenges of the changeover to IFRS. The financial controllers at headquarters, the internal auditors and the financial communication team have already received training. An intranet site is dedicated to this issue and is accessible to all personnel, facilitating the sharing of knowledge and open issues questions with the Alcatel financial community. The "Alcatel IFRS Newsletter" is also available on line.

Information system

The financial reporting system is currently being reviewed to verify that it meets the requirement of the new accounting rules. Alcatel is comparing its practices with those of other similarly-placed CAC 40 companies to best evaluate the features of each of the systems available on the market.

CONSOLIDATED INCOME STATEMENTS

(in millions of euros)	Notes	Q4 2003 (unaudited)	Q4 2002* (unaudited)	2003	2002*	2001*
Net sales	(3)	3,765	4,508	12,513	16,547	25,353
Cost of sales		(2,517)	(3,279)	(8,415)	(12,186)	(19,074)
Gross profit		**1,248**	**1,229**	**4,098**	**4,361**	**6,279**
Administrative and selling expenses		(524)	(647)	(2,173)	(2,862)	(3,773)
R&D costs		(393)	(562)	(1,593)	(2,226)	(2,867)
Income (loss) from operations	(3)	**331**	**20**	**332**	**(727)**	**(361)**
Interest expense on notes mandatorily redeemable for shares	(22)	(12)	(1)	(47)	(1)	–
Financial income (costs)	(4)	(78)	(136)	(242)	(1,018)	(1,568)
Restructuring costs	(24)	(524)	(500)	(1,314)	(1,474)	(2,124)
Other revenue (expense)	(6)	11	(292)	120	(830)	(213)
Income (loss) before amortization of goodwill and taxes		**(272)**	**(909)**	**(1,151)**	**(4,050)**	**(4,266)**
Income tax	(7)	(21)	(62)	(82)	19	1,261
Share in net income of equity affiliates and disposed of or discontinued operations	(5)	7	24	(113)	(107)	(16)
Consolidated net income (loss) before amortization of goodwill and purchased R&D		**(286)**	**(947)**	**(1,346)**	**(4,138)**	**(3,021)**
Amortization of goodwill	(9)	(210)	(147)	(578)	(589)	(1,933)
Purchased R&D		–	–	–	–	(4)
Minority interests		(28)	(25)	(20)	(18)	(5)
Net income (loss)		**(524)**	**(1,119)**	**(1,944)**	**(4,745)**	**(4,963)**
Ordinary Shares (A)**						
Basic earnings per share (in euros)	(8)	*(0.39)*	*(0.93)*	*(1.46)*	*(3.99)*	*(4.29)*
Diluted earnings per share (in euros)	(8)	*(0.39)*	*(0.93)*	*(1.46)*	*(3.99)*	*(4.29)*

* In order to make comparisons easier, restated income statements are presented in note 2 to take into account significant changes in consolidated companies during 2003 and 2002.

** Net income (loss) per share for 2002 and 2001 has been restated to take into account the conversion of class O shares into ordinary shares, on a one-for-one basis, as approved at the shareholders' meeting of April 17, 2003, and the changes made to IAS 33 in December 2003.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31

ASSETS (in millions of euros)	*Notes*	**2003**	**2002**	**2001**
Goodwill, net	*(9)*	3,839	4,597	5,257
Other intangible assets, net	*(10)*	284	312	472
Intangible assets, net		4,123	4,909	5,729
Property, plant and equipment	*(11)*	6,317	8,236	9,698
Depreciation	*(11)*	(4,817)	(5,737)	(5,496)
Property, plant and equipment, net	*(11)*	1,500	2,499	4,202
Share in net assets of equity affiliates and net assets and liabilities of disposed of or discontinued operations	*(12)*	391	306	799
Other investments and miscellaneous, net	*(13)*	822	975	1,169
Investments and other financial assets		1,213	1,281	1,968
TOTAL FIXED ASSETS		6,836	8,689	11,899
Inventories and work in progress, net	*(14) and (15)*	1,432	2,329	4,681
Trade receivables and related accounts, net	*(14) and (16)*	3,364	4,716	8,105
Other accounts receivable, net	*(17)*	3,231	4,037	6,851
Accounts receivable, net		6,595	8,753	14,956
Marketable securities, net*	*(18)*	1,635	716	490
Cash, net		4,634	5,393	4,523
Cash and cash equivalents*		6,269	6,109	5,013
TOTAL CURRENT ASSETS		14,296	17,191	24,650
TOTAL ASSETS		21,132	25,880	36,549

* The total cash and cash equivalents at December 31, 2003 includes, within marketable securities, listed securities amounting to € 44 million (€ 44 million at December 31, 2002). Excluding listed securities, cash and cash equivalents amounts to € 6,225 million (€ 6,065 million at December 31, 2002), which corresponds to the total of the cash and cash equivalents at the end of the period as indicated in the consolidated statements of cash flows.

LIABILITIES AND SHAREHOLDERS' EQUITY
(in millions of euros)

	Notes	2003 Before appropriation	2003 After** appropriation	2002 After appropriation	2001 After appropriation
Capital stock *(€ 2 nominal value: 1,284,410,224 ordinary shares issued at December 31, 2003*, 1,239,193,498 class A shares and 25,515,000 class O shares issued at December 31, 2002 and 1,215,254,797 class A shares and 25,515,000 class O shares issued at December 31, 2001)*		2,569	2,569	2,529	2,481
Additional paid-in capital		21,719	7,562	21,602	21,425
Retained earnings		(17,068)	(4,855)	(17,107)	(12,249)
Cumulative translation adjustments		(518)	(518)	(283)	(185)
Net income (loss)		(1,944)	–	–	–
Less treasury stock at cost		(1,728)	(1,728)	(1,734)	(1,842)
SHAREHOLDERS' EQUITY	(20)	3,030	3,030	5,007	9,630
MINORITY INTERESTS	(21)	363	363	343	219
OTHER EQUITY					
Notes mandatorily redeemable for shares	(22)	645	645	645	–
Accrued pension and retirement obligations	(23)	1,010	1,010	1,016	1,120
Other reserves	(24)	3,049	3,049	3,301	4,154
TOTAL RESERVES FOR LIABILITIES AND CHARGES		4,059	4,059	4,317	5,274
Convertible bonds		1,022	1,022	–	–
Bonds and notes issued		3,782	3,782	5,325	5,969
Other borrowings		489	489	458	1,706
TOTAL FINANCIAL DEBT	(25)	5,293	5,293	5,783	7,675
(of which medium and long-term portion)		4,410	4,410	4,687	5,879
Customers' deposits and advances	(14) and (27)	1,181	1,181	1,482	1,693
Trade payables and related accounts	(14)	3,617	3,617	4,162	5,080
Debt linked to bank activity	(28)	224	224	246	660
Other payables	(29)	2,720	2,720	3,895	6,318
TOTAL OTHER LIABILITIES		7,742	7,742	9,785	13,751
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		21,132	21,132	25,880	36,549

* On April 17, 2003, all outstanding class O shares were converted into ordinary shares on a one-for-one basis.
** See note 19.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of euros)	Q4 2003 (unaudited)	2003	2002	2001
Cash flows from operating activities				
Net income (loss)	(524)	(1,944)	(4,745)	(4,963)
Minority interests	28	20	18	5
Adjustments to reconcile income before minority interests to net cash provided by operating activities:				
- Depreciation and amortization, net	147	605	1,010	1,279
- Amortization and depreciation of goodwill and purchased R&D	210	577	589	1,937
- Net allowances in reserves for pension obligations	(21)	(7)	(3)	41
- Changes in valuation allowances and other reserves, net	81	54	1,358	2,001
- Net (gain) loss on disposal of non-current assets	63	(104)	(287)	(943)
- Share in net income of equity affiliates (net of dividends received)	(3)	126	188	88
Net cash provided (used) by operating activities before changes in working capital	**(19)**	**(673)**	**(1,872)**	**(555)**
Net change in current assets and liabilities:				
- Decrease (increase) in inventories	247	478	2,000	1,186
- Decrease (increase) in accounts receivable	68	1,264	3,436	1,407
- Decrease (increase) in advances and progress payments	8	33	110	(99)
- Increase (decrease) in accounts payable and accrued expenses	128	(404)	(1,084)	(925)
- Increase (decrease) in customers' deposits and advances	(23)	(206)	(173)	153
- Increase (decrease) in other receivables and debts	85	(48)	306	(622)
Net cash provided (used) by operating activities (a)	**494**	**444**	**2,723**	**545**
Cash flows from investing activities				
Proceeds from disposal of fixed assets	69	457	280	182
Capital expenditures	(86)	(253)	(490)	(1,748)
Decrease (increase) in loans (b)	3	207	(839)	299
Cash expenditures for acquisition of consolidated companies, net of cash acquired, and for acquisition of unconsolidated companies	(20)	(107)	(193)	(743)
Cash proceeds from sale of previously consolidated companies, net of cash sold, and from sale of unconsolidated companies	70	195	813	3,627
Discontinued operations*	(34)	(56)	–	–
Net cash provided (used) by investing activities	**2**	**443**	**(429)**	**1,617**
Net cash flows after investment	**496**	**887**	**2,294**	**2,162**
Cash flows from financing activities				
Increase (decrease) in debt	(578)	(1,580)	(1,469)	(1,401)
Proceeds from issuance of long-term debt	1	–	–	1,744
Proceeds from issuance of convertible bonds or notes mandatorily redeemable for shares (ORANE and OCEANE)	–	1,022	645	–
Proceeds from issuance of shares	4	1	8	8
Dividends paid	(2)	(7)	(276)	(567)
Net cash provided (used) by financing activities	**(575)**	**(564)**	**(1,092)**	**(216)**
Net effect of exchange rate changes	(73)	(136)	(150)	7
Net increase (decrease) in cash and cash equivalents	**(152)**	**187**	**1,052**	**1,953**
Cash and cash equivalents at beginning of year including discontinued activities	**6,407**	**6,065**	**5,013**	**3,060**
Cash and cash equivalents at beginning of year excluding discontinued activities	**6,377**	**6,038**	**–**	**–**
Cash and cash equivalents at end of year without listed securities	**6,225**	**6,225**	**6,065**	**5,013**
Operational cash flows (a) + (b) = Net cash provided (used) by operating activities + Decrease (increase) in loans (b)	**497**	**651**	**1,884**	**844**

* The 2003 consolidated statements of cash flows are presented so as to isolate cash flows relating to discontinued operations (see note 5).

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in millions of euros)	*Notes*	Number of shares outstanding class A	Number of shares outstanding class O	Capital stock	Additional paid-in capital	Retained earnings	Exchangeable shares Alcatel Networks Corp.	Cumulative translation adjustments	Net income (loss)	Treasury stock owned by consolidated subsidiaries	Shareholders' equity
BALANCE AT DECEMBER 31, 2000 AFTER APPROPRIATION		**1,133,273,501**	**16,500,000**	**2,457**	**21,342**	**(9,282)**	**2,217**	**(350)**	**–**	**(2,023)**	**14,361**
Capital increase linked to the acquisition of Kymata		2,200,000	9,015,000	22	72						94
Other capital increase		844,112		2	11*						13
Exchangeable shares Alcatel Networks Corporation						1,394	(1,394)				–
Acquisition of Kymata						(76)					(76)
Net change in treasury stock of class O shares owned by consolidated subsidiaries			(11,655)			(10)					(10)
Net change in treasury stock of class A shares owned by consolidated subsidiaries		10,505,542				93				181	274
Other adjustment						(31)					(31)
Translation adjustment								165			165
Net income (loss)									(4,963)		(4,963)
Appropriation of net income						(5,160)			4,963		(197)
BALANCE AT DECEMBER 30, 2001 AFTER APPROPRIATION		**1,146,823,155**	**25,503,345**	**2,481**	**21,425**	**(13,072)**	**823**	**(185)**	**–**	**(1,842)**	**9,630**
Capital increase linked to the acquisition of Astral Point		8,783,396		18	126						144
Capital increase linked to the acquisition of Telera		15,147,728		30	49						79
Other capital increase		7,577		–	2	6					8
Exchangeable shares Alcatel Networks Corporation						573	(573)				–
Acquisition of Astral Point						(162)					(162)
Acquisition of Telera						(60)					(60)
Net change in treasury stock of class A shares owned by consolidated subsidiaries		5,715,418				(7)				108	101
Other adjustment**						110					110
Translation adjustment								(98)			(98)
Net income (loss)									(4,745)		(4,745)
Appropriation of net income						(4,745)			4,745		–
BALANCE AT DECEMBER 30, 2002 AFTER APPROPRIATION		**1,176,477,274**	**25,503,345**	**2,529**	**21,602**	**(17,357)**	**250**	**(283)**	**–**	**(1,734)**	**5,007**
Conversion of class O shares into ordinary shares	*(20b)*	26,000,000	(26,000,000)								
Acquisition of iMagic TV	*(20b)*	3,531,332		7	19						26
Repayment of convertible bonds (ORANE)	*(20b)*	1,828		0	0						0
Acquisition of TiMetra	*(20b)*	15,534,934		31	94	(141)					(16)
Other capital increases		148,632	485,000	2	4						6
Exchangeable shares Alcatel Networks Corporation						44	(44)				–
Net change in treasury stock of shares owned by consolidated subsidiaries	*(20e)*	144,005	11,655			(1)				6	5
Adjustment relating to the acquisition of Kymata	*(9)*					68					68
Other adjustments**						113					113
Translation adjustments								(235)			(235)
Net income (loss)									(1,944)		(1,944)
BALANCE AT DECEMBER 31, 2003 BEFORE APPROPRIATION		**1,221,838,005**	**–**	**2,569**	**21,719**	**(17,274)**	**206**	**(518)**	**(1,944)**	**(1,728)**	**3,030**
Allocation of net income (loss)	*(19)*				(14,157)	12,213			1,944		–
BALANCE AT DECEMBER 30, 2003 AFTER ALLOCATION		**1,221,838,005**	**–**	**2,569**	**7,562**	**(5,061)**	**206**	**(518)**	**–**	**(1,728)**	**3,030**

* Of which €13 million related to a capital increase and € (2) million related to expenses for the issuance of class O shares carried out in 2000.

** Relating mainly from the follow-up of opening balance sheets of companies acquired according to "pooling of interests" accounting for stock-for-stock business combinations (provided for in paragraph 215 of regulation CRC 99-02), from the implementation as of January 1, 2002 of regulation No 00-06 (regulation on liabilities) approved by the "Comité de la Réglementation Comptable" and from the consolidation of Alcatel Shanghai Bell which had been previously accounted for under the equity method.

NOTE 1- SUMMARY OF ACCOUNTING POLICIES

Since January 1, 1999, the consolidated financial statements of Alcatel and its consolidated subsidiaries ("Alcatel" or the "Group") are presented in accordance with the "Principles and accounting methodology relative to consolidated financial statements" regulation No. 99-02 of the "Comité de la Réglementation Comptable" approved by decree dated June 22, 1999.

Since January 1, 2002, Alcatel has applied regulation No. 00-06, Regulation on liabilities, approved by the "Comité de la Réglementation Comptable". This application as of January 1, 2002 did not have a material impact on Alcatel's financial position.

a) Consolidation methods

Companies over which the Group has control are fully consolidated.

Companies over which the Group has joint control are accounted for using proportionate consolidation.

Companies over which the Group has a significant influence ("equity affiliates") are accounted for under the equity method. Significant influence is generally assumed when the Group's interest is more than 20%.

All significant intra-group transactions are eliminated.

b) Business combinations

Once a controlled company becomes consolidated, its assets and liabilities are accounted for at their fair value in accordance with regulation No. 99-02. The assets and liabilities accounted for at fair value include not only the fair values attributable to the Group but also the fair values attributable to the minority interests acquired. Any excess of the cost of the shares acquired over the Group's share of the fair value of the assets and liabilities acquired, as described above, is recorded as goodwill (see note 1f, intangible and tangible assets).

As an exception to the above-described rule and in accordance with paragraph 215 of regulation No. 99-02, in the event that:

– an acquisition is effected in one transaction and concerns at least 90% of the capital of the acquired company,
– the purchase price is paid in capital stock of a consolidated company,
– the acquisition agreement does not provide for a cash payment which is more than 10% of the total value of the capital stock issued, and
– the substance of the acquisition agreement remains consistent for the two years following the acquisition,

the assets and liabilities of the acquired company are maintained at their carrying value at the date of the acquisition, adjusted for the Group's accounting methods; the difference between this value and the acquisition cost of the shares remains in shareholders' equity.

The material acquisitions of the Group that have been accounted for using this "pooling of interests" method are described in note 9 on goodwill.

In accordance with the position taken in Bulletin No. 210 of the "Commission des Opérations de Bourse", no goodwill has been recorded directly in shareholders' equity for business combinations prior to the first application of regulation No. 99-02 of the "Comité de la Réglementation Comptable".

c) Translation of financial statements denominated in foreign currencies

The balance sheets of consolidated subsidiaries outside the euro zone are translated into euros at the year-end rate of exchange, and their income statements and cash flow statements are translated at the average annual rate of exchange. The resulting translation adjustments are included in shareholders' equity under the line item "Cumulative translation adjustments".

d) Translation of foreign currency transactions

Foreign currency transactions are translated at the rate of exchange applicable on the transaction date. At year-end, foreign currency receivables and payables are translated at the rate of exchange prevailing on that date. The resulting exchange gains and losses are recorded in the income statement.

Exchange gains or losses on foreign currency financial instruments that represent an economic hedge of a net investment in a foreign subsidiary are reported as translation adjustments in shareholders' equity under the line item "Cumulative translation adjustments".

e) Research and development expenses

These are recorded as expenses for the year in which they are incurred, except:

- software development costs are capitalized when they strictly comply with the following criteria:

– the project is clearly defined, and costs are separately identified and reliably measured;
– the technical feasibility of the software is demonstrated;
– the software will be sold or used in-house;
– a potential market exists for the software, or its usefulness, in case of internal use, is demonstrated; and
– adequate resources required for completion of the project are available;

Software development costs are amortized as follows:

– in case of internal use: over their probable service lifetime;
– in case of external use: according to prospects for sale, rental or other forms of distribution.

The amortization corresponds to the greater of either the cumulative amounts using straight-line amortization or the cumulative amounts based on the above-mentioned criteria;

- recoverable amounts disbursed under the terms of contracts with customers are included in work in progress on long-term contracts.

In connection with the treatment of acquisitions, Alcatel may allocate a significant portion of the purchase price to in-process research and development projects. As part of the process of analyzing these acquisitions, Alcatel may make the decision to buy technology that has not yet been commercialized rather than develop the technology internally. Alcatel bases these decisions on factors such as the probability of significant delays in, or failure of, new developments that can jeopardize the ability of Alcatel to keep pace with the rapid technological advances in the telecommunications/data networking industry.

The fair value of in-process research and development acquired in acquisitions is based on present value calculations of income, an analysis of the project's accomplishments and an evaluation of the overall contribution of the project, as well as the project's risks.

The revenue projection used to value in-process research and development is based on estimates of relevant market sizes and growth factors, expected trends in technology, and the nature and expected timing of new product introductions by Alcatel and its competitors. Future net cash flows from such projects are based on management's estimates of such projects' cost of sales, operating expenses and income taxes.

The value assigned to purchased in-process research and development is determined by discounting the net cash flows to their present value. The selection of the discount rate is based on Alcatel's weighted average cost of capital, adjusted upward to reflect additional risks inherent in the development life cycle.

This value is also adjusted to reflect the stage of completion, the complexity of the work completed to date, the difficulty of completing the remaining development, costs already incurred, and the projected cost to complete the projects.

If, as of the date of an acquisition, research and development projects have not yet reached technological feasibility and the research and development in progress has no alternative future use, the value allocated to these projects is immediately expensed as of the acquisition date.

Capitalized research and development is amortized over three to seven years.

f) Intangible and tangible assets

Whenever events or changes in market conditions indicate a risk of impairment of intangible assets (excluding goodwill) and property, plant and equipment, a detailed review is carried out in order to determine whether the net carrying amount of such assets remains lower than their fair value.

Whenever such review indicates that fair values are lower than carrying amounts, the Group further considers the effect on its future cash flows of alternative business strategies, such as restructuring plans at affected companies. If necessary, a reserve for these intangible assets and plant, property and equipment is established to reduce their carrying amount to fair value, as measured by their discounted forecasted operating cash flow or market value, if any.

Goodwill

Goodwill is amortized using the straight-line method over a period, determined for each transaction, not exceeding 20 years.

Following the significant decline in the Group's market capitalization during 2002 and the deterioration of the telecommunications sector, all goodwill is tested for impairment at least annually during the second quarter of each year. The impairment test methodology is based on a comparison between the fair values of each of the Group's business divisions with the business divisions' net asset carrying values (including goodwill). Such fair values are mainly determined using pre-tax discounted cash flows over five years and a discounted terminal value. The discount rate used for 2003 was the Group's weighted average cost of capital of 10.2% (11% for 2002). Management believes the assumptions used concerning sales growth and terminal values are reasonable and in line with market data available for each business division.

This method is very similar to step 1 of the impairment test as defined in SFAS 142. The impairment test used in the consolidated financial statements prepared in accordance with French GAAP is, however, carried out at a lower level of segmentation than that recommended by SFAS 142. As a result, the test can lead, in certain cases, to accounting for exceptional goodwill amortization relative to a sub-activity within a business division, which will be restated in the Group's U.S. GAAP consolidated financial statements.

This impairment test was performed as of January 1, 2002, June 30, 2002, December 31, 2002 and June 30, 2003. Furthermore, an additional review of the recoverability of goodwill relating to certain business divisions was carried out at December 31, 2003. All these impairment tests resulted in booking an exceptional goodwill amortization charge of € 171 million in 2003 and € 142 million in 2002 (see note 9).

Other intangible assets

Software reported as intangible assets is either acquired or created for internal use or is master software intended for sale to customers. For master software, copies of which will be sold, only research and development costs related to the production phase (programming, coding, test and test sets) are capitalized. Software is depreciated using the straight-line method over no more than five years.

Property, plant and equipment

Property, plant and equipment are valued at historical cost for the Group (excluding any revaluation). Depreciation is generally calculated over the following useful lives:

Industrial buildings, plant and equipment	
buildings for industrial use	20 years
infrastructure and fixtures	10-20 years
equipment and tools	5-10 years
small equipment and tools	3 years
Buildings for administrative and commercial use	**20-40 years**

Depreciation expense is determined using the straight-line method.

Fixed assets acquired through capital lease arrangements or long-term rental arrangements that transfer substantially all of the benefits and risks of ownership to the Group are capitalized.

g) Investments

Investments are stated at the lower of historical cost (excluding revaluations) or fair value (market value for investments in listed companies), and are assessed investment by investment according to their value in use for Alcatel.

h) Inventories

Inventories are valued at the lower of cost (including indirect production costs where applicable) or net realizable value. Cost is primarily calculated on a weighted average price basis.

i) Pension and retirement obligations and other employee and post-employment benefit obligations

In accordance with the laws and practices of each country, the Group participates in employee benefit plans and provides early retirement benefit plans and special termination benefits.

For defined contribution plans, the Group expenses contributions as and when they are due. As the Group is not liable for any legal or constructive obligations under the plans beyond the contributions paid, no provision as such is made. For defined benefit pension plans, liabilities and prepaid expenses are determined as follows:

- using the Projected Unit Credit Method (with projected final salary), which provides that each period of service gives rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Actuarial assumptions comprise mortality, rates of employee turnover and projection of future salary levels;
- recognizing, over the expected average remaining working lives of the employees participating in the plan, actuarial gains and losses in excess of 10% of the higher of the present value of the defined benefit obligation or the fair value of any plan assets.

Certain other post-employment benefits, such as life insurance and medical cover, are not accrued. In accordance with recommendation No. 2003-R1 of the "Conseil National de la Comptabilité" and in view of the changeover to International Financial Reporting Standards to be adopted by all European listed companies in 2005, the accrual of such obligations is envisaged effective January 1, 2004. The amounts involved at December 31, 2003 are indicated for information in note 23. As the "Conseil National de la Comptabilité"'s recommendation No. 2003-R1 specifically excludes awards granted to employees based on their length of service from the definition of benefits similar to pensions and retirement indemnities, such long-service awards have been accounted for in other reserves effective January 1, 2003 (see note 24).

j) Reserves for restructuring

Reserves for restructuring costs are provided when the restructuring programs have been finalized and approved by Group management and have been announced before the closing date of the Group's financial statements, resulting in an obligation of the Group to third parties. Such costs primarily relate to severance payments, early retirement of employees, costs for notice periods not worked, training costs of terminated employees, and other costs linked to the shutdown of facilities. Write-off of fixed assets, inventories and other assets directly linked to restructuring measures are also accounted for in restructuring costs.

k) Deferred taxation

Deferred income taxes are computed under the liability method for all temporary differences arising between tax bases of assets and liabilities and their reported amounts, including the reversal of entries recorded in individual accounts of subsidiaries solely for tax purposes. All amounts resulting from changes to the tax rate are recorded in the year in which the tax rate change is decided.

Provisions are made for taxes on proposed dividends to be distributed by subsidiaries. No provision is made for taxes payable on undistributed retained earnings.

Deferred income tax assets are recorded in the consolidated balance sheet when it is more likely than not that the tax benefit will be realized in the future.

Due to the difficulty in determining the period in which certain material temporary differences are likely to reverse, deferred tax assets and liabilities are not discounted.

To assess the ability of the Group to recover tax assets, the following elements have been taken into account:

- forecasts of future tax results,
- analysis of income or loss in recent years, excluding non-recurring items,
- historical data concerning recent years' tax results,
- undervalued assets, if any, which the Group intends to dispose of.

l) Net sales and long-term contracts

Net sales include sales and revenues net of value added taxes (VAT).

In general, the Group recognizes revenue from the sale of goods and equipment when persuasive evidence of an arrangement with its customer exists, delivery has occurred, the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. In arrangements where the customer specifies final acceptance of the goods, equipment, services or software, revenue is generally deferred until all the acceptance criteria have been met.

For revenues generated from construction contracts, primarily those related to customized network solutions and network build-outs, the Group applies the percentage of completion method of accounting in application of the above principles, provided certain specified conditions are met, based either on the achievement of contractually defined milestones or on costs incurred compared with total estimated costs. Any estimated construction contract losses are recognized immediately when known. If uncertainty exists relating to customer acceptance, or the contract's duration is relatively short, revenues are recognized only to the extent of costs incurred that are recoverable, or on completion of the contract. Work in progress on construction contracts is stated at production cost, excluding administrative and selling expenses.

Partial payments received on long-term contracts are recorded in customers' deposits and advances.

For revenues generated from licensing, selling or otherwise marketing software solutions, the Group recognizes revenue generally upon delivery of the software and on the related services as and when they are performed. For arrangements to sell software licenses with services, software license revenue is recognized separately from the related service revenue, provided the transaction adheres to certain criteria (as prescribed by the AICPA's SOP 97-2), such as the existence of sufficient vendor-specific objective evidence of fair value to permit allocation of the revenue to the various elements of the arrangement. If the arrangement does not meet the above specified criteria, revenue on the service element is recognized ratably over the period during which it is expected to be performed. For arrangements to sell services only, revenue from training or consulting services is recognized when the services are performed. Maintenance service revenue, including post-contract customer support, is deferred and recognized ratably over the contracted service period.

For product sales made through resellers and distributors, revenue is recognized at the time of shipment to the distribution channel. Accruals for any estimated returns are recorded at the same time based on contract terms and prior claims experience.

The Group accrues for warranty costs, sales returns and other allowances based on contract terms and its historical experience.

m) Income from operations

Income from operations includes gross margin, administrative and selling expenses, research and development expenses (see note 1e), pension costs (without financial component, note 1i) and employee profit sharing. Income from operations is calculated before interest expenses on notes mandatorily redeemable for shares, financial income (costs), restructuring costs, other revenue and expense, income tax, share in net income of equity affiliates and disposed of or discontinued operations, and amortization of goodwill and in-process research and development projects.

n) Financial income

Financial income includes interest charges and income, dividends received from unconsolidated companies, reserves for investments in unconsolidated companies, marketable securities and other financial assets, net exchange gain (loss) (excluding hedging of commercial transactions), financial component of the pension costs and other financial expenses and income (capital gain/loss on disposal of marketable securities, for example).

Alcatel's banking subsidiary (Electrobanque) is fully consolidated. The operational banking revenues and costs are presented in financial income (costs) since the bank's activity, being primarily an extension of the Group's activity, enables savings to be made in interest expense and contributes to the financing of net sales (see note 1t).

o) Other revenue and expense

Other revenue and expense includes capital gain/loss on share disposals and tangible and intangible asset disposals; non-recurring expenses and revenues linked to ordinary business that are exceptional in terms of materiality and frequency, and extraordinary expenses and revenues.

p) Structure of consolidated balance sheet

The consolidated balance sheet is presented by nature of assets and liabilities or order of liquidity without distinction between the amounts due in less than one year and due after one year. It is for instance the case of accounts receivable accounted for in current assets, of trade payables accounted for in other liabilities and of reserves for liabilities and charges presented separately.

q) Financial instruments

The Group uses financial instruments to manage and reduce its exposure to fluctuations in interest rates and foreign currency exchange rates. When these contracts qualify as hedges, gains and losses on such contracts are accounted for in the same period as the item being hedged; otherwise, changes in the market value of these instruments are recognized in the period of change.

r) Cash and cash equivalents

The cash and cash equivalents set forth in the consolidated statements of cash flows includes cash as well as short-term investments that are readily convertible to fixed amounts of cash. Cash and cash equivalents does not include investments in listed securities or bank accounts restricted in use, other than restrictions due to regulations applied in a specific country or sector of activities (exchange controls, etc.).

Bank overdrafts considered as financing are also excluded from cash and cash equivalents.

Cash and cash equivalents in the balance sheet corresponds to the cash and cash equivalents defined above, including listed securities accounted for as marketable securities.

s) Marketable securities

Marketable securities are valued at the lower of cost or market value.

t) Customer financing

The Group undertakes two types of customer financing:

– financing relating to the operating cycle and directly linked to actual contracts;

– longer-term financing (beyond the operating cycle) through customer loans, minority investments or other forms of financing.

The first category of financing is accounted for in current assets, and loan allowances are accounted for in income from operations or in other expenses (see note 1o). Changes in net loans receivable are presented in net change in current assets in the consolidated statements of cash flows.

The second category of financing is accounted for in other investments and miscellaneous, net, and impairments are included in financial income (costs) or in other expenses (see note 1o). Changes in net loans receivable are included in cash flows from investing activities (decrease/increase in loans) in the consolidated statements of cash flows.

Furthermore, the Group may give guarantees to banks in connection with customer financing. These are included in off-balance sheet commitments (see note 30).

Note 2 - Changes in the consolidated companies

The main changes for 2003 in the consolidated companies were as follows:

- in February 2003, Alcatel exercised its option to put its 50% shareholding in Atlinks to Thomson, its joint venture partner. This put option was part of the initial contract signed in 1999 with Thomson. Alcatel received € 68 million. Atlinks was consolidated under the equity method and this disposal has not had a significant impact on the Group's financial statements (see note 6);
- at the end of April 2003, Alcatel completed the acquisition of iMagic TV Inc, a Canadian company, which develops software products that enable service providers to create, deliver and manage digital television and media services over broadband networks. Alcatel already owned 16% of this company. The remaining 84% of the company was acquired for 3.5 million Alcatel ADSs (American Depositary Shares), resulting in an acquisition price of € 26 million. This company is consolidated from May 1, 2003. This acquisition has not had a significant impact on the accounts of Alcatel;
- in May 2003, Alcatel announced that it had entered into a binding agreement with Avanex to divest its optical components business. This transaction was completed on July 31, 2003. As part of this transaction, Avanex also acquired certain assets of Corning Incorporated's photonics activities. In consideration for the assets contributed, Alcatel received 28% of the capital of the new entity, which is consolidated using the equity method. The financial results and financial position of the optical components business have been accounted for as a disposed of or discontinued operations (see note 5);
- in June 2003, Alcatel entered into a settlement that brings to an end its litigation against Loral and its subsidiary, Space Systems/Loral Inc. With this agreement, Alcatel purchased Loral's shares in the company, Europe*Star, bringing Alcatel's stake in this company to 95% from 51%. This company, previously accounted for under the proportionate consolidation method at 51%, was fully consolidated from July 1, 2003. As a result of this change in the method of consolidation, financial debt increased by € 111 million. There was no other significant impact on the consolidated financial statements. On July 15, 2003, Loral filed for bankruptcy protection from its creditors under Chapter 11 of the United States Bankruptcy Code. Although it is not possible at this time to determine the consequences resulting from this event, Alcatel considers that its impact will not have a material effect on its financial position;
- in July 2003, Alcatel completed the acquisition of TiMetra Inc., a California company, specializing in IP/MPLS service routing at the network edge. All of the TiMetra shares were acquired for 18 million Alcatel ADSs, resulting in an acquisition price of € 145 million. This company is consolidated from August 1, 2003;
- on October 20, 2003, Alcatel announced that it had signed an agreement with Doughty Hanson, a private European investment company specializing in the acquisition and development of industrial companies, to sell SAFT, an Alcatel subsidiary specializing in batteries, for € 390 million. The financial results and financial position of Alcatel's battery business have been accounted for as a disposed of or discontinued operation (see notes 5 and 34).

The main changes for 2002 in the consolidated companies were as follows:

- at the end of December 2001, Platinum and Alcatel signed a memorandum of understanding concerning the disposal of Alcatel's European enterprise distribution activities to Platinum. The disposal was completed during the second quarter of 2002;
- in April 2002, Alcatel finalized its acquisition of Astral Point Communications Inc, a U.S. company engaged in next-generation SONET Metro Optical Systems. All outstanding shares and rights to acquire shares of Astral Point Communications Inc were exchanged for 8.8 million Class A shares, a majority of which were represented by Class A ADSs, for an acquisition price of € 144 million. This company is consolidated from April 1, 2002;
- Alcatel and STMicroelectronics signed, mid-April 2002, a memorandum of understanding relating to the disposal of Alcatel's microelectronic activities to STMicroelectronics for € 390 million. As part of this transaction, the two companies entered into cooperation for the joint development of DSL chip-sets that also are intended to be sold in the open market. The disposal was completed at the end of June 2002;
- in July 2002, Alcatel acquired control of Alcatel Shanghai Bell through the acquisition of an additional interest. The Group now owns 50% of the capital stock plus one share. This subsidiary, previously accounted for under the equity method, is fully consolidated from July 1, 2002;
- in August 2002, Alcatel completed the acquisition of the Telera Corporation. Telera's patented Voice Web software platform uses voice extensible markup language (VoiceXML) to enable service providers and enterprises to develop advanced voice applications that transform the telephone into a powerful tool to access Web-based information. All outstanding shares and rights to acquire shares of Telera Corp were exchanged for 15.5 million of Alcatel Class A ADSs for an acquisition price of € 79 million. This company is consolidated from August 1, 2002;
- in September 2002, Alcatel sold 10.3 million Thales shares, based on the modification of an agreement signed in 1998 between Alcatel and Groupe Industriel Marcel Dassault. Upon the closing of the transaction, Alcatel's shareholding in Thales decreased from 15.83% to 9.7%. Alcatel is the largest private shareholder of Thales, with three seats on Thales' Board of Directors. Alcatel still accounts for Thales using the equity method;
- in October 2002, Alcatel sold 1.5 million Nexans shares. Alcatel no longer has a significant influence on this company, and therefore the remaining securities were reclassified as marketable securities.

In order to make comparisons easier, unaudited restated income statements are presented to take into account changes in consolidated companies and discontinuation of the following businesses:

– sale of the optical components business announced in May 2003 and finalized in July 2003;
– disposal in progress of SAFT announced in October 2003 and finalized in January 2004 (see note 34).

Data for Q4 2002 and the full years 2001 and 2002 have been restated to show the results of the above businesses under the caption including disposed of or discontinued operations:

(in millions of euros)	**Q4 2003** (unaudited)	**Q4 2002** restated (unaudited)	**2003**	**2002** restated (unaudited)	**2001** restated (unaudited)
Net sales	3,765	4,377	12,513	16,014	23,165
Cost of sales	(2,517)	(3,166)	(8,415)	(11,708)	(17,521)
Cost of sales	1,248	1,211	4,098	4,306	5,644
Administrative and selling expenses	(524)	(624)	(2,173)	(2,757)	(3,277)
R&D costs	(393)	(547)	(1,593)	(2,155)	(2,705)
Income (loss) from operations	331	40	332	(606)	(338)
Interest expense on notes mandatorily redeemable for shares	(12)	(1)	(47)	(1)	–
Financial income (costs)	(78)	(135)	(242)	(1,008)	(1,528)
Restructuring costs	(524)	(497)	(1,314)	(1,379)	(1,945)
Other revenue (expense)	11	(202)	120	(737)	(109)
Income (loss) before amortization of goodwill and taxes	(272)	(795)	(1,151)	(3,731)	(3,920)
Income tax	(21)	(66)	(82)	49	1,243
Share in net income of equity affiliates and disposed of or discontinued operations	7	(86)	(113)	(513)	(428)
Consolidated net income (loss) before amortization of goodwill and purchased R&D	(286)	(947)	(1,346)	(4,195)	(3,105)
Amortization of goodwill	(210)	(147)	(578)	(532)	(1,849)
Purchased R&D	–	–	–	–	(4)
Minority interests	(28)	(25)	(20)	(18)	(5)
Net income (loss)	(524)	(1,119)	(1,944)	(4,745)	(4,963)
Ordinary Shares					
Basic earnings per share (in euros)	*(0.39)*	*(0.93)*	*(1.46)*	*(3.99)*	*(4.29)*
Diluted earnings per share (in euros)	*(0.39)*	*(0.93)*	*(1.46)*	*(3.99)*	*(4.29)*

NOTE 3 - INFORMATION BY BUSINESS SEGMENT AND BY GEOGRAPHICAL SEGMENT

a) Information by business segment

The tables below present information by the following business segments; they take into account the new organization put in place at the beginning of 2003.

Previously, Alcatel was organized along technology lines. At the beginning of 2003, Alcatel reorganized into three business segments, addressing three principal markets.

The first two business segments, Fixed Communications and Mobile Communications, serve the telecom service provider markets and comprise:

– infrastructure equipment divisions responsible for network equipment and pre and post commissioning tasks. These divisions have a strong focus on network solutions in their respective markets,

– a division focusing on applied solutions, which includes application software activities and which interacts with the equipment divisions.

The third business segment, Private Communications, fulfills a dual function:

– it is responsible for all non-telecom communication markets and is organized along vertical market segment lines covering equipment, network solutions and applied solutions,

– it provides network services supporting the entire portfolio of Alcatel customers.

The segment Other includes miscellaneous businesses outside Alcatel's core business, such as corporate purchasing, reinsurance and banking activities and corporate holding companies accounting mainly for corporate expenses. None of these activities are sufficiently significant to be disclosed as reportable segments.

The information by segment follows the same accounting policies as those used and described in these consolidated financial statements.

Data for 2002 and 2001 have been restated to take into account the new organization and the disposal and discontinuation of significant businesses described in note 2 and accounted for in the presentation of the restated and unaudited income statements.

Profit and loss for each reportable segment is measured using "income from operations".

(in millions of euros except for number of staff)	Fixed Communications	Mobiles Communications	Private Communications	Other	Eliminations	Total Group
2003						
Sales						
■ segments	5,708	3,539	3,627	16	–	**12,890**
■ between segments	(145)	(39)	(192)	(1)	–	**(377)**
Net sales	5,563	3,500	3,435	15	–	**12,513**
Income (loss) from operations*	127	226	123	(144)	–	**332**
Depreciation of property, plant and equipment	(271)	(74)	(132)	(1)	–	**(478)**
Changes in operational reserves (current assets and accrued contract costs)	216	107	(41)	–	–	**282**
Capital expenditures	55	40	47	–	–	**142**
Property, plant and equipment, net	787	254	497	(38)	–	**1,500**
Operating assets**	2,171	1,340	1,481	34	(123)	**4,903**
Staff	26,502	14,110	19,282	592	–	**60,486**

* For 2003, due to their unusual amounts, reserves on receivables, non-recurring expenses linked to the interruption of contracts and costs related to operations to be discontinued, have been reclassified under the line "other revenue (expense)" (Note 6).

** Operating assets includes net inventories and work in progress, net receivables and related accounts and advances and progress payments.

(in millions of euros except for number of staff)	**Fixed Communications**	**Mobiles Communications**	**Private Communications**	**Other**	**Eliminations**	**Total Group**
2002 restated (unaudited)						
Sales						
■ segments	7,826	4,542	4,109	21	–	16,498
■ between segments	(252)	(62)	(170)	–	–	(484)
Net sales	7,574	4,480	3,939	21	–	16,014
Income (loss) from operations*	(784)	204	115	(141)	–	(606)
Depreciation of property, plant and equipment	(515)	(96)	(174)	4	–	(781)
Changes in operational reserves (current assets and accrued contract costs)	566	193	103	–	–	862
Capital expenditures	173	45	105	18	–	341
Property, plant and equipment, net	1,495	324	646	34	–	2,499
Operating assets**	3,589	1,723	1,829	38	(157)	7,022
Staff	35,110	14,816	20,467	706	–	71,099

* For 2002, due to their unusual amounts, reserves on receivables, non-recurring expenses linked to the interruption of contracts and costs related to operations to be discontinued, have been reclassified under the line "other revenue (expense)" (note 6).

** Operating assets includes net inventories and work in progress, net receivables and related accounts and advances and progress payments.

(in millions of euros except for number of staff)	**Fixed Communications**	**Mobiles Communications**	**Private Communications**	**Other**	**Eliminations**	**Total Group**
2001 restated (unaudited)						
Net sales	13,560	4,868	5,603	8	(760)	23,279
Income (loss) from operations*	(95)	(354)	100	12	–	(337)

* For 2001, due to their unusual amounts, reserves on receivables, non-recurring expenses linked to the interruption of contracts and costs related to operations to be discontinued, have been reclassified under the line "other revenue (expense)" (note 6).

b) Information by geographical segment

Data for 2002 and 2001 have been restated to take into account the new organization and the disposal and discontinuation of significant businesses described in note 2 and accounted for in the presentation of the restated income statements.

(in millions of euros except for number of staff)	France	Germany	Other Western Europe	Other Rest of Europe	Asia Pacific	North America	Rest of world	Conso-lidated
2003								
Net sales								
■ by subsidiary location	4,592	1,118	2,200	266	1,549	2,016	772	**12,513**
■ by geographical market	1,587	818	2,934	980	2,206	1,879	2,109	**12,513**
Income (loss) from operations	(113)	22	115	43	143	96	26	**332**
Property, plant and equipment, net	452	194	413	28	112	247	54	**1,500**
Total Assets	12,089	1,069	2,769	195	1,987	2,479	543	**21,131**
Staff	18,989	7,381	11,285	1,694	8,716	9,075	3,346	**60,486**
2002 restated (unaudited)								
Net sales								
■ by subsidiary location	5,811	1,481	2,756	390	1,840	2,761	975	**16,014**
■ by geographical market	2,299	1,186	3,334	1,164	2,744	2,729	2,558	**16,014**
Income (loss) from operations	(260)	(32)	(261)	45	131	(299)	70	**(606)**
Property, plant and equipment, net	744	252	609	41	161	448	83	**2,338**
Total Assets	13,498	1,318	4,071	249	2,305	3,244	706	**25,391**
Staff	22,446	8,549	15,179	2,092	8,916	10,138	3,779	**71,099**
2001 restated (unaudited)								
Net sales								
■ by subsidiary location	7,365	2,272	4,011	322	1,966	5,572	1,657	**23,165**
■ by geographical market	3,428	1,765	4,741	1,141	2,915	5,246	3,929	**23,165**
Income (loss) from operations	(199)	230	33	32	75	(598)	89	**(338)**
Property, plant and equipment, net	961	360	980	52	110	1,120	137	**3,720**
Total Assets	16,875	1,741	7,442	242	1,562	6,683	1,391	**35,936**
Staff	25,447	11,346	20,615	2,304	5,427	16,018	4,821	**85,978**

The above information is analyzed by subsidiary location, except for net sales which are also analyzed by geographical market.

Note 4 - Financial income (costs)

(in millions of euros)	Q4 2003 (unaudited)	2003	2002	2001
Net interest (expense) income	(35)	(102)	(159)	(278)
Dividends	–	4	9	47
Provision for depreciation of investments*	9	(39)	(669)	(1,228)
Net exchange gain (loss)	(18)	(21)	(82)	(118)
Financial component of the pension costs	(17)	(70)	(70)	(61)
Other financial items (net)	(17)	(14)	(47)	70
Net financial income (costs)	(78)	(242)	(1,018)	(1,568)

* Of which:
– € (80) million represent depreciation of the assets held related to Globalstar's activities for 2001.
– € (480) million and € (171) million, respectively, for reserves to cover guarantees issued by a member of the Group and vendor financing in 2002 and 2001.
– € (820) million of reserves against financial investments in 2001.

Note 5 - Equity affiliates and disposed of or discontinued operations

Income statement (in millions of euros)	Q4 2003 (unaudited)	2003	2002	2001
Share in net income of equity affiliates*	(9)	(12)	(75)	(16)
Income of disposed of or discontinued operations**	16	(101)	(32)	–
Total	7	(113)	(107)	(16)

* For 2002, € (79) million related to the actual share in net income of Thales since an estimated figure had been included in the 2001 full year results. From January 1, 2002, share in net income of Thales will be taken into account only after the publication of their financial statements. 2003 information for Thales was not available at the closing date of Alcatel's financials, so no share in net income of Thales was taken into account in the income statement for the second half of 2003.

** Disposed of or discontinued operations are described in note 2.

The income statements of disposed of or discontinued operations for 2003 and 2002 are as follows:

	Q4 2003 (unaudited)	2003	2002
Net sales*	140	545	318
Cost of sales*	(95)	(412)	(257)
Gross margin	45	133	61
Administrative and selling expenses	(19)	(83)	(82)
R&D costs	(6)	(34)	–
Income (loss) from operations	20	16	(21)
Net income (loss)	16	(101)	(32)

* The net sales and cost of sales represent transactions outside the Group and are therefore after elimination of intra-Group transactions.

The cash flows of disposed of or discontinued operations in 2003 were as follows:

(in millions of euros)	2003
Net income (loss)	(101)
Net cash provided (used) by operating activities before changes in working capital	(3)
Net cash provided (used) by operating activities	(5)
Net cash provided (used) by investing activities	(51)
Net cash provided (used) by financing activities	60*
Net effect of exchange rate changes	(5)
Net increase (decrease) in marketable securities and cash	(1)

* Alcatel Group's Central Treasury provided financing for the optical components business and for the SAFT Group until the date of disposal.

Disposed of or discontinued operations as of December 31, 2003 were the optical components business (Optronics France and Optronics UK, formerly Kymata) and the SAFT Group.

NOTE 6 - OTHER REVENUE (EXPENSE)

(in millions of euros)	Q4 2003 (unaudited)	2003	2002	2001
Net capital gains (loss) on disposal of property, plant and equipment	(13)	199	(9)	42
Net capital gains (loss) on disposal of shares	(50)	(95)	296	901
Net capital gains (loss) on disposal of assets*	**(63)**	**104**	**287**	**943**
Write-off of trade receivables and inventories**	95	90	(548)	(455)
Write-off of other assets***	(3)	(151)	(473)	(141)
Cost linked to the termination or disposal of activities****	–	5	(2)	(302)
Other	(18)	72	(94)	(258)
Other revenue (expense)	**74**	**16**	**(1,117)**	**(1,156)**
Total	**11**	**120**	**(830)**	**(213)**

		Q4 2003 (unaudited)	2003	2002	2001
*	of which:				
	– disposal of Alstom shares	–	–	–	1,122
	– disposal of Vivendi, Société Générale, Thales and Thomson Multimedia shares	–	–	261	467
	– disposal of Nexans securities	–	–	(22)	(692)
	– disposal of Alcatel Microelectronics shares	(3)	6	221	–
	– disposal of properties	6	215	–	–
	– disposal of optical components business	–	(76)	–	–
	– miscellaneous (less than € 100 million of net value each)	(66)	(41)	(164)	4
**	of which:				
	– related to the Fixed Communications segment	95	74	(450)	–
	– related to the Mobile Communications segment	–	–	–	
	– related to the Private Communications segment	–	16	(98)	–
***	of which:				
	– impairment of fixed assets in Fixed Communications segment	(2)	(126)	(394)	–
****	of which:				
	– shut-down of the LMDS activity	–	–	–	(32)
	– disposal of CPE activities	–	5	10	(166)
	– write-off of acquired technologies	–	–	(9)	(82)
	– miscellaneous	–	–	(3)	
				(22)	

NOTE 7 - INCOME TAX

a) Analysis of income tax (charge) benefit

(in millions of euros)	Q4 2003 (unaudited)	2003	2002*	2001
Current income tax (charge) benefit	(40)	(62)	283	(151)
Deferred income tax (charge) benefit, net	19	(20)	(264)	1,412
Income tax (charge) benefit	(21)	(82)	19	1,261

* Due to the decision taken to carry back tax losses, mainly in France, a current income tax profit has been recorded during 2002 (see note 30b) of which the counterpart is a charge in deferred income tax.

Given income expectations and local tax regulations, in the second quarter of 2002 the Group extended the scope of countries where deferred tax assets are no longer recorded.

As a result, there is a deferred income tax charge for 2003 of € 20 million and for 2002 of € 264 million, compared to a deferred income tax benefit of € 1,412 million for 2001.

b) Effective income tax rate

The effective tax rate can be analyzed as follows:

(in millions of euros except for percentage)	2003	2002	2001
Income (loss) before taxes, share in net income of equity affiliates, amortization of goodwill and purchased R&D	(1,151)	(4,050)	(4,266)
Average income tax rate	32.85%	35.6 %	34.7%
Expected tax (charge) benefit	378	1,442	1,480
Impact of:			
- reduced taxation of certain revenues*	4	5	92
- utilization (unrecognized) tax loss carry forwards	(575)	(1,903)	(388)
- tax credits	(3)	25	33
- other permanent differences	114	450	44
Actual income tax (charge) benefit	(82)	19	1,261
Effective tax rate	(7.1%)	0.5%	29.6%

* Primarily capital gains on disposal of assets.

Average income tax rate is the sum of income (loss) before taxes, multiplied by the local statutory rate for each subsidiary, divided by consolidated income (loss) before taxes.

c) Deferred tax balances

Deferred tax assets (liabilities) are included in the following captions of the consolidated balance sheet:

(in millions of euros)	2003	2002	2001
Other accounts receivable			
- deferred tax assets recognizable	6,317	6,284	5,587
- deferred tax assets not recognized	(4,306)	(4,128)	(2,488)
Deferred tax assets*	2,011	2,156	3,099
Other payables			
- deferred tax liabilities	(70)	(112)	(529)
Deferred tax liabilities*	(70)	(112)	(529)
Net deferred tax assets (liabilities)	1,941	2,044	2,570

* See notes 17 and 29.

The Group carries out an analysis of its deferred taxes in each country by applying to each subsidiary or tax grouping the national tax regulations, particularly those regarding tax losses carried forward.

Due to the importance of tax losses in 2002 within certain companies or tax groupings, it was decided, in the second quarter of 2002, to extend the scope of countries where deferred tax assets are no longer recorded. Moreover, deferred tax assets have been assessed based on forecasts of future tax results and Alcatel's ability to recover those assets. Only deferred tax assets with supportable and tangible proof of recovery in the future were recorded as of December 31, 2003. Projections of future taxable results, providing support for the recording of deferred tax assets, have been restricted to a maximum time-frame of 10 years, which is significantly less than the tax loss carryforward periods available under certain countries' tax laws.

Deferred tax assets primarily relate to tax loss carryforwards, accrued pension and retirement obligations and other non-tax deductible reserves.

Deferred taxes that are not recognized because of their uncertain recovery amount to € 4,305 million, € 4,128 million and € 2,488 million respectively at December 31, 2003, 2002 and 2001.

d) Tax losses carried forward

Tax losses carried forward and not yet utilized represent a potential tax saving of € 4,483 million at December 31, 2003 (€ 4,292 million at December 31, 2002 and € 2,986 million at December 31, 2001).

Tax losses carried forward expire as follows:

(in millions of euros)

Years	Amount
2004	34
2005	14
2006	8
2007	135
2008 and thereafter	4,292
Total	4,483

Note 8 - Earnings per share

Earnings per share is calculated in compliance with IAS 33 (as revised December 2003).

Basic earnings per share is computed using the weighted average number of shares issued after deduction of the weighted average number of shares owned by consolidated subsidiaries. Regarding the Newbridge acquisition, the entire issuance of Alcatel shares is taken into account for the earnings per share calculation (including shares exchangeable within five years for ADSs).

In accordance with IAS 33 revised (paragraph 23), the weighted average number of shares to be issued upon conversion of notes mandatorily redeemable for shares is included in the calculation of basic earnings per share for 2003 and 2002.

Diluted earnings per share takes into account share equivalents having a dilutive effect, after deducting the weighted average number of share equivalents owned by consolidated subsidiaries, but not share equivalents that do not have a dilutive effect. Net income is adjusted for after-tax interest expense relating to convertible and redeemable bonds.

The dilutive effects of stock option or stock purchase plans are calculated using the "treasury stock method", which provides that proceeds to be received from exercise or purchase, are assumed to be used first to purchase shares at market price. The dilutive effects of notes mandatorily redeemable for shares are calculated on the assumption that the notes will be systematically redeemed for shares (the "if converted method").

As a result of the approval received at the shareholders' meeting held on April 17, 2003, Alcatel's Class O shares were converted into ordinary shares on a one-for-one basis. The earnings per share amounts for the ordinary shares presented below are therefore restated to include the Class O shares, which are considered to be ordinary shares for all periods presented.

The tables below reconcile basic earnings per share to diluted earnings per share for the three years presented:

2003	Net income (loss) (in millions of euros)	Ordinary shares Number of shares	Per share amount
Basic earnings per share	(1,944)	1,332,364,920	€ (1.46)
Stock option plans		–	–
Notes mandatorily redeemable for shares		–	–
Diluted earnings per share	**(1,944)**	**1,332,364,920**	**€ (1.46)**

Ordinary shares

Consolidated subsidiaries of the Group owned 62,988,536 Alcatel ordinary shares and no share equivalents.

Shares subject to future issuance

The number of stock options not exercised as of December 31, 2003 amounted to 119,425,586 shares. These shares, subject to issuance in the future, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

Furthermore, 63,192,027 new or existing Alcatel ordinary shares, which are issuable in respect of Alcatel's mandatorily redeemable notes (OCEANE) issued on June 12, 2003, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

2002	Net income (loss) (in millions of euros)	Ordinary shares Number of shares	Per share amount
Basic earnings per share	(4,745)	1,190,067,515	€ (3.99)
Stock option plans	–	–	–
Diluted earnings per share	**(4,745)**	**1,190,067,515**	**€ (3.99)**

Ordinary shares

Consolidated subsidiaries owned 63,333,004 Alcatel ordinary shares and no share equivalents.

Shares subject to future issuance

The number of stock options not exercised as of December 31, 2002 amounted to 101,011,736 shares. These shares, subject to issuance in the future, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

2001	Net income (loss) (in millions of euros)	Ordinary shares Number of shares	Per share amount
Basic earnings per share	(4,963)	1,158,143,038	€ (4.29)
Stock option plans	–	–	–
Diluted earnings per share	**(4,963)**	**1,158,143,038**	**€ (4.29)**

Ordinary shares

Consolidated subsidiaries owned 74,411,275 Alcatel ordinary shares and no share equivalents.

Shares subject to future issuance

The number of stock options not exercised as of December 31, 2001 amounted to 103,340,189 shares. These shares, subject to issuance in the future, have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

Note 9 - Goodwill, net

Acquisitions (in millions of euros)	Amort. length	2003 Gross value	2003 Cumulative amortization	2003 Net	2002 Gross value	2002 Cumulative amortization	2002 Net	2001 Net
CFA*	20	3,614	(2,451)	1,163	3,614	(2,270)	1,344	1,525
Telettra	20	1,703	(1,320)	383	1,703	(1,279)	424	466
"Optical fibers" and "submarine cables" activities**	20	328	(131)	197	328	(115)	213	230
Alcatel Submarine Networks Tel	20	866	(722)	144	926	(761)	165	187
Alcatel Network Systems Inc.	20	528	(398)	130	635	(458)	177	235
Alcatel Space	20	1,236	(357)	879	1,148	(177)	971	1,027
Thales (former Thomson-CSF)	20	261	(76)	185	261	(65)	196	343
Xylan/Packet Engines	20	964	(664)	300	1,415	(933)	482	610
Assured Access	–	–	–	–	287	(287)	–	–
Internet Devices	–	–	–	–	130	(130)	–	–
Innovative Fibers	–	–	–	–	114	(114)	–	56
Alcatel Shanghai Bell	20	142	(7)	135	205	(5)	200	–
Other	5 to 20	755	(432)	323	997	(572)	425	578
Total		10,397	(6,558)	3,839	11,763	(7,166)	4,597	5,257

* Corresponds to the buy-back of the activities of ITT Corporation's subsidiaries in the 1990s.
** The value of goodwill, net for the optical fibers activity was zero.

During 2003, changes of gross values and reserves for goodwill were as follows:

Gross value (in millions of euros)	12.31.2002	Acquisitions	Disposal	Other movements	12.31.2003
CFA	3,614	–	–	–	3,614
Telettra	1,703	–	–	–	1,703
"Optical fibers" and "submarine cables" activities	328	–	–	–	328
Alcatel Submarine Networks Tel	926	–	–	(60)	866
Alcatel Network Systems Inc.	635	–	–	(107)	528
Alcatel Space	1,148	88	–	–	1,236
Thales	261	–	–	–	261
Xylan/Packet Engines	1,415	–	–	(451)	964
Assured Access	287	–	–	(287)	–
Internet Devices	130	–	–	(130)	–
Innovative Fibers	114	–	–	(114)	–
Alcatel Shanghai Bell	205	–	–	(63)	142
Other	997	88	(80)	(250)	755
Total	11,763	176	(80)	(1,462)	10,397

Other changes correspond primarily to exchange rate fluctuations and to the removal of fully amortized goodwill.

In 2002, the Group acquired an additional 18.35% interest in the capital of Alcatel Shanghai Bell, which enabled the Group to assume control of this company in which it had held a 31.65% interest and had previously accounted for under the equity method. As a result, this entity has been fully consolidated since July 1, 2002 and final goodwill of € 142 million was booked at December 31, 2003.

During the third quarter of 2002, Alcatel disposed of 10.3 million Thales shares, resulting in a decrease of € 166 million in gross goodwill and of € 39 million in cumulative amortization.

Goodwill of € 632 million in respect of Alcatel Space was booked due to the acquisition, in July 2001, by Alcatel of the remaining 49% interest in Alcatel Space held by Thales. The disposal of Thales shares as a 50% part payment for the minority interest in Alcatel Space reduced the gross value of the goodwill relating to Thales by € 305 million.

The disposal of 7 million Thales shares in November 2001 reduced the gross value of goodwill related to Thales by € 126 million.

Historically, Alcatel has not charged goodwill to shareholders' equity. However, certain acquisitions have been accounted for using the pooling of interests method of accounting for stock-for-stock business combinations (provided for in article 215 of Regulation No. 99-02 of the "Comité de la Réglementation Comptable" (CRC). Details of recent acquisitions accounted for by this method are given below.

The acquisition of TiMetra during the third quarter 2003 was financed by a capital increase. The pooling of interests method of accounting for stock-for-stock business combinations (art. 215) was applied to this acquisition. As a result, € 141 million, representing the difference between the acquisition price and the net book value of TiMetra's assets and liabilities acquired, was charged to shareholders' equity.

The acquisition of Telera during the second half of 2002 was financed by a capital increase. The pooling of interests method of accounting for stock-for-stock business combinations was also applied to this acquisition. As a result, € 60 million, representing the difference between the acquisition price and the net book value of Telera's assets and liabilities acquired, was charged to shareholders' equity.

The acquisition of Astral Point during the first six months of 2002 was financed by a capital increase. The pooling of interests method of accounting for stock-for-stock business combinations was also applied to this acquisition. As a result, € 162 million, representing the difference between the acquisition price and the net book value of Astral Point's assets and liabilities, was charged to shareholders' equity.

The acquisition of Kymata in September 2001 was financed by a capital increase. The pooling of interests method of accounting for stock-for-stock business combinations was similarly applied to this acquisition. As a result, € 76 million, representing the difference between the acquisition price and the net book value of the assets and liabilities acquired, was charged to shareholders' equity. As a result of the disposal of Alcatel's optical components business on July 31, 2003, which occurred less than two years from the date of the original acquisition, goodwill has been reinstated as of January 1, 2003 (see consolidated statement of changes in shareholders' equity) and fully amortized during the year to income from disposed of or discontinued operations (restatement of the amortization since the date of acquisition, see note 5) and to other revenue (expense) (see note 6).

In addition to TiMetra, Astral Point and Telera, the pooling of interests method of accounting for stock-for-stock business combinations was also applied to these other acquisitions: DSC, Genesys and Newbridge.

Amortization (in millions of euros)	**12.31.2002**	**2003 Appropriation**	**Exceptional amortization**	**Changes in consolidated companies**	**Other movements**	**12.31.2003**
CFA	2,270	181	–	–	–	2,451
Telettra	1,279	41	–	–	–	1,320
"Optical fibers" and "submarine cables" activities	115	16	–	–	–	131
Alcatel Submarine Networks Tel	761	15	–	–	(54)	722
Alcatel Network Systems Inc.	458	19	–	–	(79)	398
Alcatel Space	177	56	40	–	84	357
Thales	65	11	–	–		76
Xylan/Packet Engines	933	27	85	–	(381)	664
Assured Access	287	–	–	–	(287)	–
Internet Devices	130	–	–	–	(130)	–
Innovative Fibers	114	–	–	–	(114)	–
Alcatel Shanghai Bell	5	3	–	–	(1)	7
Other	572	38	46	(26)	(198)	432
Total	**7,166**	**407**	**171**	**(26)**	**(1,160)**	**6,558**

Other changes correspond primarily to exchange rate fluctuations and to the removal of fully amortized goodwill.
The method applied for the goodwill impairment tests performed in 2003 and 2002 is described in note 1f.

Note 10 - Other intangible assets, net

a) Changes in other intangible assets

	Gross value		
(in millions of euros)	**Software**	**Other**	**Total**
December 31, 2000	1,006	340	1,346
Additions	230	44	274
Disposals	(128)	(20)	(148)
Other movements	(146)	(68)	(214)
December 31, 2001	962	296	1,258
Additions	144	6	150
Disposals	(112)	(18)	(130)
Write-offs	(57)	(1)	(58)
Other movements	(308)	(32)	(340)
December 31, 2002	629	251	880
Additions	104	7	111
Disposals	(128)	(25)	(153)
Write-offs	–	–	–
Other movements	(24)	(51)	(75)
December 31, 2003	581	182	763

b) Changes in accumulated amortization of other intangible assets

	Accumulated amortization		
(in millions of euros)	**Software**	**Other**	**Total**
December 31, 2000	660	182	842
Amortization charges	162	126	288
Write-backs	(124)	(17)	(141)
Other movements	(134)	(69)	(203)
December 31, 2001	564	222	786
Amortization charges	192	31	223
Write-backs	(108)	(18)	(126)
Write-offs and exceptional amortization charges	(12)	8	(4)
Other movements	(281)	(30)	(311)
December 31, 2002	355	213	568
Amortization charges	111	16	127
Write-backs	(127)	(23)	(150)
Write-offs and exceptional amortization charges	–	–	–
Other movements	(16)	(50)	(66)
December 31, 2003	323	156	479

c) Changes in other intangible assets, net

(In millions of euros)	Net value Software	Other	Total
December 31, 2000	**346**	**158**	**504**
Additions	230	44	274
Net impact of disposals	(4)	(3)	(7)
Amortization charges	(162)	(126)	(288)
Other movements	(12)	1	(11)
December 31, 2001	**398**	**74**	**472**
Additions	144	6	150
Net impact of disposals	(4)	–	(4)
Amortization charges	(192)	(31)	(223)
Write-offs and exceptional amortization charges	(45)	(9)	(54)
Other movements	(27)	(2)	(29)
December 31, 2002	**274**	**38**	**312**
Additions	104	7	111
Net impact of disposals	(1)	(2)	(3)
Amortization charges	(111)	(16)	(127)
Write-offs and exceptional amortization charges	–	–	–
Other movements	(8)	(1)	(9)
December 31, 2003	**258**	**26**	**284**

NOTE 11 - PROPERTY, PLANT AND EQUIPMENT, NET

a) Changes in property, plant and equipment, gross

(in millions of euros)	Gross value Land	Buildings	Plant, equipment and tools	Other	Total
December 31, 2000	**249**	**2,816**	**6,911**	**1,965**	**11,941**
Additions	5	152	684	633	1,474
Disposals	(30)	(133)	(412)	(139)	(714)
Other changes	(35)	(598)	(1,565)	(805)	(3,003)
December 31, 2001	**189**	**2,237**	**5,618**	**1,654**	**9,698**
Additions	8	33	168	131	340
Disposals	(4)	(167)	(626)	(230)	(1,027)
Write-offs	(9)	(1)	(85)	(65)	(160)
Other changes	(11)	11	(272)	(343)	(615)
December 31, 2002	**173**	**2,113**	**4,803**	**1,147**	**8,236**
Additions	–	9	86	47	142
Disposals	(19)	(229)	(743)	(101)	(1,092)
Write-offs	–	(2)	(26)	–	(28)
Other changes	3	(100)	(532)	(312)	(941)
December 31, 2003	**157**	**1,791**	**3,588**	**781**	**6,317**

Property, plant and equipment acquired under capital leases and long-term rental arrangements account for less than 1% of the Group's total property, plant and equipment.

b) Changes in accumulated depreciation of property, plant and equipment

(in millions of euros)	Accumulated depreciation				
	Land	Buildings	Plant, equipment and tools	Other	Total
December 31, 2000	42	1,461	4,657	1,123	7,283
Depreciation charges	2	129	728	135	994
Write-backs	(6)	(92)	(363)	(117)	(578)
Other changes	(27)	(488)	(1,407)	(281)	(2,203)
December 31, 2001	11	1,010	3,615	860	5,496
Depreciation charges	2	111	572	102	787
Write-backs	6	(102)	(542)	(133)	(771)
Write-offs and exceptional depreciation charges	–	129	518	2	649
Other changes	–	(49)	(298)	(77)	(424)
December 31, 2002	19	1,099	3,865	754	5,737
Depreciation charges	1	124	295	58	478
Write-backs	(1)	(75)	(666)	(94)	(836)
Write-offs and exceptional depreciation charges	3	73	127	6	209
Other changes	(1)	(96)	(583)	(91)	(771)
December 31, 2003	21	1,125	3,038	633	4,817

c) Changes in property, plant and equipment, net

(in millions of euros)	Net value				
	Land	Buildings	Plant, equipment and tools	Other	Total
December 31, 2000	207	1,355	2,254	842	4,658
Additions	5	152	684	633	1,474
Net impact of disposals	(24)	(41)	(49)	(22)	(136)
Depreciation charges	(2)	(129)	(728)	(135)	(994)
Other changes	(8)	(110)	(158)	(524)	(800)
December 31, 2001	178	1,227	2,003	794	4,202
Additions	8	33	168	131	340
Net impact of disposals	(10)	(65)	(84)	(97)	(256)
Depreciation charges	(2)	(111)	(572)	(102)	(787)
Write-offs and exceptional depreciation charges	(9)	(130)	(603)	(67)	(809)
Other changes	(11)	60	26	(266)	(191)
December 31, 2002	154	1,014	938	393	2,499
Additions	–	9	86	47	142
Net impact of disposals	(18)	(154)	(77)	(7)	(256)
Depreciation charges	(1)	(124)	(295)	(58)	(478)
Write-offs and exceptional depreciation charges	(3)	(75)	(153)	(6)	(237)
Other changes	4	(4)	51	(221)	(170)
December 31, 2003	136	666	550	148	1,500

Note 12 - Share in net assets of equity affiliates and net assets and liabilities of disposed of or discontinued operations

a) Equity affiliates

	Percentage owned			Value in millions of euros		
	2003	2002	2001	2003	2002	2001
Avanex [(1)]	26.2	–	–	33	–	–
Shanghai Bell [(2)]	–	–	31.7	–	–	233
Altech [(3)]	–	–	40.0	–	–	10
Thales (former Thomson-CSF) [(4)]	9.5	9.7	15.8	128	129	292
Skybridge	49.9	49.9	49.9	–	–	3
Tesam [(5)]	–	–	49.0	–	–	–
Atlinks [(6)]	–	50.0	50.0	–	36	51
Nexans [(7)]	–	–	20.0	–	–	84
Other (less than € 50 million)	–	–	–	124	141	126
Total share of equity affiliates				**285**	**306**	**799**
Assets, net of liabilities, of discontinued operations [(8)]				106	–	–
Total				**391**	**306**	**799**

(1) In connection with the disposal of Alcatel's optical components business completed on August 1, 2003, Alcatel received 28% of the capital of Avanex in consideration for the assets contributed (see note 2). Following capital increases made by Avanex since August 1, 2003, Alcatel's stake is now 26.2%.
(2) As a result of the acquisition described in note 2, Alcatel's stake in Alcatel Shanghai Bell increased from 31.65% to 50% and one vote, and from July 1, 2002 this company is fully consolidated.
(3) Further to the acquisition of the minority interest, Altech is fully consolidated since October 1, 2002.
(4) Further to the disposals described in note 2, Alcatel's stake in Thales decreased from 25.29% to 20.03% in July 2001, to 15.83% in November 2001 and to 9.7% in September 2002. Alcatel confirms nevertheless its position as the largest private shareholder of Thales, with three seats on Thales' Board of Directors. Due to the Group's continuing significant influence on this company, Alcatel still accounts for Thales using the equity method. At December 31, 2003, Alcatel's stake was 9.5% (13.8% in voting rights).
(5) Tesam is no longer consolidated since April 1, 2001.
(6) Alcatel's interest in Atlinks was sold to Thomson in February 2003 (see note 2).
(7) Following the initial public offering of Nexans described in note 2, Nexans was accounted for under the equity method between January 1, 2001 and October 2002. After the disposal of shares in October 2002 (also described in note 2), Alcatel's interest in Nexans decreased from 20% to 15% and Alcatel no longer has a significant influence on Nexans. Therefore, Alcatel's remaining shares are reclassified as marketable securities.
(8) Relates to disposal in progress of SAFT (see note 2).

b) Information on equity affiliates

Summarized financial information for Thales at December 31:

(in millions of euros)	2003*	2002	2001
Balance sheet data			
Non-current assets		4,680	5,114
Current assets		13,529	14,237
Total assets		**18,209**	**19,351**
Shareholders' equity		2,139	2,146
Minority interests		29	28
Financial debt		2,376	3,317
Reserves and other liabilities		13,665	13,860
Total liabilities and shareholders' equity		**18,209**	**19,351**
Income statement data			
Net sales		11,105	10,268
Income from operations		447	471
Net income (loss)		111	(366)

* The 2003 figures had not been published when Alcatel's accounts were approved by its Board of Directors.

Summarized financial information for Nexans at December 31:

(in millions of euros)	2001
Balance sheet data	
Non-current assets	1,040
Current assets	1,908
Total assets	**2,948**
Shareholders' equity	1,096
Minority interests	104
Financial debt	348
Reserves and other liabilities	1,400
Total liabilities and shareholders' equity	**2,948**
Income statement data	
Net sales	4,777
Income from operations	139
Net income	30

Aggregated financial information for other equity affiliates as if those entities were fully consolidated:

(in millions of euros)	2003	2002	2001
Total assets	712	607	2,998
Shareholders' equity	336	151	1,188
Net sales	396	295	1,526
Net income (loss)	(91)	(70)	(69)

Note 13 - Other investments and miscellaneous, net

(in millions of euros)	2003 At cost	2003 Provision	2003 Net value	2002 Net value	2001 Net value
Investments in:					
. listed companies*	240	(239)	1	22	238
. unlisted companies	411	(202)	209	245	413
Total	**651**	**(441)**	**210**	**267**	**651**
Electro Banque / Customer loans and advances**	229	(5)	224	176	384
Other***	1,491	(1,103)	388	532	134
Total	**2,371**	**(1,549)**	**822**	**975**	**1,169**

* Market value 2003: € 8 million
2002: € 31 million
2001: € 490 million

** See note 28.

*** Change between 2001 and 2002 is mainly due to the loan buy-backs from the SVF trust and the inception of a deferred payment related to loans sold to this trust (see note 30b). The 2003 net value reflects a € 820 million reserve on 360 Networks bonds at December 31, 2003 (€ 820 million at December 31, 2002).

Investments in listed companies at December 31, 2003:

(in % and millions of euros)	% interest	Net value	Market value	Shareholders' equity*	Net income*
Loral**	2.2%	–	6	(280)	(1,298)
Other (less than € 10 million of net value)		1	2		
Total		**1**	**8**		

* Data set forth are at December 31, 2002, because financial data at December 31, 2003 are generally not published at the closing date of Alcatel's financial statements.

** Ordinary and preferred shares.

NOTE 14 - OPERATING WORKING CAPITAL

(in millions of euros)	12.31.2002	Cash flow	Change in consolidated companies	Translation adjustments and other	12.31.2003
Inventories and work in progress, net	3,723	(478)	(215)	(620)	2,410
Receivables and related accounts, net*	5,808	(1,264)	(112)	(632)	3,800
Advances and progress payments, net	147	(33)	(1)	(7)	106
Advances and customer deposits	(1,482)	206	11	84	(1,181)
Accounts payable and accrued expenses	(4,162)	404	75	66	(3,617)
Operating working capital requirement - gross	4,034	(1,165)	(242)	(1,109)	1,518
Valuation allowance	(2,486)		94	978	(1,414)
Operating working capital requirement - net	1,548	(1,165)	(148)	(131)	104

* Customer receivables sold without recourse amounted to € 898 million at December 31, 2003 (€ 1,010 million at December 31, 2002 and € 1,019 million at December 31, 2001).

NOTE 15 - INVENTORIES AND WORK IN PROGRESS, NET

(in millions of euros)	2003	2002	2001
Raw materials and goods	620	1,181	2,242
Industrial work in progress	589	696	1,233
Work in progress on long-term contracts	221	397	539
Finished products	980	1,449	2,255
Gross value	2,410	3,723	6,269
Valuation allowance	(978)	(1,394)	(1,588)
Net value	1,432	2,329	4,681

NOTE 16 - TRADE RECEIVABLES AND RELATED ACCOUNTS, NET

(in millions of euros)	2003	2002	2001
Receivables on long-term contracts	744	1,268	2,607
Receivables bearing interest	198	462	835
Other trade receivables	2,858	4,078	5,591
Gross value	3,800	5,808	9,033
Valuation allowance	(436)	(1,092)	(928)
Net value	3,364	4,716	8,105

NOTE 17 - OTHER ACCOUNTS RECEIVABLE, NET

(in millions of euros)	2003	2002	2001
Advances and progress payments	107	147	223
Prepaid taxes	257	351	612
Deferred taxes	2,011	2,156	3,099
Prepaid expenses	234	236	234
Advances made to employees	31	21	35
Other accounts	626	1,162	2,665
Gross value	3,266	4,073	6,868
Valuation allowance	(35)	(36)	(17)
Net value	3,231	4,037	6,851

NOTE 18 - MARKETABLE SECURITIES, NET

Marketable securities primarily consist of investments in money market instruments, bonds and other transferable securities.

The market value of these securities, excluding listed securities, was € 1,590 million at December 31, 2003, € 675 million at December 31, 2002 and € 500 million at December 31, 2001.

Following the disposal of 1,500,000 Nexans shares on October 30, 2002, the remaining interest of the Group in this company was reclassified as listed marketable securities at the market value on the day of the transaction, which was € 44 million. The Group believes that it no longer has a significant influence on this company.

The market value of the remaining interest in Nexans was € 92 million at December 31, 2003 and € 55 million at December 31, 2002.

NOTE 19 - ALLOCATION OF 2003 RESULT

The Board of Directors will propose to the shareholders' ordinary annual general meeting not to distribute any dividends for the December 31, 2003 fiscal year (distributions for previous years: no dividends were distribruted for 2002. For 2001: € 0.16 per share on 1,215,254,797 Class A shares existing on January 1, 2001, for an aggregate distribution of € 194 million and € 0.10 per share on 25,515,000 Class O shares, for an aggregate distribution of € 2.6 million).

The Board of Directors will also propose to the shareholders' ordinary annual general meeting to allocate the net loss for the year and part of prior year losses to reserves and additional paid-in capital.

NOTE 20 - SHAREHOLDERS' EQUITY

a) Capital increase program for employees with subscription stock option plan

Under a capital increase program reserved for employees of the Group, approved by the Board of Directors on March 7, 2001, 91,926 Class A shares were issued at a price of € 50 per share. Each share subscribed included the right to receive three options, each exercisable for one Class A share. 275,778 options were granted and are exercisable during a period of one year from July 1, 2004 or from the end of the unavailability period set by article 163 bis C of the General Tax Code (4 years on this date), for the beneficiaries who were employees of a member of the Group whose registered office is located in France at the time the options were granted.

b) Capital stock and additional paid-in capital

At December 31, 2003 and further to the conversion of Class O shares into Class A shares, on a one-for-one basis, as approved at the shareholders' meeting of April 17, 2003, the capital stock consisted of 1,284,410,224 ordinary shares of nominal value € 2 (1,239,193,498 Class A shares of nominal value € 2 and 25,515,000 Class O shares of nominal value € 2 at December 31, 2002 and 1,215,254,797 Class A shares of nominal value € 2 and 25,515,000 Class O shares of nominal value € 2 at December 31, 2001).

During 2003, increases in capital stock and additional paid-in capital amounted to € 157 million. These increases relate to the following actions:

- issuance of 108,632 shares for € 0.8 million corresponding to the exercise of 108,632 options (including additional paid-in capital of € 0.6 million),
- acquisition of iMagic TV in April 2003, which resulted in the issuance of 3,301,322 shares for € 24 million (including additional paid-in capital of € 18 million). In addition, of the 415,922 bonds redeemable for Alcatel shares issued in this transaction by Coralec (a subsidiary of Alcatel) at a price of € 7.44, to cover the exercise of options and the conversion of notes, 230,000 bonds were redeemed by the issuance of an equal number of Alcatel shares, generating a capital increase of € 2 million, including additional paid-in capital of € 1 million,
- acquisition of TiMetra in July 2003, which resulted in the issuance of 14,378,738 shares for € 116.2 million (including additional paid-in capital of € 87 million). In addition, of the 3,601,000 bonds redeemable for Alcatel shares issued in this transaction by Coralec (subsidiary of Alcatel) at the price of € 8.08 euros, 1,156,196 bonds were redeemed by the issuance of an equal number of Alcatel shares, generating a capital increase of € 9.3 million, including additional paid-in capital of € 7 million,
- redemption of 40,000 and 485,000 bonds redeemable for Alcatel shares issued in relation to the acquisitions of Astral Point in 2002 and Kymata in 2001, generating capital increases of € 0.7 million, including additional paid-in capital of € 0.6 million, and € 3.3 million, including additional paid-in capital of € 2.4 million, respectively,
- ORANE redemption of 1,828 bonds issued in 2002 and redeemable for new or existing Alcatel shares, generating a capital increase of € 9 thousand, including additional paid-in capital of € 6 thousand.

c) Stock options

At December 31, 2003, stock options plans were as follows:

(in number of options)	1996 Plans		1997 Plans		1998 Plans	1999 Plans	1999-2000 U.S. Plans	2000 Plans			
Exercise price	€ 12.96	€ 13.42	€ 19.27	€ 20.95	€ 20.52	€.28.40	USD 21.40 USD 84.88	€ 48.00	€ 48.00	€ 65.00	€ 64.00
Exercise period From	07.01.98	07.01.98	05.01.02	12.11.02	12.09.03	09.08.04		04.01.03 04.01.05	07.01.03 07.01.05	12.13.03 12.13.05	12.13.01 12.13.04
To	12.31.03	12.31.03	12.31.04	12.31.04	12.31.05	12.31.05		12.31.05 12.31.07	06.30.04 06.30.06	12.31.05 12.31.07	12.12.08 12.12.08
Outstanding at January 1, 1996	–	–	–	–	–	–	–	–	–		
Granted	9,069,500	394,000	–	–	–	–	–	–	–		
Exercised	–	–									
Forfeited	(185,000)	–	–	–	–	–	–	–	–		
Expired	–	–	–	–	–	–	–	–	–		
Outstanding at December 31, 1996	8,884,500	394,000	–	–	–	–	–	–			
Granted	–	–	8,199,500	367,000	–						
Exercised	–	–	–	–	–	–	–	–	–		
Forfeited	(396,000)	(7,500)	(115,000)	–	–	–	–	–	–		
Expired	–	–	–	–	–	–	–	–	–		
Outstanding at December 31, 1997	8,488,500	386,500	8,084,500	367,000	–	–	–	–	–		
Granted	–	–	–	–	11,602,500	–		–	–		
Exercised	(2,163,950)	(114,000)	–	–	–	–	–	–	–		
Forfeited	(30,500)	(5,000)	(45,000)	(5,000)	–	–	–	–	–		
Expired	–	–	–	–	–	–	–	–	–		
Outstanding at December 31, 1998	6,294,050	267,500	8,039,500	362,000	11,602,500	–		–			
Granted	–	–	–	–	–	545,000	7,866,630				
Exercised	(1,630,425)	(38,250)	(35,000)	–	–	–	–	–	–		
Forfeited	(5,000)	–	(100,000)	(7,500)	(427,250)	–	(143,650)	–	–		
Expired	–	–	–	–	–	–	–	–	–		
Outstanding at December 31, 1999	4,658,625	229,650	7,904,500	354,500	11,175,250	545,000	7,722,980	–	–		
Granted	–	–	–	–	–	–	19,407,838	15,239,250	8,905,804	1,235,500	306,700
Exercised	(1,277,690)	(92,750)	(56,000)	–	–	–	(393,296)	(10,000)	–	–	–
Forfeited	–	–	(112,500)	(2,500)	(412,000)	(46,250)	(3,060,818)	(923,120)	(47,328)	–	–
Expired	–	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2000	3,380,935	136,500	7,736,000	352,000	10,763,250	498,750	23,676,704	14,306,130	8,858,476	1,235,500	306,700
Exercised	(732,728)	(1,250)	(15,000)	–	–	–	(261,205)	(3,000)	(376)	–	–
Forfeited	–	–	(30,000)	–	(60,000)	(5,000)	(3,327,376)	(161,500)	(122,364)	(130,150)	(3,600)
Expired	–	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2001	2,648,207	135,250	7,691,000	352,000	10,703,250	493,750	20,088,123	14,141,630	8,735,736	1,105,350	303,100
Exercised	(6,577)	–	(1,000)	–	–	–	–	–	–	–	–
Forfeited	(12,000)	–	(157,500)	(30,000)	(306,000)	(22,500)	(3,871,401)	(581,075)	(37,684)	(40,000)	(5,100)
Expired	–	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2002	2,629,630	135,250	7,532,500	322,000	10,397,250	471,250	16,216,722	13,560,555	8,698,052	1,065,350	298,000
Exercised	–	–	–	–	–	–	–	–	–	–	–
Forfeited	(27,500)	–	(40,000)	(10,000)	(165,000)	(17,500)	(2,797,641)	(320,500)	(6,524)	(32,500)	(86,421)
Expired	–	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2003	2,602,130	135,250	7,492,500	312,000	10,232,250	453,750	13,419,081	13,240,055	8,691,528	1,032,850	211,579

(in number of options)					2001 Plans					
Exercise price	€ 50.00	€ 50.00	€ 41.00	€ 39.00	€ 32.00	€ 19.00	€ 9.00	€ 20.80	€ 9.30	€ 20.80
Exercise period From	03.07.02 03.07.05	07.01.04 07.01.05	04.02.02	04.02.02	06.15.02 06.15.05	09.03.02 09.03.05	11.15.02 11.15.05	12.19.02 12.19.05	12.19.02 12.19.05	01.01.05 01.01.06
To	03.06.09 03.06.09	06.30.05 06.30.06	04.01.09	04.01.09	06.14.09 06.14.09	09.02.09 09.02.09	11.14.09 11.14.09	12.18.09 12.18.09	12.18.09 12.18.09	12.31.05 12.31.06
Granted	37,668,588	275,778	48,850	2,500	977,410	138,200	162,000	27,871,925	565,800	935,660
Exercised	–	–	–	–	–	–	–	–	–	–
Forfeited	(1,075,160)	(825)	(7,050)	–	(19,350)	–	–	–	–	–
Expired	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2001	36,593,428	274,953	41,800	2,500	958,060	138,200	162,000	27,871,925	565,800	935,660
Exercised	–	–	–	–	–	–	–	–	–	–
Forfeited	(1,271,749)	(2,343)	(5,500)	–	(21,175)	(10,300)	(30,000)	(2,283,225)	(37,200)	(16,840)
Expired	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2002	35,321,679	272,610	36,300	2,500	936,885	127,900	132,000	25,588,700	528,600	918,820
Exercised	–	–	–	–	–	–	–	–	(64,444)	–
Forfeited	(6,345,632)	(150)	(24,050)	–	(119,780)	(13,050)	(23,000)	(2,517,719)	(68,750)	(23,950)
Expired	–	–	–	–	–	–	–	–	–	–
Outstanding at December 31, 2003	28,976,047	272,460	12,250	2,500	817,105	114,850	109,000	23,070,981	395,406	894,870

(in number of options)			2002 Plans					
Exercise price	€ 17.20	€ 16.90	€ 14.40	€ 13.30	€ 5.20	€ 3.20	€ 4.60	€ 5.40
Exercise period From	02.15.03 02.15.06	04.02.03	05.13.03 05.13.06	06.03.03 06.03.06	09.02.03 09.02.06	10.07.03 10.07.06	11.14.03 11.14.06	12.02.03 12.02.06
To	02.14.10 05.14.10	04.01.10	05.12.10 05.12.10	06.02.10 06.02.10	06.01.10 06.01.10	10.06.10 10.06.10	11.13.10 11.13.10	12.01.10 12.01.10
Granted	123,620	55,750	54,300	281,000	1,181,050	30,500	111,750	54,050
Exercised	–	–	–	–	–	–	–	–
Forfeited	(14,250)	(1,000)	–	(17,660)	(64,250)	–	–	–
Expired	–	–	–	–	–	–	–	–
Outstanding at December 31, 2002	109,370	54,750	54,300	263,340	1,116,800	30,500	111,750	54,050
Exercised	–	–	–	–	(32,182)	(853)	(3,375)	–
Forfeited	(20,425)	(13,000)	(5,250)	(14,090)	(165,232)	(9,138)	(4,250)	(10,250)
Expired	–	–	–	–	–	–	–	–
Outstanding at December 31, 2003	88,945	41,750	49,050	249,250	919,386	20,509	104,125	43,800

(in number of actions)			2003 Plans					
Excercise price	€ 6.70	€ 6.70	€ 7.60	€ 8.10	€ 9.30	€ 10.90	€ 11.20	€ 11.10
Exercise period From	03.07.04 03.07.07	07.01.06 07.01.07	06.18.04 06.18.07	07.01.04 07.01.07	09.01.04 09.01.07	10.01.04 10.01.07	11.14.04 11.14.07	12.01.04 12.01.07
To	03.06.11 03.03.11	06.30.07 06.30.08	06.17.11 06.17.11	06.30.11 06.30.11	08.31.11 08.31.11	09.30.11 09.30.11	11.13.11 11.13.11	11.30.11 11.30.11
Granted	25,626,865	827,348	338,200	53,950	149,400	101,350	63,600	201,850
Exercised	(7,750)	(28)	–	–	–	–	–	–
Forfeited	(1,583,230)	(17,193)	–	–	–	–	–	–
Expired	–	–	–	–	–	–	–	–
Outstanding at December 31, 2003	24,035,885	810,127	338,200	53,950	149,400	101,350	63,600	201,850

The option plans of companies that were acquired by Alcatel provide for the issuance of Alcatel shares or ADSs upon exercise of options granted under such plans in an amount determined by applying the exchange ratio used in the acquisition to the number of shares of the acquired company which were the subject of the options (see the following table).

The following table sets forth the U.S. and Canadian companies, the range of exercise prices, the number of outstanding and exercisable options as of December 31, 2003, the weighted average exercise price and the weighted average exercise period.

		Outstanding options			Exercisable options	
Company	**Exercise price**	**Number outstanding at 12.31.2003***	**Weighted remaining exercise period (years)**	**Weighted average exercise price**	**Amount exercisable at 12.31.2003**	**Weighted average exercise price**
Packet Engines	USD 0.29-USD 0.86	14,372	3.89	0.50	14,372	0.50
Xylan	USD 0.05-USD 18.14	2,598,583	4.06	8.69	2,596,207	8.69
Internet Devices Inc	USD 0.26-USD 1.17	26,480	4.83	0.89	26,480	0.89
DSC	USD 16.57-USD 44.02	113,003	2.67	30.78	113,003	30.78
Genesys	USD 0.01-USD 41.16	4,066,893	5.27	20.41	4,048,505	20.32
Newbridge	USD 11.72-USD 52.48	6,331,420	3.76	33.35	6,331,420	33.35
Astral Point	EUR 0.29-EUR 58.71	439,540	7.44	17.08	308,395	19.57
Telera	EUR 0.43-EUR 6.36	273,596	7.06	5.44	196,757	5.13
iMagic TV	EUR 2.84-EUR 64.68	198,955	3.26	13.35	114,429	14.54
TiMetra	EUR 0.53-EUR 7.97	2,858,957	6.58	4.43	772,715	0.61
Total number of options		16,921,799			14,522,283	

* In number of Alcatel shares.

Except in the case of Astral Point, Telera, iMagic TV and TiMetra, upon exercise, Alcatel will not issue new ADSs (or, consequently, shares); the options set forth in the above table entitle the holders to purchase existing ADSs held by Group subsidiaries.

The existing option plans of Alcatel Optronics U.K. Ltd. (formerly Kymata Ltd) acquired in September 2001, provided for the issuance of up to 402,595 class O ADSs or Alcatel O shares at an exercise price ranging from € 0.80 to € 35.15. As part of the disposal of its optical components business, these stock option plans were transferred to Avanex.

d) Distributable retained earnings

Not all consolidated retained earnings are available for the distribution of dividends, due primarily to the impact of consolidation adjustments. At December 31, 2003, Alcatel, the parent company, had distributable retained earnings of € 1,873 million. Distributable retained earnings were € 0 million at December 31, 2002 and € 5,594 million at December 31, 2001.

e) Treasury stock

Alcatel has established a buy-back program authorized at the shareholders' ordinary annual general meetings held on May 3, 2001, April 18, 2002 and April 17, 2003, both for the class A shares and class O shares, in order to optimize return on equity and to carry out transactions to improve earnings per share. The purchases may only relate up to a maximum of 10% of the capital stock over a period of up to 18 months from the most recent shareholders' general meeting. As part of this program, no shares had been purchased as of December 31, 2003 (no shares had been purchased as of December 31, 2002 and 30,343,255 shares had been purchased as of December 31, 2001 for a total of € 565 million).

Alcatel shares owned by Group consolidated subsidiaries, which amounted to € 1,728 million at December 31, 2003 (€ 1,734 million at December 31, 2002 and € 1,842 million at December 31, 2001), are deducted at cost from consolidated retained earnings.

Note 21 - Minority interests

(in millions of euros)	
Balance at December 31, 2000	**435**
Other changes*	(221)
Minority interests in 2001 income	5
Balance at December 31, 2001	**219**
Other changes**	106
Minority interests in 2002 income	18
Balance at December 31, 2002	**343**
Other changes	–
Minority interests in 2003 income	20
Balance at December 31, 2003	**363**

* Of which € (48) million related to the disposal of Nexans and € (160) million related to the buy-back of the minority interests of Alcatel Space.

** Of which € 252 million related to the consolidation of Alcatel Shanghai Bell.

Note 22 - Notes mandatorily redeemable for shares

On December 19, 2002, Alcatel issued 120,786,517 bonds, of nominal value € 5.34 each, mandatorily redeemable for new or existing shares (ORANE) (one share for one bond), for a total amount of € 645 million, with a maturity date of December 23, 2005. The notes carry an annual interest rate of 7.917%. On January 2, 2003, Alcatel paid the full amount of the discounted interest, calculated from the settlement date to the maturity date at a discount rate of 7.917%, which amounted to € 1.09115 for each bond.

For the repayment of the ORANEs, Alcatel may either issue new shares, use treasury shares held by consolidated companies, or shares acquired not for cash but in connection with restructuring operations.

During 2003, 2,338 bonds were repaid by issuance of 1,828 shares (the difference corresponding to the reimbursement of prepaid interest by the bondholders).

Interest due on the ORANEs for 2003 amounted to € 47 million. Pre-paid interest of € 83 million is recorded in other accounts receivable and is shown in the Consolidated Statements of Cash Flows under the heading "Net cash provided (used) by operating activities (increase/decrease in other receivables and debts)".

Note 23 - Pensions, retirement indemnities and other post-retirement benefits

In accordance with the laws and customs of each country, the Group provides to its employees pension plans, medical insurance and reimbursement of medical expenses. In France, Group employees benefit from a retirement indemnity plan. In other countries, the plans depend upon local legislation, the business and the historical practice of the subsidiary concerned.

Over and above state pension plans, the plans can be defined contribution plans or defined benefit plans. In the latter case, the plans are wholly or partially funded by assets solely to support such plans (securites, bonds, insurance contracts or other types of dedicated investments).

State plans

In certain countries, and more particularly in France and Italy, the Group participates in state plans, for which contributions expensed correspond to the contributions due to the state organizations.

Defined contribution plans

The benefits paid out depend solely on the amount of contributions paid into the plan and the investment returns arising from the contributions. The Group's obligation is limited to the amount of contributions that are expensed.

Defined benefit plans

Independent actuaries calculate annually the Group's obligation in respect of these plans, using the projected unit credit method. Actuarial assumptions comprise mortality, rates of employee turnover and projection of future salary levels. Future estimated benefits are discounted using discount rates appropriate to each country. The discount rates are determined by reference to market yields on government bonds and high quality corporate bonds.

These plans have differing characteristics :

- perpetual annuity : the retirees benefit from the receipt of a pension during the whole of their retirement. These plans are to be found primarily in Germany, United Kingdom and the United States,
- lump-sum payment on the employee's retirement or departure : in France, an employee leaving for retirement benefits from an end-of-career indemnity. In Italy, an employee departing from the Group receives a TFR indemnity ("trattamento di fine rapporto"),
- post-employment medical care during retirement: in the United States, Alcatel contributes to plans that reimburse medical expenses of retired employees.

a) Pensions and retirement indemnities

Pensions and retirement obligations are determined in accordance with the accounting principles presented in note 1i).

For defined benefit plans requiring an actuarial valuation, actuaries have determined general assumptions on a country-by-country basis and specific assumptions (rate of employee turnover, salary increases) company by company. The assumptions for 2003, 2002 and 2001 are as follows (the rates indicated are weighted average rates):

	2003	2002	2001
Discount rate	4.81%	5.75%	5.93%
Future salary increases	3.55%	3.72%	3.89%
Expected long-term return on assets	4.50%	4.47%	5.13%
Average residual active life	15-27 years	15-27 years	15-27 years
Amortization period of transition obligation	15 years	15 years	15 years

The above rates are broken down by geographical segment as follows for 2003 and 2002:

2003	Discount rate	Future salary increases	Expected long-term return on assets
France	4.30%	2.25%	3.42%
Germany	4.80%	3.00%	5.81%
Rest of Europe	4.83%	4.27%	4.02%
North America	5.28%	4.00%	7.01%
Other	5.12%	4.19%	4.92%
2002			
France	5.50%	2.57%	5.00%
Germany	6.00%	2.98%	7.00%
Rest of Europe	5.36%	4.64%	3.59%
North America	6.50%	4.93%	7.40%
Other	6.45%	5.11%	5.98%

The discount rates are obtained by reference to market yelds on high quality bonds having maturity dates equivalent to those of the plans.

The returns on plan assets depend upon the make-up of the investment portfolio, the maturity dates of the assets and the expected future performance.

Components of net periodic cost:

(in millions of euros)	2003	2002	2001
Service cost	96	138	130
Interest cost	153	180	181
Expected return on plan assets	(95)	(110)	(121)
Amortization of transition obligation	(2)	(2)	(1)
Amortization of prior service cost	5	5	4
Amortization of recognized actuarial gain/(loss)	(19)	(11)	4
Effect of curtailments	(55)	(35)	(3)
Effect of settlements	23	23	41
Special termination benefits	1	(1)	(4)
Net periodic benefit cost	**107**	**187**	**231**
Of which operational costs	37	117	171
financial costs	70	70	60

The change in the obligation recorded in the balance sheet is as follows:

(in millions of euros)	2003	Retirement obligations 2002	2001
CHANGE IN BENEFIT OBLIGATION			
Benefit obligation at beginning of year	3,270	3,305	4,080
Service cost	96	138	131
Interest cost	153	180	181
Plan participants' contributions	5	8	8
Amendments	23	101	23
Business combinations	–	1	8
Disposals	(36)	(157)	(741)
Curtailments	(73)	(73)	–
Settlements	(65)	(44)	(90)
Special termination benefits	1	(1)	(5)
Actuarial loss/(gain)	211	139	(143)
Benefits paid	(186)	(250)	(184)
Other (foreign currency translation)	(117)	(77)	37
Benefit obligation at end of year	3,282	3,270	3,305
CHANGE IN PLAN ASSETS			
Fair value of plan assets at beginning of year	2,137	2,281	2,904
Actual return on plan assets	91	(36)	(47)
Employers' contribution	68	103	81
Plan participants' contributions	5	8	8
Amendments	4	78	15
Business combinations	–	19	(1)
Disposals	(5)	(71)	(478)
Curtailments	(3)	–	–
Settlements	(61)	(83)	(100)
Benefits paid/Special termination benefits	(108)	(129)	(133)
Other (foreign currency translation)	(78)	(33)	32
Fair value of plan assets at end of year	2,050	2,137	2,281
Funded status	(1,232)	(1,133)	(1,024)
Unrecognized actuarial loss/(gain)	162	45	(118)
Unrecognized transition obligation	(3)	2	(6)
Unrecognized prior service cost	63	70	28
NET AMOUNT RECOGNIZED	(1,010)	(1,016)	(1,120)
Actuarial obligation excluding effect of salary increases	2,825	2,852	2,839
Effect of salary increases	457	418	466
Benefit obligation at end of year	3,282	3,270	3,305

The unfunded status, which amounted to € 1,232 million at December 31, 2003 (€ 1,133 million at December 31, 2002 and € 1,024 million at December 31, 2001), relates primarily to France and Germany. Decisions on funding the benefit obligations are taken based on each country's legal requirements and the tax-deductibility of the contributions made. In France and Germany, the funding of pension obligations relies primarily on defined contribution plans; setting up other funding arrangements is not common practice. Furthermore, in Germany, the benefits accruing to employees are guaranteed in the event of bankruptcy through a system of mutual insurance common to all companies involved in similar plans.

Plan assets are invested as follows:

(in millions of euros and percentage)	Private and public bonds	Equity shares	Marketables securities	Property assets	Total
2001	912	950	201	218	2,281
	40%	*41%*	*9%*	*10%*	*100%*
2002	952	597	390	198	2,137
	45%	*28%*	*18%*	*9%*	*100%*
2003	845	546	372	287	2,050
	41%	*27%*	*18%*	*14%*	*100%*

The investment policy relating to plan assets within the Group depends upon local practices. In all cases, the proportion of equity shares cannot exceed 80% of plan assets and no individual equity share may represent more than 5% of total equity shares within the plan. The equity shares held by the plan must be listed on a recognized exchange.

The bonds held by the plan must have a minimum "A" rating according to Standard & Poor's or Moody's rating criteria.

Marketable securities must also have a long-term minimum "A" rating according to Standard & Poor's or Moody's rating criteria.

b) Other post-retirement benefits

The recording of a provision for other post-retirement benefits is not mandatory under French GAAP. These post-retirement benefits or obligations relate primarily to North American employees for medical insurance and life insurance. Such benefits are only recorded in the financial statements prepared in accordance with U.S. GAAP.

However, in accordance with the "Conseil National de la Comptabilité" (CNC)'s recommendation No. 2003-R1, and in view of the changeover in 2005 to International Financial Reporting Standards to be adopted by all European listed companies (standards under which the recording of such post-retirement benefits is mandatory), it is envisaged to account for such benefits with effect from January 1, 2004. Early accounting for these obligations as of 2003 has been excluded due to significant changes to the initial agreements that occurred at the end of 2003; the accounting treatment of such changes was under review at year-end.

At December 31, 2003, before taking into account positive impacts arising from the changes to the above-mentioned initial agreements, these deferred obligations represented an after-tax amount of € 51 million (€ 56 million at December 31, 2002 and € 61 million at December 31, 2001).

Note 24 - Other reserves

a) Balance at closing

(in millions of euros)	2003	2002	2001
Reserves for product sales	1,203	1,489	1,818
Reserves for restructuring	1,068	919	1,113
Other reserves	778	893	1,223
Total	3,049	3,301	4,154

Reserves for product sales relate primarily to warranties, contract losses and penalties relating to commercial contracts.

In 2003, and following the CNC's recommendation No. 2003-R1, long-service awards are accounted for in other reserves (see note 1), resulting in an impact in other expense of € 34.2 million (accounted for at January 1, 2003) and a reduction in the reserve for 2003 of € 0.3 million (accounted for in income (loss) from operations).

b) Change during 2003

(in millions of euros)	12.31.02	Appropriation	Used	Reversals	Change in consolidated companies	Other	12.31.03
Reserves for product sales	1,489	604	(331)	(453)	(52)	(54)	1,203
Reserves for restructuring	919	1,181	(980)	(21)	(20)	(11)	1,068
Other reserves	893	141	(106)	(105)	(91)	46	778
Total	3,301	1,926	(1,417)	(579)	(163)	(19)	3,049
Effect on the income statement (net of expenses booked):							
- income from operations		(619)		475			(144)
- financial income		(40)		18			(22)
- restructuring costs		(1,181)		21			(1,160)
- other revenue (expense)		(70)		56			(14)
- taxes		(16)		9			(7)
Total		(1,926)		579			(1,347)

c) Analysis of reserves for restructuring

(in millions of euros)	2003	2002	2001
Opening balance	919	1,113	442
Expensed during year	(980)	(1,105)	(665)
New plans and adjustments to previous estimates	1,160	1,081	1,389
Effect of acquisition (disposal) of consolidated subsidiaries	(20)	(41)	(62)
Currency translation adjustments and others	(11)	(129)	9
Closing balance	1,068	919	1,113

* In 2003, restructuring costs amounted to € 1,314 million, of which € 154 million related to asset write-offs and € 1,160 million related to new plans and adjustments to previous estimates (in 2002, restructuring costs amounted to € 1,474 million, of which € 393 million related to asset write-offs and € 1,081 million related to new plans and adjustments to previous estimates).

For 2003, restructuring reserves related mainly to concern costs linked to continuing layoffs in France, Italy, Spain, Germany and the United States.

For 2002, the restructuring reserves related mainly to:

- costs linked to the continuation of restructuring in the United States (carrier networking activities),
- costs linked to the continuation of layoffs in European activities (carrier networking activities),
- costs linked to restructuring in the optics division, mainly optronics and optical fiber.

For 2001, the restructuring reserves related mainly to:

- costs relating to outsourcing of Alcatel's GSM handsets to Flextronics (the € 87 million receivable from disposal of inventories to Flextronics is recorded in "other accounts receivable"),
- severance costs and asset write-offs linked to restructuring in the United States,
- closing costs of the SAFT factory in Tijuana, Mexico,
- costs relating to the announced reorganization of the optics division,
- costs linked to restructuring in European activities.

Note 25 - Financial debt

On December 31, 2003, outstanding Alcatel bonds amounted to € 4,804 million compared to € 5,325 million a year before. This is the result of the following transactions in 2003:

(in millions of euros)		Maturing in 2003	Maturing after 2003
Convertible bond issue (OCEANE)	1,022	–	1,022
Tender offer to repurchase bonds	(342)	–	(342)
Buy-back of bonds from the market	(645)	(287)	(358)
Repayments	(556)	(556)	–
Total repurchases, buy-backs and repayments	(1,543)	(843)	(700)

a) Analysis of debt by type

(in millions of euros)	2003	2002	2001
Convertible bonds	1,022	–	–
Bonds	3,782	5,325	5,969
Bank loans and overdrafts	313	244	1,454
Capital lease obligations	57	80	105
Accrued interest	119	134	147
Total	5,293	5,783	7,675

Convertible bonds

On June 12, 2003, Alcatel issued 63,192,027 bonds having a nominal value of € 16.18 each, convertible into new or existing Alcatel ordinary shares (OCEANE) for a total value of € 1,022 million. These bonds mature on January 1, 2011 and bear interest at a rate of 4.75% per annum.

Other bonds

During 2003, € 987 million of bonds were repurchased and cancelled. These buy-backs are detailed in the following notes.

2003 tender offer to repurchase bonds

Following the issuance of bonds convertible into new or existing Alcatel ordinary shares (OCEANE) referred to above, and with the aim of extending the maturity dates of its financial debt, Alcatel announced on June 16, 2003 a tender offer to bondholders to repurchase part of the bonds of three debt issues maturing in 2004 and 2005. This offer, which began on June 16, 2003, was made by way of bookbuilding by institutional investors, followed by a fixed price offer to individuals. By the expiration date of the offer, Alcatel had purchased € 352 million of bonds, having a nominal value of € 342 million. The difference between the purchase price and the nominal value has been included in financial income (costs).

The result of this offer is set out in the following table:

Repurchased bonds	Nominal value repurchased
5.75% FRF February 2004	€ 72,722,746
5% EUR October 2004	€ 108,912,000
5.875% EUR September 2005	€ 160,701,000

The offer closed on July 7, 2003.

Other changes in 2003

In addition to the tender offer to repurchase bonds, certain other bonds were subject to buy-back and cancellation in 2003, amounting to € 642 million, corresponding to a nominal value of € 645 million, detailed as follows:

Maturity date	
September 2003	€ 287,167,000
February 2004	€ 30,902,972
October 2004	€ 31,855,000
September 2005	€ 45,878,000
December 2006	€ 110,025,000
March 2007	€ 35,342,277
February 2009	€ 103,250,000

The difference between the repurchased amount and the nominal value was also included in financial income (costs).

Other changes for 2003 were as follows:

– repayment on September 12, 2003 of the residual € 271 million on € 600 million in floating rate bonds issued by Alcatel in September 2000,

– repayment on October 22, 2003 of the residual € 284 million on € 305 million in bonds at a fixed rate of 6.375% issued by Alcatel in October 1993.

The main changes for 2002 were as follows:

– repayment on March 20, 2002 of the residual Yen 28 billion (€ 243 million) on the initial Yen 30 billion bond issued by Alcatel in March 2000,

– repayment on June 20, 2002 of the residual € 315 million on € 600 million in floating rate bonds issued by Alcatel in June 2000,

– buy-back and cancellation of bonds in the amount of € 86 million (€ 41 million related to bonds maturing in September 2003, € 21 million related to bonds maturing in October 2003, € 17 million related to bonds maturing in February 2004 and € 7 million related to bonds maturing in February 2009).

The main changes for 2001 were as follows:

– issuance by Alcatel, on December 7, 2001, of € 1.2 billion in bonds at a 7% fixed rate and maturing on December 7, 2006,

– issuance by Alcatel, on December 3, 2001, of an additional € 120 million of the € 1 billion bonds issued in February 1999, bearing interest at a rate of 4.375% and maturing on February 17, 2009,

– issuance of a 40 million Singapore dollars in bonds (€ 25 million) bearing interest at a 4% rate and maturing on October 11, 2004,

– repayment on October 31, 2001, of Yen 2 billion (€ 18 million) on Yen 30 billion in bonds (€ 280 million) issued by Alcatel in March 2000 and maturing on March 20, 2002,

– repayment on December 20, 2001, of € 285 million on € 600 million in bonds with a floating rate (Euro OverNight Index Average + 24 basis points) issued by Alcatel on June 20, 2000 and maturing on June 20, 2002.

b) Analysis by maturity date

(in millions of euros)	2003
Short-term financial debt	883
2005	847
2006	1,308
2007	223
2008	–
2009 and thereafter	2,032
Long-term financial debt	4,410
Total	5,293

c) Debt analysis by rate

(in millions of euros)		2003		2002
	Before hedging	After hedging	After hedging	Before hedging
Total fixed rate debt	5,100	1,297	4,927	1,800
Total floating rate debt	193	3,996	856	3,983
Total	**5,293**	**5,293**	**5,783**	**5,783**

At December 31, 2003, the weighted average interest rate of financial debt before accounting for hedging instruments was 5.6%.

At December 31, 2003, the weighted average interest rate of financial debt after accounting for hedging instruments was 4%.

d) Debt analysis by currency

(in millions of euros)		2003		2002
	Before hedging	After hedging	Before hedging	After hedging
Euro	5,143	5,161	5,597	3,530
U.S. dollar	86	86	90	2,093
Other	64	46	96	160
Total	**5,293**	**5,293**	**5,783**	**5,783**

e) Fair value

The fair value of Alcatel's debt is determined for each loan by discounting the future cash flows using a discount rate corresponding to bond yields at end of the year, adjusted by the Group's credit rate risk. The fair value of the interest rate derivatives designated as hedging instruments for the debt has also been calculated by discounting the future cash flows using interest rates current at year-end.

At December 31, 2003, the fair value of debt before hedging amounted to € 5,574 million.

After hedging, the fair value amounts to € 5,409 million.

f) Credit rating and financial covenants

As of January 12, 2004, Alcatel credit ratings were as follows:

Rating Agency	Long-term Debt	Short-term Debt	Outlook	Last Update
Standard & Poor's	B +	B	Stable	August 11, 2003
Moody's	B1	Not Prime	Stable	December 5, 2003

During 2003, the two agencies decided to revise their rating outlook for Alcatel from negative to stable..

Recent history of Alcatel's long-term debt credit rating

Date	Standard & Poor's		Date	Moody's	
August 11, 2003	B +	Outlook Stable	December 5, 2003	B1	Outlook Stable
October 4, 2002	B +	Outlook Negative	November 20, 2002	B1	Outlook Negative
July 12, 2002	BB +	Outlook Negative	July 9, 2002	Ba1	Outlook Negative
November13, 2001	BBB	Outlook Negative	February 18,2002	Baa2	Outlook Negative

Rating clauses affecting Alcatel debt at December 31, 2003

Alcatel's short-term debt rating allows a very limited access to the commercial paper market. Alcatel's outstanding bonds do not contain clauses that could trigger an accelerated repayment in the event of a lowering of its credit ratings. However, the € 1.2 billion bond issue maturing in December 2006 includes a "step up rating change" clause, which provides that the interest rate is increased by 150 basis points if Alcatel's ratings fall below investment grade. This clause was triggered when Alcatel's credit rating was lowered to below investment grade status in July 2002. The 150 basis point increase in the interest rate from 7% to 8.5% became effective in December 2002, and applied to the payment of the December 2003 coupon. This bond issue also contains a "step down rating change" clause that provides that the interest rate will be decreased by 150 basis points if Alcatel's ratings move back to investment grade.

Syndicated facility

On April 9, 2002, Alcatel closed a € 2,075 million syndicated credit facility available for general corporate purposes. At the same time, the existing outstanding undrawn bilateral credit lines were cancelled. The facility comprised a three-year tranche of € 1,375 million and a 364-day tranche of € 700 million that expired, undrawn, on April 9, 2003.

The availability of this syndicated credit facility of € 1,375 million is not dependent upon Alcatel's credit ratings. At December 31, 2003, the credit facility had not been drawn and remained undrawn at the date of approval of the financial statements by the Board of Directors. Alcatel's ability to draw on this facility is conditioned upon its compliance with certain financial covenants (which are identical to the financial covenants relating to the SVF trust vendor financing securitization program). The facility contains two financial covenants, the first is a gearing ratio (net debt/equity including minority interests) and the second is a ratio linked to the capacity of Alcatel to generate sufficient cash to repay its debt. Alcatel was in compliance with these financial covenants at December 31, 2003. As the Group had cash and cash equivalents in excess of its gross financial debt at December 31, 2003, the above-mentioned ratios were not applicable at year-end.

NOTE 26 - MARKET-RELATED EXPOSURES

The Group has a centralized treasury management in order to minimize the Group's exposure to market risks, including interest rate risk, foreign exchange risk, and counterparty risk. The Group uses derivative financial instruments primarily to manage its exposure to fluctuations in interest rates and foreign exchange rates.

Almost all of Alcatel's debt is issued in euros. Interest rate derivatives are used to convert fixed rate debt into floating rate debt in order to reduce the Group's net exposure to interest rate risk.

In the context of its business, the Group is exposed to foreign exchange rate risk on commercial bids in progress and on firm commitments denominated in foreign currencies. The currency derivative financial instruments that are entered into are primarily directed at protecting the Group from adverse fluctuations in the value of its underlying commitments.

Firm commercial contracts or other firm commitments are hedged by forward foreign exchange transactions, while commercial bids, which are not firmly committed, are hedged by currency options. The duration of such bids does not usually exceed 18 months.

The Group controls credit risk related to these financial instruments through credit approval procedures, investment limit authorizations and centralized treasury policies, but does not require pledges of collateral or other guarantees to cover the risks linked to these financial instruments. Because of the diversity of its customers and their diverse geographical locations, management believes that the credit risk relating to customers is limited and that there is no risk of significant credit concentration

A – Interest rate risk

Derivative financial instruments held at December 31, 2003 are intended to reduce the cost of debt and to hedge interest rate risk. As of December 31, 2003, outstanding interest rate derivatives have the following characteristics:

a) Outstanding interest rate derivatives at December 31, 2003

– Analysis by type and maturity date:

(in millions of euros)	2003 Contract notional amounts Maturity date Less than one year	1 to 5 years	After 5 years	Total	Market value	2002 Total	Market value
Interest rate swaps							
– pay fixed rate	1,286	326	95	1,707	(42)	4,210	(158)
– pay floating rate	1,449	3,098	1,016	5,563	204	6,127	272
Caps							
– buy	12,774	1,832	–	14,606	3	23,849	24
– sell	12,774	1,050	–	13,824	–	22,814	(24)
Floors							
– buy	9,056	396	–	9,452	100	18,024	335
– sell	9,056	396	–	9,452	(100)	18,069	(335)
FRA							
– buy	500	100	–	600	(1)	288	–
– sell	500	100	–	600	1	238	–
Options on interest rate swaps USD Libor							
– buy	–	871	–	871	7	1,049	5
– sell	–	871	–	871	(7)	954	(5)

b) Interest rate sensitivity

An immediate increase in interest rates of 1%, applied to financial assets and liabilities and related hedging instruments, would decrease interest expense by € 15 million.

An increase of 1% in the interest rate curve, applied to financial debt and related hedging instruments, would have a positive impact of € 62 million on the market value.

B - Currency risk

The financial instruments held or issued at December 31, 2003 are hedges of exchange risks arising from payables or receivables, either commercial or financial, and known future transactions as of the year-end. The latter mainly relate to commercial bids expressed in foreign currency. Most of the currency derivatives mature within one year.

At December 31, 2003, off-balance sheet financial instruments held to manage currency risk were as follows:

– Outstanding currency derivatives at December 31, 2003:

(in millions of euros)	2003 U.S. dollar	Pound sterling	Other	Total	Market value	2002 Total	Market value
Buy/Lend currency							
Forward exchange contracts	1,128	246	772	2,146	(74)	2,754	(96)
Short-term exchange swaps	73	–	90	163	(6)	462	(9)
Cross currency swaps	–	–	19	19	(6)	34	(1)
Currency option contracts:							
– buy call	917	889	566	2,372	140	1,502	74
– sell put	520	151	717	1,388	(55)	755	(50)

	2003					2002	
(in millions of euros)	U.S. dollars	Pound sterling	Other	Total	Market value	Total	Market value
Sell/Borrow currency							
Forward exchange contracts	2,157	456	552	3,165	235	4,041	300
Short-term exchange swaps	455	142	210	807	27	3,670	133
Cross currency swaps	73	–	–	73	27	1,134	214
Currency option contracts:							
– sell call	805	912	587	2,304	(146)	1,802	(74)
– buy put	1,068	131	718	1,917	73	1,309	71

C - Fair value of cash and cash equivalents net of financial debt

	2003	
(in millions of euros)	Carrying value	Fair value
Assets		
– Marketable securities, net	1,635	1,683
– Cash	4,634	4,634
Liabilities		
– Convertible bonds	(1,022)	(1,148)
– Bonds and notes issued	(3,782)	(3,929)
Other borrowings	(489)	(497)
Interest rate derivatives	–	165
Cash and cash equivalents net of financial debt	976	908

D - Stock market risk

Alcatel and its subsidiaries are not engaged in speculative trading in the stock markets. Subject to approval by Alcatel, subsidiaries may make equity investments in selected companies (see note 13).

As of December 31, 2003, no transactions are in progress on Alcatel shares or on other shares held by Alcatel.

Note 27 - Customers' deposits and advances

(in millions of euros)	2003	2002	2001
Advance payments received on long-term contracts	842	1,024	1,101
Other deposits and advances received from customers	339	458	592
Total customers' deposits and advances	1,181	1,482	1,693

Note 28 - Debt linked to the bank activity

(in millions of euros)	2003	2002	2001
Debt linked to the bank activity	224	246	660

This corresponds to the amount of customer loans and advances presented under the captions "Other investments" and "Other accounts receivable":
2003: "Other investments" were € 224 million (note 13).
2002: "Other investments" were € 176 million (note 13) and under "Other accounts receivable" were € 70 million.
2001: "Other investments" were € 384 million (note 13) and under "Other accounts receivable" were € 276 million.

Note 29 - Other payables

Analysis is as follows:

(in millions of euros)	2003	2002	2001
Accrued payables and other	1,330	2,354	3,983
Wages, salaries and other social payables	913	1,001	918
Accrued taxes	361	380	642
Deferred taxes	71	112	529
Dividends to be paid	–	–	197
Government grants	45	48	49
Total	2,720	3,895	6,318

Note 30 - Contractual obligations and disclosure related to off-balance sheet commitments

a) Contractual obligations

The following table presents minimum payments that the Group will have to make in the future under contracts and firm commitments. Amounts related to financial debt and capital lease obligations are fully reflected in the consolidated balance sheet.

(in millions of euros)			Maturity date		
Contractual cash obligations	**Less than one year**	**1-3 years**	**4-5 years**	**After 5 years**	**Total**
Financial debt (excluding capital leases)	877	2,143	203	2,013	5,236
Capital lease obligations	6	12	20	19	57
Sub-total – included in balance sheet	883	2,155	223	2,032	5,293
Operating leases	115	176	191	130	612
Commitments to purchase fixed assets	22	–	–	–	22
Unconditional purchase obligations*	290	154	–	–	444
Sub-total – Commitments	427	330	191	130	1,078

* Other firm commitments result mainly from purchase obligations under multi-year supply contracts linked to the sale of businesses to third parties.

b) Off-balance sheet commitments

Commitments given as a result of the usual activity of the Group are as follows.

Only performance guarantees issued by financial institutions are presented in the table below. The figures published in 2002 and 2001 also included guarantees given by Group parent companies in respect of their subsidiaries' contracts which, in accordance with current practice, are no longer considered to represent an off-balance sheet commitment of the Group. These amounted to € 5,743 million and € 6,679 million at December 31, 2002 and 2001, respectively.

(in millions of euros)	2003	2002	2001
Guarantees given on contracts made by entities within the Group or by non-consolidated subsidiaries*	2,106	2,787	3,067
Discounted notes receivable and other	25	14	63
Other contingent commitments	702	833	1,004
Sub-total - Contingent commitments	2,833	3,634	4,134
Secured borrowings	157	262	236
Guarantees on cash pooling	652	807	1,390
Total	3,642	4,703	5,760

* Estimated amount for 2001.

No material commitments are omitted from this note 30 in accordance with current accounting practice.

Contingent commitments

(in millions of euros)

Contingent commitments	Maturity date: Less than one year	1-3 years	4-5 years	After 5 years	Total
Guarantees on Group contracts*	1,181	352	96	152	1,781
Guarantees on third party contracts	129	130	58	8	325
Discounted notes receivable and other	25	-	-	-	25
Other contingent commitments	344	28	26	304	702
Total	1,679	510	180	464	2,833
Counter guarantees received	199	146	33	51	429
* reflected in balance sheet					928

The amounts reflected in the preceding table represent the maximum potential amounts of future payments (undiscounted) that the Group could be required to make under current guarantees granted by the Group. These amounts are not reduced by any amounts that may be recovered under recourse provisions in the guarantees or guarantees given by customers for the Group's benefit, which are included in the "counter guarantees received" line.

Commitments related to product warranties, pension and end-of-career indemnities are not included in the preceding table. These commitments are fully reflected in the financial statements. Contingent liabilities arising out of litigation, arbitration or regulatory actions are not included in the preceding table with the exception of those linked to Group long-term contracts. For more information concerning litigation, see note 33.

Guarantees given on Group long-term contracts consist of performance bonds issued by financial institutions to customers and bank guarantees given to secure advance payments received from customers (excluding security interests and restricted cash which are indicated in the table "Guarantees granted on borrowings and advance payments received such as security interests" of this note). Alcatel gives guarantees related to advances and payments received from customers, or commits to indemnify the customer, if the subsidiary contractor does not perform the contract in compliance with the terms of the contract. In the event that, due to occurrences, such as delay in delivery or litigation related to failure in performance on the underlying contracts, it becomes likely that Alcatel will become liable for such guarantees, the estimated risk is reserved for on the consolidated balance sheet under the caption "product sale reserves" (see note 24) or in inventory reserve. The amounts concerned are given in the preceding table in the specific line item "Reflected in balance sheet".

Commitments related to contracts that have been cancelled or interrupted due to the default or bankruptcy of the customer are included in the above-mentioned "Guarantees on Group contracts" as long as the legal release of the guarantee has not been obtained.

Additionally, most of the performance guarantees given to Group customers are insured. The evaluation of risk related to guarantees should take into account the insurance proceeds that may be received in case of a claim.

Guarantees given on third party long-term contracts could contingently require the Group to make payments to the guaranteed party based on a non-consolidated company's failure to perform under an agreement. The fair value of these contingent liabilities, corresponding to the premiums received by the guarantor for issuing the guarantees, was € 3 million at December 31, 2003 (€ 5 million at December 31, 2002).

Guarantees granted on debt advance payments received and security interests granted

(in millions of euros)

Guarantees on borrowings and advance payments received	Maturity date: Less than one year	1-3 years	4-5 years	After 5 years	Total
Security interests	28	11	32	5	76
Other guarantees granted	67	–	–	14	81
Total	95	11	32	19	157
Net book value of assets given in guarantee:					
– financial assets	24	11	32	5	72
– other assets	4	–	–	–	4

Guarantee on cash pooling

Not included in the preceding table is the guarantee granted to the banks that implement the Group cash pooling. This guarantee covers the risk involved in any debit position that could remain outstanding after daily transfers between Alcatel Central Treasury accounts and subsidiaries' accounts. As of December 31, 2003, this guarantee was valued at € 0.7 billion (€ 0.8 billion as of December 31, 2002 and € 1.4 billion as of December 31, 2001).

Other specific commitments linked to significant operations

> *SVF trust program* (all references to "$" in this section refer to U.S. dollars)

In 1999, Alcatel launched a vendor financing securitization program, called the SVF trust, which was amended in May 2003, following previous amendments in June 2000 and May 2002.

The principal changes made in May 2003 were as follows:

- the revolving period of the program has been extended from May 14, 2004 to April 16, 2007, meaning that Alcatel can sell new receivables to the program until that date. As initially foreseen, Alcatel expects to fully repay the program (through a repurchase of the remaining receivables) by the end of the fifth year from May 14, 2002. The notional amortization of the amount sold, which was to occur beginning May 14, 2004, prior to the May 2003 amendment, has been replaced by a reduction in the program size, as described below, and by a one-month amortization period, which will now run from April 16, 2007 to May 14, 2007;
- the program size was reduced to $ 698.4 million effective May 14, 2003 and was scheduled in the amendment to be further reduced on each anniversary date to the following amounts:

– May 2004 $ 575 million
– May 2005 $ 450 million
– May 2006 $ 350 million

Subsequent to the amendment, Alcatel made a voluntary election to reduce the program size to $ 575 million effective December 31, 2003. The scheduled reductions in May 2005 and 2006 remain unaffected.

To the extent that the level of receivables sold exceeds the ceiling amounts set forth above at any anniversary date, Alcatel would be required to purchase for cash a promissory note from the SVF trust for the difference.

The other characteristics of the program remain unchanged and are as follows:

- a syndicate of 13 banks, which provides a backstop liquidity facility available on a 364-day basis, supports the SVF program. Prior to October 7, 2002, the SVF trust was principally funded through a Citibank commercial paper conduit vehicle. Due to the downgrading by Standard & Poor's of Alcatel's credit rating to B+ on October 4, 2002, the Citibank commercial paper conduit was unable to continue to fund the program. On October 7, 2002, Alcatel drew on the backstop facility provided by the banks to repay the funds previously provided to Alcatel by the commercial paper conduit. The loss of funding from the commercial paper conduit resulted in an increase in the cost of funds to the SVF trust to LIBOR plus 300 basis points, instead of the commercial paper rates charged by the Citibank conduit. The operation of the program was otherwise unaffected by the downgrading of Alcatel's credit rating on October 4, 2002 and Alcatel may continue to sell new receivables to the program, which will be funded by the syndicate of banks, up to the limit of the available facility;
- the syndicate of banks renewed the credit facility for 364 days effective May 14, 2003. In the event that the banks do not elect to renew their facility on any renewal date, Alcatel has the right to draw down the full amount of the facility to ensure the SVF program's continuity without interruption. In these circumstances, at any time during the revolving period, funds not immediately needed by the SVF trust to finance receivables would be placed on deposit by the trust, to be available to fund future sales of receivables by Alcatel;
- prior to the downgrade by Moody's of Alcatel's credit rating to Ba1 on July 9, 2002, Alcatel sold receivables to the SVF trust without notifying its debtors. However, following the downgrade, Alcatel is now required to notify its debtors of the sale of their receivables to the SVF trust;
- Alcatel provides credit support to the SVF trust in the form of over-collateralization and the provision of certain guarantees. The required level of over-collateralization is 15%, which means that Alcatel receives cash equal to 85% of the face value of the receivables sold. The remaining 15% of the purchase price is deferred and represents a fully subordinated receivable due from the SVF trust. This over-collaterization was put in place effective May 14, 2002 and finalized on July 31, 2002. The deferred purchase price is accounted for in "other investments and miscellaneous, net";
- the program provides for various Alcatel guarantees, the principal ones being:

– a first loss guarantee up to 30% of:

• the program amount during the revolving period, and

• the funded portion of the program during the amortization period (which is now less than one month);

– two portfolio diversification guarantees. To the extent that the portfolio of receivables held by the trust does not comply with its stated diversification criteria, Alcatel must provide a guarantee in excess of the 30% first loss guarantee described above, which could be as high as 100%. As an alternative to including non-compliant receivables in the calculation of this general pool guarantee, Alcatel has the option to elect to guarantee up to 100% of the receivables that are non-compliant. These guarantees only come into force at the end of the revolving period of the program or at an earlier termination event;

– a political risk guarantee that covers all receivables, with some limited exceptions, for up to 100% of principal and interest, in case of political risks, including expropriation, political violence, inconvertibility of currencies and transfer risks;

– other specific guarantees concerning particularly currency risks (for receivables not denominated in U.S. dollars), amortization of the SVF trust and contract completion risks.

- the program provides for certain early termination events. These include a breach of certain financial covenants by Alcatel, which are identical to those in the € 2.1 billion syndicated bank facility (see note 25 f – Syndicated facility), which was reduced to € 1.4 billion at the end of March 2003. Adherence to these covenants is tested quarterly. Upon the occurrence of an early termination event, Alcatel is required to monetize its various guarantees within three days.

Summarized balance sheets of the SVF trust as of December 31, 2003 and December 31, 2002:

(in millions of dollars)	12.31.03	12.31.02		12.31.03	12.31.02
Loan receivables	345	428	Certificates of beneficial interest	25	43
Other assets	9		Financial debt (Trust A notes)	276	321
			Deferred purchase price	53	64
Total	354	428	Total	354	428

As of December 31, 2003, loan receivables held by the SVF trust amounted to $ 345 million ($ 428 million as of December 31, 2002 and $ 700 million as of December 2001). Changes during 2003 were due to the sale of $ 100 million of new receivables, to the sale of a receivable held by the SVF trust outside the Group for $ 108 million and to the repayment of $ 75 million of receivables.

The deferred purchase price, representing the difference between the face value of the receivables sold to the SVF trust and the funded amount received from the trust, is accounted for in other investments and miscellaneous, net in Alcatel's consolidated financial statements and amounted to $ 53 million as of December 31, 2003 ($ 64 million as of December 31, 2002 and $ 0 million as of December 31, 2001).

As of December 31, 2003, a reserve of € 42 million was booked in Alcatel's consolidated financial statements in respect of guarantees given to the SVF trust (€ 24 million as of December 31, 2002 and € 60 million as of December 31, 2001). As the Alcatel Group does not own any equity share in the trust, the SVF trust is not consolidated within the Group's accounts in accordance with the "Comité de la Réglementation Comptable"'s Regulation No. 99-02. The SVF trust will be consolidated from January 1, 2004 in accordance with new financial regulations, which are applicable from the first financial accounting year beginning after August 2, 2003. Consolidating the trust at January 1, 2004 is estimated to lead to increases in the Group's net debt of € 215 million (corresponding primarily to $ 276 million of Trust A notes), minority interests of € 17 million and other investments and miscellaneous, net of € 232 million.

> Securitization of customer loans

On May 31, 2002, Alcatel entered into a € 480 million securitization program with a multi-seller asset-backed commercial paper conduit vehicle sponsored by a financial institution for the sale of customer loans related to mobile infrastructure contracts.

This securitization program was terminated in December 2003 and the customer loans sold by Alcatel have been fully repaid at the date of termination

> Sale of carry-back receivable

In May 2002, Alcatel sold to a credit institution a carry-back receivable with a face value of € 200 million resulting from Alcatel's decision to carry back 2001 tax losses. The cash received from this sale was € 149 million, corresponding to the discounted value of this receivable that will mature in five years. The difference between the net cash proceeds and the nominal value is being recorded over the five-year period as a financial expense. The financial expense for 2003 amounted to € 10.5 million.

Alcatel is required to indemnify the purchaser in case of any error or inaccuracy concerning the amount or nature of the receivable sold. The sale will be retroactively cancelled in the event of a modification to the law or regulations that substantially changes the rights attached to the receivable sold.

> Securitization of customer receivables

In December 2003, Alcatel entered into a further securitization program for the sale of customer receivables without recourse. Eligible receivables are sold to a special purpose vehicle, which benefits from a subordinated financing from the Group representing an over-collateralization determined on the basis of the portfolio of receivables sold. At December 31, 2003, the Group was a shareholder of the special purpose vehicle, which is fully consolidated in accordance with paragraph 10052 of the "Comité de la Réglementation Comptable"'s Regulation No. 99-02. The receivables sold at December 31, 2003, which amounted to € 54 million, are therefore maintained in the consolidated balance sheet. At December 31, 2003, the maximum amount of receivables that can be sold amounted to € 150 million, representing a credit line available to the Group. This amount can be increased ultimately to € 250 million. The purpose of this securitization program is to optimize the management and recovery of receivables in addition to providing extra financing.

Note 31- Related party transactions

The definition of related parties retained by the Group, effective January 1, 2003, is that of IAS 24 (revised in December 2003).

Management is not aware of any shareholder holding more than 5.79% of the parent company's share capital.

Transactions with related parties during 2003 were as follows:

(in millions of euros)	2003
Net sales of goods and services	
– Non-consolidated affiliates	47
– Equity affiliates	10
Cost of sales	
– Non-consolidated affiliates	29
– Equity affiliates	6

Outstanding balances arising from related party transactions at December 31, 2003 were as follows:

(in millions of euros)	2003
Assets	
– Non-consolidated affiliates	23
– Equity affiliates	4
– Valuation allowances	(5)
Other liabilities	
– Non-consolidated affiliates	56
– Equity affiliates	7
Financial debt	
– Non-consolidated affiliates	5
– Equity affiliates	17

Key management personnel being members of the Group's executive committee are listed in the Corporate Governance section of the Annual Report. In 2003, the total compensation paid to members of the executive committee was as follows:

(in millions of euros)	2003
Salary and benefits in kind paid in 2003	7

(in number of options)	2003
Stock options granted in 2003	1,396,256

Note 32 - Payroll and staff

(in millions of euros and number of staff)	2003	2002	2001
Wages and salaries (including social security/pension costs)	4,004	5,488	6,937
*of which remuneration of executive officers in Alcatel or in the consolidated subsidiaries**	*7.5*	*7.7*	8.6
Staff of consolidated companies at year-end	*60,486*	*75,940*	*99,314*
of which executives and senior technical staff**	*55%*	*53%*	*51%*

* Aggregate amount of compensation paid for the full year to the 11 members of the Senior Management as of December 31, 2003 because of their functions in Alcatel or in consolidated companies, amounts to € 7.5 million in 2003 (€ 7.7 million in 2002 and € 8.6 million in 2001).

** Executives, senior technical staff and positions normally requiring a minimum of three years of higher education.

NOTE 33 - CONTINGENCIES

Alcatel is involved in a number of legal proceedings related to the normal conduct of its business which management does not believe will result in any significant costs to the Group. In addition, Alcatel is involved in the following legal proceedings for which management has determined that no reserves are currently required in its financial statements without however entirely excluding the possibility that one or more of these proceedings may have an impact on Alcatel's financial statements in the future.

France Telecom

Since 1993, a legal investigation has been ongoing concerning "overbillings" which are alleged to have been committed in Alcatel CIT, a subsidiary, to the detriment of its principal customer, France Telecom, based on an audit of production costs conducted for the first time in 1989 in the transmission division, and for the second time in 1992 in the switching division.

The issue relating to the transmission division resulted in the signing of a settlement agreement with France Telecom. France Telecom, however, filed a civil complaint with the investigating magistrate regarding the switching activity without quantifying the amount of the alleged damages.

In April 1999, the Group learned that the criminal investigation had been extended to determine whether corporate funds of Alcatel CIT and Alcatel had been misused. As a consequence, both Alcatel CIT and Alcatel filed civil complaints to preserve their rights with respect to this investigation.

In January 2000, the investigating magistrate declared his investigation closed (it is unclear whether wholly or partially). Since then, the file has been the subject of several procedural developments. First, on May 29, 2002, the "Cour de Cassation, Chambre Criminelle" rejected the essence of Alcatel's requests concerning the validity of the experts' reports. Additionally, several appeals relating to a former employee of Alcatel CIT, who has been indicted, have been filed and are not closed. It is unlikely that the investigating magistrate will be able to close his investigation before the last quarter of 2004 at the earliest.

Class A and Class O shareholders

Several purported class action lawsuits have been filed since May 2002 against Alcatel and certain of its officers and directors challenging the accuracy of certain public disclosures that were made in the prospectus for the initial public offering of Alcatel Class O shares and in other public statements regarding market demand for Optronics Division products.

The lawsuits purport to be brought on behalf of persons who (i) acquired Alcatel Class O shares in or pursuant to the initial public offering of the ADSs conducted by Alcatel in October 2000, (ii) purchased Alcatel Class A and Class O shares in the form of ADSs between October 20, 2000 and May 29, 2001 and (iii) purchased Alcatel Class A shares in the form of ADSs between May 1, 2000 and May 29, 2001.

The actions have been consolidated in the United States District Court, Southern District of New York. Alcatel is conducting a vigorous defense and denies any liability or wrongdoing with respect to this litigation.

Although it is not possible at this stage of these cases to predict the outcome with any degree of certainty, Alcatel believes that the ultimate outcome of these proceedings will not have a material adverse effect on its consolidated financial position. Alcatel is not aware of any other exceptional circumstances or proceedings that have had or may have a significant impact on the business, the financial position, the net income or the assets of the Group.

NOTE 34 - SUBSEQUENT EVENTS

On January 14, 2004, Alcatel, pursuant to its announcement in October 2003, finalized the sale of its battery operations to Doughty Hanson for € 390 million. The battery operations have been recorded as a discontinued operation for the year through December 31, 2003 (see note 2 to the consolidated financial statements).

On February 10, 2004, Alcatel and Draka Holding N.V., a Dutch cable and cable system company, announced their plan to combine their communications cable and optical fiber operations within a new entity in which Draka would hold 50.1% and Alcatel 49.9%. This company will be a leading player in China, as well as in Europe, and a major supplier in North America.

As a result, Alcatel intends to record the optical fiber businesses under the equity method on the date the agreement is finalized.

On March 10, 2004, Standard & Poor's, the credit rating agency, raised its rating for Alcatel's long-term debt from B+ to BB-, with a stable outlook. Standard & Poor's decision was largely a reflection of the continuous improvement in the Group's financial results and financial structure. The rating for short-term debt of B was confirmed.

On March 17, 2004, Alcatel launched an offer to exchange bonds in a strategy primarily to lengthen its average debt maturity. On March 30, 2004, Alcatel announced that bonds with a nominal value of € 366 million, coming from Alcatel's 7% bond issue of € 1.2 billion, due 2006, had been exchanged by the holders for new euro bonds having a nominal value of € 412 million, due 2014. The new bonds bear interest at 6.375% per annum and produce a return of 6.49%. As a result, including additional bonds having a nominal value of € 50 million that were issued at the same time, the total nominal value of the new issue, due 2014, amounts to € 462 million.

NOTE 35 - MAIN CONSOLIDATED COMPANIES

Company	Country	% control	% interest	Consolidation method
Alcatel ** **and** ***	France			Parent company
OPERATING COMPANIES*				
Alcatel Australia Limited	Australia			Full consolidation
Alcatel Austria A.G.	Austria			Full consolidation
Alcatel Bell NV	Belgium			Full consolidation
Alcatel Business Systems S.A.	France			Full consolidation
Alcatel Canada Inc	Canada			Full consolidation
Alcatel Cable France	France			Full consolidation
Alcatel CIT	France			Full consolidation
Alcatel China Investment CO. Ltd	PRC			Full consolidation
Alcatel Contracting GmbH	Germany			Full consolidation
Alcatel España S.A.	Spain			Full consolidation
Alcatel Indetel S.A. de C.V.	Mexico			Full consolidation
Alcatel Italia S.p.A.	Italy			Full consolidation
Alcatel Optical Fiber GmbH	Germany			Full consolidation
Alcatel Polska SA	Poland			Full consolidation
Alcatel Portugal SA	Portugal			Full consolidation
Alcatel Schweiz AG	Switzerland			Full consolidation
Alcatel SEL A.G.	Germany			Full consolidation
Alcatel Shanghai Bell	PRC	50	50	Full consolidation
Alcatel Space	France			Full consolidation
Alcatel Submarine Networks Limited	U.K.			Full consolidation
Alcatel Submarine Networks S.A.	France			Full consolidation
Alcatel Suzhou Telecommunications CO.	PRC			Full consolidation
Alcatel Telecom Limited	U.K.			Full consolidation
Alcatel Telecom Nederland BV	The Nertherlands			Full consolidation
Alcatel Telecom Norway A/S	Norway			Full consolidation
Alcatel Telecommunicacoes SA	Brazil			Full consolidation
Alcatel U.S.A. Inc	U.S.			Full consolidation
Radio Frequency Systems GmbH	Germany			Full consolidation
Radio Frequency Systems Inc	U.S.			Full consolidation
Shanghai Bell Alcatel Mobile Communication System CO. Ltd	PRC	50	50	Full consolidation
Taiwan International Standard Electronics Ltd. (Taisel)	Taiwan	60	60	Full consolidation
Alda Marine	France	51	51	Proportionate
Evolium Holding SAS	France	66	66	Proportionate

Company	Country	% control	% interest	Consolidation method
HOLDINGS AND OTHER SEGMENT***				
Aerospace, defence and IT&S				
Thales (formerly Thomson-CSF)**	France	9.5	9.5	Equity
Financial Holdings				
Alcatel Holding Canada Corp.	Canada			Full consolidation
Alcatel NV	The Netherlands			Full consolidation
Alcatel Participations	France			Full consolidation
Alcatel UK Limited	U.K.			Full consolidation
Compagnie Financière Alcatel	France			Full consolidation
Coralec	France			Full consolidation
Lubelec	France			Full consolidation
SAFT Participations	France			Full consolidation
Financial Services				
Electro Banque	France			Full consolidation
Electro Ré	Luxembourg			Full consolidation

* Percentages of control and interest equal 100% unless otherwise specified.
** Publicly traded.
*** Financial data for Alcatel, as the parent company, are included in this business segment.

NOTE 36 - QUARTERLY INFORMATION (UNAUDITED)

a) Consolidated income statements

2003 (in millions of euros)	**Q1 restated**	**Q2 restated**	**Q3 restated**	**Q4**	**Total**
Net sales	2,828	3,011	2,909	3,765	12,513
Cost of sales	(1,971)	(2,064)	(1,863)	(2,517)	(8,415)
Gross profit	**857**	**947**	**1,046**	**1,248**	**4,098**
Administrative and selling expenses	(586)	(547)	(516)	(524)	(2,173)
R&D costs	(421)	(395)	(384)	(393)	(1,593)
Income (loss) from operations	**(150)**	**5**	**146**	**331**	**332**
Interest expense on notes mandatorily redeemable for sharess	(12)	(12)	(11)	(12)	(47)
Financial income (cots)	(26)	(67)	(71)	(78)	(242)
Restructuring costs	(273)	(305)	(212)	(524)	(1,314)
Other revenue (expense)	206	(86)	(11)	11	120
Income (loss) before amortization of goodwill, taxes and purchased R&D	**(255)**	**(465)**	**(159)**	**(272)**	**(1,151)**
Income tax	(28)	(13)	(20)	(21)	(82)
Share in net income of equity affiliates and disposed of or discontinued operations	(31)	(91)	2	7	(113)
Consolidated net income (loss) before amortization of goodwill and purchased R&D	**(314)**	**(569)**	**(177)**	**(286)**	**(1,346)**
Amortization of goodwill	(152)	(114)	(102)	(210)	(578)
Purchased R&D	–	–	–	–	–
Minority interests	5	8	(5)	(28)	(20)
Net income (loss)	**(461)**	**(675)**	**(284)**	**(524)**	**(1,944)**
Ordinary shares (A)					
Basic earnings per share (in euros)	*(0.35)*	*(0.51)*	*(0.21)*	*(0.39)*	*(1.46)*
Diluted earnings per share (in euros)	*(0.35)*	*(0.51)*	*(0.21)*	*(0.39)*	*(1.46)*

Data for Q1, Q2 and Q3 have been restated to take into account the principal changes in the consolidated companies during 2003, as described in note 2. The following businesses have been restated as disposed of or discontinued operations:

– disposal of the optical components business,
– disposal in progress of the SAFT Group.

2002 restated (in millions of euros)	Q1	Q2	Q3	Q4	Total
Net sales	4,144	4,094	3,399	4,377	16,014
Cost of sales	(3,077)	(3,021)	(2,444)	(3,166)	(11,708)
Gross profit	1,067	1,073	955	1,211	4,306
Administrative and selling expenses	(789)	(701)	(643)	(624)	(2,757)
R&D costs	(589)	(513)	(506)	(547)	(2,155)
Income (loss) from operations	(311)	(141)	(194)	40	(606)
Interest expense on notes mandatorily redeemable for shares	–	–	–	(1)	(1)
Financial income (costs)	(66)	(289)	(518)	(135)	(1,008)
Restructuring costs	(136)	(428)	(318)	(497)	(1,379)
Other revenue (expense)	(246)	(251)	(38)	(202)	(737)
Income (loss) before amortization of goodwill, taxes and purchased R&D	(759)	(1,109)	(1,068)	(795)	(3,731)
Income tax	177	(4)	(58)	(66)	49
Share in net income of equity affiliates and disposed of or discontinued operations	(139)	(204)	(84)	(86)	(513)
Consolidated net income (loss) before amortization of goodwill and purchased R&D	(721)	(1,317)	(1,210)	(947)	(4,195)
Amortization of goodwill	(112)	(121)	(152)	(147)	(532)
Purchased R&D	–	–	–	–	–
Minority interests	(3)	–	10	(25)	(18)
Net income (loss)	(836)	(1,438)	(1,352)	(1,119)	(4,745)
Ordinary shares (A)					
Basic earnings per share (in euros)	*(0.71)*	*(1.21)*	*(1.13)*	*(0.93)*	*(3.99)*
Diluted earnings per share (in euros)	*(0.71)*	*(1.21)*	*(1.13)*	*(0.93)*	*(3.99)*

b) Information by segment

2003 restated (in millions of euros)	Q1	Q2	Q3	Q4	Total
Net sales					
Fixed Communications	1,315	1,405	1,341	1,647	5,708
Mobile Communications	798	834	815	1,092	3,539
Private Communications	817	868	839	1,103	3,627
Other	3	4	4	5	16
Eliminations	(105)	(100)	(90)	(82)	(377)
Total	2,828	3,011	2,909	3,765	12,513
Income (loss) from operations					
Fixed Communications	(81)	0	66	142	127
Mobile Communications	15	10	79	122	226
Private Communications	(34)	21	41	95	123
Others	(50)	(26)	(40)	(28)	(144)
Total	(150)	5	146	331	332

2002 restated (in millions of euros)	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
Net sales					
Fixed Communications	2,127	2,095	1,592	2,012	7,826
Mobile Communications	1,176	1,110	973	1,283	4,542
Private Communications	989	1,007	919	1,194	4,109
Other	–	9	7	5	21
Eliminations	(148)	(127)	(92)	(117)	(484)
Total	4,144	4,094	3,399	4,377	16,014
Income (loss) from operations					
Fixed Communications	(228)	(153)	(248)	(155)	(784)
Mobile Communications	(5)	28	50	131	204
Private Communications	(22)	21	23	93	115
Others	(56)	(37)	(19)	(29)	(141)
Total	(311)	(141)	(194)	40	(606)

c) Earnings per share

Earnings per share is determined according to the method described in note 8. The following tables present a reconciliation of basic earnings per share and diluted earnings per share for Q4 2003 and Q4 2002.

		Ordinary shares	
Q4 2003 (in millions of euros)	**Net income (loss)**	**Number of shares**	**Per share amount**
Basic earnings per share	(524)	1,342,366,503	€ (0.39)
Stock option plans	–	–	–
Notes mandatorily redeemable for shares	–	–	–
Diluted earnings per share	(524)	1,342,366,503	€ (0.39)

Ordinary shares

The earnings per share computation takes into account that consolidated subsidiaries of the Group owned 62,789,755 Alcatel ordinary shares and no share equivalents.

Shares subject to issuance in the future have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect. In addition, notes mandatorily redeemable for new or existing Alcatel shares have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

		Ordinary shares	
Q4 2002 restated (in millions of euros)	**Net income (loss)**	**Number of shares**	**Per share amount**
Basic earnings per share	(1,119)	1,201,979,168	€ (0.93)
Stock option plans	–	–	
Diluted earnings per share	(1,119)	1,201,979,168	€ (0.93)

Ordinary shares

The earnings per share computation takes into account that consolidated subsidiaries of the Group owned 62,729,430 Alcatel ordinary shares and no share equivalents.

Shares subject to issuance in the future have not been taken into account in the calculation of the diluted earnings per share amount due to their anti-dilutive effect.

STATUTORY AUDITORS REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS OF ALCATEL (DECEMBER 31, 2003)

This is a free translation into English of the statutory auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. The statutory auditors' report includes for the information of the reader, as required under French law in any auditor's report, whether qualified or not, an explanatory paragraph separate from and presented below the audit opinion discussing the auditors' assessments of certain significant accounting and auditing matters. These assessments were considered for the purpose of issuing an audit opinion on the consolidated financial statements taken as a whole and not to provide separate assurance on individual account caption or on information taken outside of the consolidation financial statements. Such report, together with the statutory auditors report addressing financial reporting in management's report on internal control, should be read in conjunction and construed in accordance with French law and French auditing professional standards.

Dear Alcatel Shareholders,

At our request and in our capacity as statutory auditors, we present below our certificate on the audit of the accompanying consolidated accounts of Alcatel of December 31, 2003.

These consolidated accounts have been prepared by the Board of directors. Our responsibility is to express an opinion on these accounts based on our audit.

I. Opinion on the consolidated accounts

We conducted our audit in accordance with French professional standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated accounts are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in these accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall account presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated accounts present fairly, in all material respects, the financial position of the Group as of December 31, 2003 and the results of the Group's operations included in the consolidation for the year then ended, in accordance with French accounting principles.

II. Justification of assessments

In accordance with the requirements of Article L.225-235 of the French Code de Commerce, relating to the justification of our assessments, introduced on 1 August, 2003 by the Loi de Sécurité Financière and applicable for the first time this year, we bring to your attention the following matters:

Your company's management makes estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying Notes. These assumptions are, by nature, subject to uncertainties, and actual results could differ from these assumptions. The accounts affected by significant accounting estimates are deferred tax assets, goodwill, fixed assets and reserves for liabilities and charges.

- As stated in notes 7, 9, 11, 1 f) and 1 k) of the notes to the financial statements, your company reports in the balance sheet deferred tax asset amounting to 2011 million euros, goodwill amounting to 3839 million euros, and fixed assets amounting to 1500 milion euros.

  Your company uses financial planning tools to elaborate multi-annual financial plans, which include different components (e.g. forecasted cash flow and taxable income in particular), to check, if necessary, the fair value of fixed assets and the recoverable amount of deferred tax assets.

  We have examined the relevance of the methodology outlined in notes 1 f) and 1 k) to the financial statements and the amounts and assumptions used in its implementation.

- Your company reports in the balance sheet other reserves for liabilities and charges amounting to 3,049 millions euros. We considered the basis for providing such amounts, examined the approval procedures carried out by the Management and reviewed the relating documentation.

We have considered whether these estimates were reasonable. Thus, the assessment we provide is part of our audit procedures relating to the consolidated financial statements, taken as a whole, and contributes to the unqualified opinion expressed above in the first part of this report.

III. Specific procedures

We have also reviewed the information relating to the Group contained in the Directors' report in accordance with French professional standards. We have nothing to report with respect to the fairness of this information and its consistency with the consolidated accounts.

Neuilly-sur-Seine, March 30, 2004

The statutory auditors

DELOITTE TOUCHE TOHMATSU	BARBIER FRINAULT & AUTRES
Alain Pons	Christian Chiarasini

PARENT COMPANY ACCOUNTS

PARENT COMPANY ACCOUNTS

KEY FIGURES

The net loss of Alcatel, the parent company, amounted to € (3,255.4) million in 2003 compared to € (14,710.5) million in 2002.

Total assets decreased from € 31.7 billion at the end of 2002 to € 27.4 billion at the end of 2003. Shareholders' equity after appropriation decreased from € 15.3 billion to € 12.3 billion over the same period.

APPROPRIATION OF INCOME AND DIVIDEND DISTRIBUTION

The 2003 net loss of Alcatel, the parent company, totalled € 3,255,425,911.04.

In view of this loss and the negative retained earnings brought forward, no dividend will be paid on the 2003 results.

It will be proposed to the annual shareholders' meeting to allocate the 2003 net loss and the accumulated losses brought forward to the reserves and additional paid-in capital.

The following appropriation will therefore be proposed to the annual shareholders' meeting to be held on June 4, 2004:

(in euros)

Available for distribution	
Loss of the year	(3,255,425,911.04)
Retained earnings brought forward	(11,066,369,514.06)
Transfer from capital surplus	–
Total	**(14,321,795,425.10)**
Appropriation	
Transfer to legal reserve	–
Transfer to special net long-term gains reserve	–
Allocation to reserves	(165,120,200.99)
Allocation to additional paid-in capital	(14,156,675,224.11)
Proposed dividend	–
Distribution tax	–
Retained earnings	–
Total	**(14,321,795,425.10)**

In accordance with French legal requirements, dividends per share for the past three years are detailed in the following table:

	2003 (proposal)	2002	2001	2000
Number of A shares eligible for dividends	1,284,410,224	1,239,193,498	1,215,254,797	1,212,210,685
Number of O shares eligible for dividends	–*	25,515,000	25,515,000	16,500,000
Par value	2.00	2.00	2.00	2.00
Total number of shares	1,284,410,224	1,264,708,498	1,240,769,797	1,228,710,685
A shares				
Net dividend per share including tax credit	–	–	0.24	0.72
Net dividend per share	–	–	0.16	0.48
Tax credit ("avoir fiscal") per share	–	–	0.08	0.24
O shares				
Net dividend per share including tax credit	–	–	0.15	0.15
Net dividend per share	–	–	0.10	0.10
Tax credit ("avoir fiscal") per share	–	–	0.05	0.05

* The extraordinary shareholders' meeting held on April 17, 2003 approved the cancellation of the specific rights attached to the O shares and conversion of the O shares into ordinary shares.

PARENT COMPANY INCOME STATEMENTS

(in millions of euros)	Notes	2003	2002	2001
Net sales		747.7	852.4	1,249.9
Other revenues		38.3	42.0	40.2
Operating revenues		**786.0**	**894.4**	**1,290.1**
Purchases of services and other expenses		(783.7)	(906.3)	(1,239.4)
Taxes and similar payments, excluding income tax		(41.3)	(44.7)	(77.8)
Payroll costs		(4.8)	(3.0)	(4.3)
Operating expenses		**(829.8)**	**(954.0)**	**(1,321.5)**
Operating income (loss)	*(2)*	**(43.8)**	**(59.6)**	**(31.4)**
Interest on bonds redeemable in shares		(47.2)	(1.2)	–
Interest on other equity	*(13)*	**(47.2)**	**(1.2)**	**–**
Revenues from investments in subsidiaries and associates	*(3)*	103.1	280.5	393.5
Interest income and similar revenues		1,315.0	2,171.1	2,476.4
Interest expense and similar expenses		(1,414.8)	(2,001.0)	(2,252.6)
Net change in financial provisions and amortization	*(4)*	5,018.3	(15,471.0)	(3,722.0)
Other financial revenues (expenses)		69.2	87.4	286.4
Financial income (loss)	*(2)*	**5,090.8**	**(14,933.0)**	**(2,818.3)**
Income (loss) before non-recurring items and income tax	*(2)*	**4,999.8**	**(14,993.8)**	**(2,849.7)**
Non-recurring revenues*		2,968.1	440.7	3,671.0
Non-recurring expenses**		(11,057.9)	(511.4)	(3,884.9)
Non-recurring income (loss)	*(2)*	**(8,089.8)**	**(70.7)**	**(213.9)**
Income tax	*(2)/(5)*	(165.4)	354.0	97.5
Net income (loss) after tax		**(3,255.4)**	**(14,710.5)**	**(2,966.1)**

* Includes investments sold (at selling price or contributed value).
** Includes the book value of investments sold.

PARENT COMPANY BALANCE SHEETS AT DECEMBER 31

ASSETS (in millions of euros)	Notes	2003 Gross value	2003 Amortization and depreciation	2003 Net value	2002 Net value	2001 Net value
Intangible assets		20.3	(16.8)	3.5	4.0	4.6
Land		–	–	–	–	–
Buildings		0.3	(0.3)	–	–	–
Other property, plant and equipment		0.4	(0.3)	0.1	0.1	0.2
Property, plant and equipment		0.7	(0.6)	0.1	0.1	0.2
Investments in subsidiaries and associates	(7)	20,869.2	(11,130.3)	9,738.9	13,659.6	25,735.3
Receivables from subsidiaries and associates	(8)	1.1	(0.6)	0.5	0.5	0.5
Other financial assets	(8)	2,266.0	(236.9)	2,029.1	2,374.8	2,735.6
Investments and other non-current assets		23,136.3	(11,367.8)	11,768.5	16,034.9	28,471.4
TOTAL NON-CURRENT ASSETS		23,157.3	(11,385.2)	11,772.1	16,039.0	28,476.2
Accounts receivable and other current assets	(9)/(16)	10,767.9	–	10,767.9	11,330.8	11,867.5
Marketable securities	(9)	1,330.7	(55.0)	1,275.7	497.4	304.1
Cash	(9)	3,034.7	–	3,034.7	3,584.0	3,439.3
TOTAL CURRENT ASSETS		15,133.3	(55.0)	15,078.3	15,412.2	15,610.9
Prepayments and deferred charges		587.7	–	587.7	257.5	128.8
TOTAL ASSETS	(6)	38,878.3	(11,440.2)	27,438.1	31,708.7	44,215.9

LIABILITIES AND SHAREHOLDERS' EQUITY (in millions of euros)

	Notes	2003		2002	2001
		Before appropriation	After appropriation*	After appropriation	After appropriation
Capital stock	(11)	2,568.8	2,568.8	2,529.4	2,481.5
Additional paid-in capital	(12)	21,719.1	7,562.4	21,601.8	21,425.8
Reserves	(12)	2,284.1	2,119.0	2,284.1	2,284.1
Retained earnings		(11,066.4)	–	(11,066.3)	3,555.5
Net income (loss) for the year		(3,255.4)	–	–	–
Statutory provisions		–	–	–	–
SHAREHOLDERS' EQUITY	(12)	12,250.2	12,250.2	15,349.0	29,746.9
OTHER EQUITY	(13)	645.0	645.0	645.0	–
RESERVES FOR LIABILITIES AND CHARGES	(14)	3,485.9	3,485.9	3,467.8	404.5
Bonds convertible into new or existing shares (OCEANE)	(15)/(16)	1,022.4	1,022.4	–	–
Others bonds and notes issued	(15)/(16)	3,782.1	3,782.1	5,324.7	5,968.7
Bank loans and overdrafts	(16)	198.8	198.8	297.4	673.0
Miscellaneous borrowings	(16)	244.7	244.7	190.5	898.4
TOTAL FINANCIAL DEBT		5,248.0	5,248.0	5,812.6	7,540.1
Taxation and social security	(16)	4.8	4.8	3.0	6.0
Other liabilities	(16)	5,794.9	5,794.9	6,431.2	6,472.3
TOTAL LIABILITIES		5,799.7	5,799.7	6,434.2	6,478.3
Currency translation adjustment		9.3	9.3	0.1	46.1
TOTAL		27,438.1	27,438.1	31,708.7	44,215.9

* Proposal.

PARENT COMPANY STATEMENTS OF CHANGES IN FINANCIAL POSITION

(in millions of euros)	2003	2002	2001
Sources of funds			
Net income (loss)	(3,255.4)	(14,710.5)	(2,966.1)
Depreciation and amortization	0.5	0.7	0.3
Changes in valuation allowances and other reserves, net	(5,169.8)	15,234.9	3,762.8
Net (gain)/loss on disposal of non-current assets	8,171.1	111.5	159.7
Funds provided (used) by operations	**(253.6)**	**636.6**	**956.7**
Increase in capital stock	156.7	223.9	108.0
Increase in other equity	–	645.0	–
Increase in convertible bonds (OCEANE)	1,022.4	–	–
Increase in long-term debt	–	7.8	1,744.8
Property, plant and equipment	–	–	–
Investments sold	4,047.8	375.7	3,397.4
Other sources of funds	–	–	–
Total sources	**4,973.3**	**1,889.0**	**6,206.9**
Application of funds			
Increase in property, plant, equipment and intangible assets	–	–	3.1
Increase in investments	3,585.3	301.7	1,155.1
Dividend payable*	–	–	197.0
Conversion of bonds	–	–	–
Other application of funds	1,586.2	1,040.5	547.1
Total application	**5,171.5**	**1,342.2**	**1,902.3**
Analysis of changes in working capital			
Accounts receivable and other current assets	(130.0)	117.2	(322.7)
Non-financial debt**	(185.2)	462.3	841.0
Cash and cash equivalents:	–	–	
– short-term financial debt	764.3	270.2	866.6
– cash	(1,425.6)	(348.8)	2,756.7
– marketable securities	778.3	45.9	163.0
Increase (decrease) in current funding	**(198.2)**	**546.8**	**4,304.6**

* A shares and O shares for the dividend distributed on 2001 earnings.
** The net change in income tax reserve is shown on the line "Non-financial debt".

NOTE 1 - ACCOUNTING POLICIES

The financial statements have been prepared in accordance with accounting principles and valuation methods applicable in France. As in previous years, emphasis has been placed on disclosure of key items.

The following accounting principles are applied:

a) Property, plant and equipment

Property, plant and equipment are recorded at cost, except for assets revalued in accordance with French law (most recently in 1976). Depreciation is calculated using the straight-line or declining balance method over the following useful lives:

- buildings: 40 years (straight-line method),
- other property, plant and equipment: from 5 to 10 years (straight-line or declining balance method).

b) Investments in subsidiaries and associates

Investments in subsidiaries and associates are recorded at acquisition cost, excluding incidental expenses, subject to any revaluation in accordance with French law.

When the carrying value of such investments is less than their gross value, a valuation allowance is set up for the difference.

Carrying values are based on:

- value in use of the investment, in respect of subsidiaries and associates held for the long-term. Value in use is determined case by case based on the fair value of the underlying assets, re-evaluation of net assets, estimated market values, and, for listed companies, the stock market value;
- estimated market value, in respect of associates that could be sold if market conditions proved favorable, and, in respect of listed companies, estimated market value based on the average stock market prices for the last month of the accounting period.

As required, when the carrying value of the investment is negative, in addition to the valuation allowance set up, other assets are depreciated and, if necessary, a general risk reserve is recorded.

Capital gains or losses on disposal of investments are calculated on the basis of the weighted average cost of such investments.

Dividends received from subsidiaries and associates are recorded in the period in which the distribution is decided.

c) Treasury stock

Alcatel shares owned by the parent company do not fulfill any particular classification criteria and, therefore, are recorded as other financial assets in the balance sheet.

Their carrying value is calculated at year-end on the basis of the average stock market prices for the last month of the accounting period. If necessary, a valuation allowance is recorded.

d) Marketable securities

Marketable securities are recorded at the lower of cost and net realizable value (either average market price for the last month of the period, or period-end sales value, or estimated market value).

e) Foreign currency transactions

Foreign currency revenues and expenses are recorded at the equivalent euro value at the date of the transaction. Accounts payable, accounts receivable and related off-balance sheet financial instruments denominated in foreign currency are translated at period-end rates of exchange. The resulting currency translation adjustments are shown in the income statement. A reserve for potential foreign exchange losses is set up for unrealized foreign exchange losses that are not offset by corresponding unrealized foreign exchange gains, unless related financial instruments are used that qualify as a hedge and are such that no significant loss will arise when they mature.

f) Accounting for liabilities – Principle defined by the “Comité de la Réglementation Comptable”

The “Comité de la Réglementation Comptable” adopted the “Conseil National de la Comptabilité”’s regulation No. 00-06 dated April 20, 2000 on accounting for liabilities. Following approval by ministerial decree, this regulation became legally applicable as from January 1, 2002. The text sets out that a liability can only be recorded when, at period-end, it is probable or certain that the liability will generate an outflow of funds without at least an offsetting equivalent inflow of funds. In application of this principle, reserves for liabilities amounting to € 84.6 million that did not meet the criteria above were released through shareholders’ equity in 2002.

g) Bonds issued

Bonds issued at a premium or with a reimbursement premium are recorded in liabilities for their total value, including the premiums. The contra-entry for such premiums is recorded in the balance sheet as an asset. The premiums are amortized on a straight-line basis over the life of the corresponding bonds. This amortization is accelerated in case of partial buy-backs of issued bonds.

The fees and expenses linked to the issuance of bonds are recorded in the income statement on a straight-line basis over the life of the corresponding bonds.

NOTE 2 - INCOME STATEMENT ANALYSIS

Net loss totaled € (3,255.4) million in 2003, compared with € (14,710.5) million in 2002. The decrease is analyzed below:

(in millions of euros)	2003	2002
Operating income (loss)	(43.8)	(59.6)
Interest on other equity	(47.2)	(1.2)
Financial income (loss)	5,090.8	(14,933.0)
Income (loss) before non-recurring items and income tax	**4,999.8**	**(14,993.8)**
Non-recurring items	(8,089.8)	(70.7)
Income tax	(165.4)	354.0
Net income (loss) after tax	**(3,255.4)**	**(14,710.5)**

1) In 2003, operating activities resulted in a loss of € 43.8 million, as compared to a loss of € 59.6 million in 2002.

The improvement results primarily from non-recurrent bank fees and commissions incurred on financing operations in 2002.

Revenues, which derive principally from the subsidiaries' contributions to the financing of the Group's shared system of research, decreased from € 834.1 million in 2002 to € 690.1 million in 2003; globally, the funding paid to the subsidiaries decreased proportionally.

2) Interests of € 47.2 million on bonds redeemable for new or existing shares, issued in December 2002, relate to a full year in 2003 compared with € 1.2 million in 2002 on a pro rata basis.

3) Financial income increased from a loss of € 14,933.0 million in 2002 to income of € 5,090.8 million in 2003 as a result of four principal factors:

- the net change in financial reserves and depreciation resulted in income of € 5,018.3 million in 2003 compared to a loss of € 15,471.0 million in 2002.

  Depreciation reversals were booked in 2003, in particular on the investment in Alcatel USA Inc (€ 7,058.2 million), which was contributed to Compagnie Financière Alcatel. In accordance with French generally accepted accounting principles, the capital loss corresponding to this contribution is recorded in non-recurring items.

  In addition, a further reserve for depreciation of € 1,405.9 million was made on the investment in Compagnie Financière Alcatel (this investment had already been depreciated by € 2,757.3 million in 2002).

  New reserves for depreciation were booked in 2003 on the following investments in subsidiaries: Alcatel Submarine Networks: € 920.8 million, Alcatel Space: € 286.6 million (euro 267.2 million in 2002) and Coralec (which indirectly holds the Group's investment in Alcatel Canada Inc): € 12.2 million (€ 5,182.4 million in 2002). In addition, financial risk reserves of € 30 million were recorded in 2003 to cover Alcatel's commitment regarding Alcatel Canada Inc. (€ 2,630.0 million reserve in 2002).

  Reserves for guarantees given, which were recorded in 2002 for € 521.4 million, were partly utilized in 2003 (€ 337.9 million) and increased by a further € 33.0 million;
- the dividends received from subsidiaries decreased from € 280.5 million in 2002 to € 103.1 million in 2003 (see note 3);
- interest paid on long-term borrowings remained stable (€ 251.0 million in 2003 compared to euro 270.7 million in 2002). Profits on short-term cash management, including the Group's system of guaranteeing exchange rates on subsidiaries' commercial bids in foreign currencies, decreased by € 55 million in 2003 compared to 2002;
- an expense of euro 340.0 million was recorded in 2003 in respect of guarantees exercised by third parties (€ 122.3 million in 2002).

4) Non-recurring items resulted in a net loss of € 8,089.8 million in 2003 compared to a net loss of € 70.7 million in 2002.

This net loss includes capital losses of € 7,526.0 million on the contribution of the investment in Alcatel USA Inc to Compagnie Financière Alcatel, € 507.6 million on the disposal of the investment in Alcatel Cable France to Alcatel Participations and € 67.6 million on the disposal of Florelec to Coralec.

The net loss also includes capital gains and losses on the mergers with Alcatel of the following companies, using the "Transmission Universelle de Patrimoine" procedure: Générale Occidentale (capital gain of € 12.3 million), Codelec (capital loss of € 69.2 million) and Société Immobilière La Boétie (SILBO) (capital loss of € 11.7 million, offset by the capital gain realized by SILBO on the disposal of the Group's headquarters' building "La Boétie" for € 62.2 million).

5) The income tax expense of € 165.4 million relates to the French Tax Group (see note 5). The parent company's stand-alone tax bases, taxed either at the standard rate or at the long-term capital gains rate, are negative.

Note 3 - Revenues from investments in subsidiaries and associates

(in millions of euros)	2003	2002
Subsidiaries		
Electro Banque	99.9	19.9
Société Immobilière Nieuport	2.3	0.2
Sofinel	0.1	26.6
Alcatel Norway	–	115.8
Codelec	–	82.8
Alcatel Cable France	–	18.5
Alcatel Contracting	–	14.4
Others	0.1	0.2
Associates		
Nexans	0.7	2.1
Total	**103.1**	**280.5**

Note 4 - Net change in reserves

	2003		2002	
(in millions of euros)	Increase	(Write-back)	Increase	(Write-back)
Reserves for investments in subsidiaries and associates	2,654.6	(7,546.2)	12,089.3	(254.6)
Reserves for other financial investments and other financial assets	14.0	(140.4)	346.7	–
Reserves for marketable securities	–	(36.9)	91.9	–
Reserves for financial risks	487.4	(456.9)	3,261.4	(69.8)
Amortization of premiums on bonds	6.1	–	6.1	–
Total	**3,162.1**	**(8,180.4)**	**15,795.4**	**(324.4)**

Write-backs of reserves for investments in subsidiaries and associates relate mainly to Alcatel USA Inc (€ 7,058.2 million) following the contribution of this investment to Compagnie Financière Alcatel, Alcatel Cable France (€ 237.6 million) and Florelec (€ 178.7 million), which were both sold during 2003, and Codelec (€ 69.2 million) following its dissolution and merger with Alcatel using the "Transmission Universelle de Patrimoine" procedure.

Increases in the reserves for investments in subsidiaries and associates relate mainly to Compagnie Financière Alcatel (€ 1,405.9 million), Alcatel Submarine Networks (euro 920.8 million) and Alcatel Space (€ 286.6 million).

These reserves are based on the fair value of the Alcatel Group, calculated on the basis of the fair values of the different business divisions. The approach consisted in calculating for each business division a fair value excluding debt and taxes, based on discounted future cash flows for the period 2004 to 2008 and on a terminal value in 2008. The discount rate used of 10.6% was the weighted average cost of the Group's capital in 2003. The sum of these fair values, adjusted for consolidated net cash and other balance sheet items, such as tax assets and liabilities, financial assets and other non-operating assets and liabilities, constitutes the fair value of the Group.

The fair value was then allocated to all the legal entities comprising the Group, generally pro rata to their contributions to the Group's gross profit. The other balance sheet items and the consolidated net cash were allocated entity by entity. The value so obtained for each entity was then compared to the historical book value of each investment held by Alcatel and, where necessary, a reserve for depreciation was set up.

The movements on reserves for depreciation of other financial investments relate mainly to Alcatel shares owned by the company, representing a write-back of € 140.4 million in 2003 (increase of € 345.5 million in 2002).

Reserves for financial risks cover Alcatel's commitment to buy back a part of the investment in Alcatel Canada Inc. (€ 2,660.0 million in the balance sheet, of which € 30.0 million was reserved in 2003 and € 2,630.0 million in 2002 – see note 18a), risks on guarantees given (reserve for € 521.4 million booked in 2002, of which € 337.9 million was utilized in 2003 and to which € 33.0 million was added in 2003), and unrealized foreign exchange losses.

Note 5 - Income tax

1) French Tax Group

a) The number of French subsidiaries belonging to the French Tax Group ("intégration fiscale") was 55 in 2003, compared to 67 in 2002. Each company compiled its tax computation independently and provided for income tax accordingly. In addition, Alcatel has accounted for the impact of the adjustments arising from applying the tax grouping rules.

b) As in previous years, the excess of payments received or receivable from subsidiaries over the amount of tax actually paid or payable for the 2003 tax year is held in a specific account in the parent company balance sheet. A part of this account, representing an estimate of definitive tax gains, has been transferred to 2003 net income. Such tax gains are considered realized when a loss-making subsidiary belonging to the French Tax Group cannot expect to utilize its accumulated tax loss carryforwards against future taxable profits, mainly when the tax loss carryforwards become time-expired or lost due to some other event. After the transfer to 2003 net income, this specific account amounted to € 1,195.6 million at December 31, 2003.

2) Tax charge breakdown

The annual parent company tax charge breaks down as follows:

	2003		2002	
(in millions of euros)	Pre-tax amount	Tax	Pre-tax amount	Tax
Operating income (loss)	(43.8)	(71.2)	(59.6)	43.8
Interest on other equity	(47.2)	–	(1.2)	–
Financial income (loss)	5,090.8	(149.3)	(14,933.0)	310.4
Income (loss) before non-recurring items and income tax	**4,999.8**	**(220.5)**	**(14,993.8)**	**354.2**
Non-recurring items	(8,089.8)	55.1	(70.7)	(0.2)
Total tax charge	**(165.4)**	**(165.4)**	**354.0**	**354.0**
Net income (loss) after tax	**(3,255.4)**	–	**(14,710.5)**	–

Note: non-deductible expenses defined in article 39.4 of the French General Tax Code amounted to € 0.3 million.

Note 6 - Balance sheet

Total assets decreased from € 31.7 billion at the end of 2002 to € 27.4 billion at the end of 2003. Significant changes in the 2003 balance sheet include the following:

- investments in subsidiaries and associates decreased from € 13.7 billion at the end of 2002 to € 9.7 billion at the end of 2003 (see notes 4 and 7);
- other asset captions decreased from € 18.0 billion in 2002 to € 17.7 billion in 2003; these captions mainly include short-term advances made to subsidiaries within the context of the Group's treasury convention, and cash and marketable securities (see note 9);
- shareholders' equity after appropriation decreased from € 15.3 billion to € 12.3 billion mainly due to the loss for the year; the main increases in capital in 2003 were linked to the acquisitions of iMagic TV Inc and TiMetra Inc (see notes 11 and 12);
- financial debt decreased from € 5.8 billion at the end of 2002 to € 5.2 billion at the end of 2003;
- other liabilities decreased by € 0.6 billion (€ 5.8 billion in 2003 compared to € 6.4 billion in 2002); this caption mainly includes short-term advances received from subsidiaries within the context of the Group's treasury convention (see note 9).

Note 7 - Investments in subsidiaries and associates

(in millions of euros)	Gross value	Depreciation	Net value
December 31, 2002			
Subsidiaries	28,409.3	(15,573.6)	12,835.7
Associates	1,093.5	(269.6)	823.9
Total	**29,502.8**	**(15,843.2)**	**13,659.6**
Acquisitions	3,585.4	–	3,585.4
Disposals	(12,219.0)	–	(12,219.0)
(Increases)/Write-backs of provisions		4,712.9	4,712.9
December 31, 2003			
Subsidiaries	19,776.6	(10,574.9)	9,201.7
Associates	1,092.6	(555.4)	537.2
Total	**20,869.2**	**(11,130.3)**	**9,738.9**

The changes in investments in subsidiaries and associates during the year mainly result from:

- the contribution to Compagnie Financière Alcatel of investments in Alcatel USA Inc, Alcatel NA Cable Systems and Alcatel USA Holding (€ 9,131.7 million), part of which were purchased from Saft Participations during 2003 (€ 286.6 million). These transfers resulted in a capital increase of Compagnie Financière Alcatel subscribed by Alcatel (€ 1,605.7 million),
- the disposal of Alcatel Cable France to Alcatel Participations (€ 585.2 million),
- the disposal to Coralec of the investment in Florelec, which was originally acquired through the absorption of Codelec (€ 664.2 million),
- the subscription to an increase in Alcatel Submarine Networks' capital (€ 773.9 million),
- the acquisition of TiMetra Inc, which was subsequently contributed to Alcatel USA Inc, resulting in a capital increase of the latter (€ 145.5 million),
- the cancellation of investments in companies which were dissolved and merged with Alcatel using the "Transmission Universelle de Patrimoine" procedure, namely Générale Occidentale (€ 1,099.5 million), Codelec (€ 664.2 million) and Société Immobilière La Boétie (€ 72.5 million).

NOTE 8 - RECEIVABLES FROM SUBSIDIARIES AND ASSOCIATES AND OTHER FINANCIAL ASSETS

The changes during the year were as follows:

(in millions of euros)	Gross value	Depreciation	Net value
December 31, 2002	2,739.2	(363.9)	2,375.3
Increases	107.2		107.2
Decreases	(579.4)		(579.4)
(Increases)/Write-backs of provisions		126.5	126.5
December 31, 2003	2,267.0	(237.4)	2,029.6
Alcatel shares held	471.9	(205.0)	266.9
Long-term loans to subsidiaries	1,760.1	(0.6)	1,759.5
Other financial assets	35.0	(31.8)	3.2
December 31, 2003	2,267.0	(237.4)	2,029.6

The market value of Alcatel shares owned by the company amounted to € 266.9 million, based on the average stock market prices for the month of December 2003. No acquisition or disposal of such shares occurred in 2003.

NOTE 9 - MARKETABLE SECURITIES, CASH AND SHORT-TERM FINANCIAL DEBT

The net amounts of short-term financial assets and debts (excluding accrued interest, but including short-term advances to or from subsidiaries in the context of the Group's Treasury Convention, which appear in the balance sheet in "Accounts receivable and other current assets" or "Other liabilities") are as follows:

(in millions of euros)	2003	2002
Cash *	13,503.8	14,419.3
Marketable securities **	1,275.7	497.4
Short-term financial debt ***	(4,398.6)	(5,103.8)
Total	10,380.9	9,812.9

* Including bank deposits and short-term advances to subsidiaries resulting from the Group's Treasury Convention.

** Including primarily euro denominated certificates of deposit, whose market value, after taking into account accrued interest, is not significantly different from book value. This caption also includes the investment in Nexans.

*** Including euro and non-euro denominated commercial paper, bank loans and overdrafts and short-term advances from subsidiaries resulting from the Group's Treasury Convention.

The change in Alcatel's short-term financial assets and debts reflects a large volume of transactions undertaken by the parent company on behalf of its subsidiaries.

Note 10 - Market-related exposures

Currency risks and interest rate risks are analyzed below.

a) Currency risks

As of December 31, 2003, the off-balance sheet financial instruments, held for hedging purposes, are summarized below:

	Buy/lend		Sell/borrow	
(in millions of euros)	Principal amount	Fair value	Principal amount	Fair value
Forward exchange contracts	2,109.6	(73.7)	3,095.4	234.8
Long-term exchange rate swaps	–	–	–	–
Short-term exchange rate swaps	137.2	(6.1)	698.2	20.2
Currency swaps (long-term)	18.6	(6.2)	73.4	27.0
Currency swaps (short-term)	–	–	–	–
Currency option contracts:				
– call	2,372.7	140.1	2,304.1	(145.9)
– put	1,917.1	73.3	1,386.8	(55.0)

	Maturity dates	
	Earliest	Latest
Forward exchange contracts	01.02.2004	09.22.2005
Long-term exchange rate swaps	–	–
Short-term exchange rate swaps	01.05.2004	10.12.2004
Currency swaps (long-term)	10.11.2004	10.12.2004
Currency swaps (short-term)	–	–
Currency option contracts:		
– call	01.06.2004	12.21.2004
– put	01.02.2004	12.21.2005

b) Interest rate risks

At December 31, 2003, off-balance sheet financial instruments held to manage interest rate risks are as follows:

	Buy/lend		Sell/borrow	
(in millions of euros)	Principal amount	Fair value	Principal amount	Fair value
Interest rate swaps (long-term)	5,472.5	199.0	1,430.9	(39.2)
Interest rate swaps (short-term)	–	–	–	–
FRA	600.0	(0.8)	600.0	0.8
Caps	14,601.6	3.3	13,824.4	–
Floors	9,451.9	99.7	9,451.9	(99.7)
Options on interest rate swaps:				
– call	475.1	5.6	475.1	(5.6)
– put	395.9	1.6	395.9	(1.6)

Analysis by maturity date and interest rate:

	Maturity dates		Interest rate	
	Earliest	Latest	Lowest	Highest
Interest rate swaps (long-term)	01.12.2004	10.31.2011	1.130%	7.685%
Interest rate swaps (short-term)	–	–	–	–
FRA	01.12.2004	07.12.2004	2.185%	2.910%
CAPS	01.12.2004	12.07.2006	3.000%	5.000%
Floors	01.12.2004	02.10.2005	2.500%	4.500%
Options on interest rate swap:				
– call	06.28.2004	07.16.2004	2.500%	3.750%
– put	06.08.2004	08.12.2004	3.250%	4.750%

c) Credit rating and financial covenants

As of January 10, 2004, Alcatel credit ratings were as follows:

Rating agency	Long-term debt	Short-term debt	Outlook	Last update
Standard & Poor's	B+	B	Stable	August 11, 2003
Moody's	B1	Not Prime	Stable	December 5, 2003

During 2003, the two agencies decided to revise their rating outlook for Alcatel from negative to stable.

Recent history of Alcatel's long-term debt credit rating:

Date	Standard & Poor's		Date	Moody's	
August 11, 2003	B+	Outlook stable	December 5, 2003	B1	Outlook stable
October 4, 2002	B+	Outlook negative	November 20, 2002	B1	Outlook negative
July 12, 2002	BB+	Outlook negative	July 9, 2002	Ba1	Outlook negative
November 13, 2001	BBB	Outlook negative	February 18, 2002	Baa2	Outlook negative

Rating clauses affecting Alcatel debt at December 31, 2003

Alcatel's short-term debt rating allows a very limited access to the commercial paper market.

Alcatel's outstanding bonds do not contain clauses that could trigger an accelerated repayment in the event of a lowering of its credit ratings. However, the € 1.2 billion bond issue maturing in December 2006 includes a "step up rating change" clause, which provides that the interest rate is increased by 150 basis points if Alcatel's ratings fall below investment grade. This clause was triggered when Alcatel's credit rating was lowered to below investment grade status in July 2002. The 150 basis point increase in the interest rate from 7% to 8.5% became effective in December 2002, and applied to the payment of the December 2003 coupon. This bond issue also contains a "step down rating change" clause that provides that the interest rate will be decreased by 150 basis points if Alcatel's ratings move back to investment grade.

Syndicated facility

On April 9, 2002, Alcatel closed a € 2,075 million syndicated revolving credit facility available for general corporate purposes. At the same time, the existing outstanding undrawn bilateral credit lines were cancelled. The facility comprised a three-year tranche of € 1,375 million, and a 364-day tranche of € 700 million which matured on April 9, 2003.

The availability of this syndicated revolving credit facility is not dependent upon Alcatel's credit ratings. At December 31, 2003, the credit facility had not been drawn and remained undrawn at the date of approval of the 2003 financial statements by the Board of Directors. Alcatel's ability to draw on this facility is conditional upon its compliance with certain financial covenants (which are identical to the financial covenants relating to the SVF Trust vendor financing securitization program). The facility contains two financial covenants, the first is a gearing ratio (net debt/equity including minority interests) and the second is a ratio linked to the capacity of Alcatel to generate cash to reimburse its debt. At year-end 2003, the Group's cash and marketable securities exceed gross debt. Consequently, such ratios are not applicable at December 31, 2003.

NOTE 11 - CAPITAL STOCK

Capital stock, consisting of 1,284,410,224 ordinary shares of nominal value € 2, increased from € 2,529.4 million at the end of 2002 to € 2,568.8 million at the end of 2003.

As approved at the shareholders' meeting of April 17, 2003, the class O shares were converted into ordinary shares on a one-for-one basis.

(number of shares)

At December 31, 2002	**1,264,708,498**
Capital increase arising from:	
– repayment of bonds reimbursable in shares (ORA)	
– issued in 2003 – TiMetra acquisition *	15,534,934
– issued in 2003 – iMagic TV acquisition *	3,531,332
– issued in 2002 – Astral Point acquisition *	40,000
– issued in 2001 – Kymata acquisition*	485,000
– repayment of bonds reimbursable in new or existing shares (ORANE) 7.91% 2002–2005	1,828
– stock options exercised during 2003	108,632
At December 31, 2003	**1,284,410,224**

* These capital increases were made at the time of the repayment of the bonds reimbursable in shares (ORA), which were issued by an intermediate company dedicated to financing the acquisitions of Kymata, Astral Point, iMagic TV and TiMetra.

NOTE 12 - SHAREHOLDERS' EQUITY

The increase in shareholders' equity results from increases in capital stock (see note 11) and from related increases in additional paid-in capital, which were as follows:

(in millions of euros)

At December 31, 2002	**21,601.8**
Additional paid-in capital arising from:	
– repayment of bonds reimbursable in shares (ORA)	
– issued in 2003 – TiMetra acquisition *	94.5
– issued in 2003 – iMagic TV acquisition *	19.2
– issued in 2002 – Astral Point acquisition *	0.6
– issued in 2001 – Kymata acquisition *	2.4
– repayment of bonds reimbursable in new or existing shares (ORANE) 7.91% 2002–2005	–
– stock options exercised during 2003	0.6
At December 31, 2003	**21,719.1**

* These capital increases were made at the time of the repayment of the bonds reimbursable in shares (ORA), which were issued by an intermediate company dedicated to financing the acquisitions of Kymata, Astral Point, iMagic TV and TiMetra.

At December 31, 2003 and considering the proposed allocation of accumulated losses, additional paid-in capital and reserves were as follows:

	2003		2002
(in millions of euros)	Before appropriation	After appropriation	After appropriation
Additional paid-in capital	21,719.1	7,562.4	21,601.8
Legal reserve	245.7	245.7	245.7
Statutory reserves	1,873.3	1,873.3	1,873.3
Other reserves	165.1	–	165.1
Total	24,003.2	9,681.4	23,885.9

In view of the above-mentioned proposed allocation of losses, the legally distributable reserves amount to € 1,873.3 million.

Note 13 - Other equity

On December 19, 2002, Alcatel issued 120,786,517 bonds, of nominal value € 5.34 each, mandatorily redeemable for new or existing shares (ORANE) (one share for each bond), for a total amount of € 645 million, maturing on December 23, 2005. The notes carry an annual interest rate of 7.917%. On January 2, 2003, Alcatel paid the full amount of the discounted interest, calculated from the settlement date to the maturity date at a discount rate of 7.917%, which amounted to € 1.09115 for each bond.

For the repayment of the ORANEs, Alcatel will either issue new shares, use treasury shares held by subsidiary companies, or use shares acquired not for cash but in connection with restructuring operations.

During 2003, 2,338 bonds were repaid by issuance of 1,828 new shares (the difference corresponding to the reimbursement of prepaid interest by the bondholders).

Interest due on the ORANEs for 2003 amounted to € 47.2 million. Pre-paid interest of € 83.4 million was recorded in accounts receivable and other current assets in the balance sheet.

Note 14 - Reserves for liabilities and charges

The movements on reserves for liabilities and charges in 2003 were as follows:

(in millions of euros)	12.31.2002	Additions	(Write-backs)	(Utilization)	12.31.2003
Reserve for unrealized foreign exchange losses	110.0	419.7	(110.0)	–	419.7
Reserve for financial risks (see note 4)	3,151.4	67.7	(9.0)	(337.9)	2,872.2
Reserves for legal disputes, guarantees given on investments sold and other reserves	186.8	9.4	(20.5)	–	175.7
Reserves for pension and retirement indemnities	19.1	–	–	(1.3)	17.8
Other reserves	0.5	–	–	–	0.5
Total	3,467.8	496.8	(139.5)	(339.2)	3,485.9
Recorded in operating income (loss)		–	–		–
Recorded in financial income (loss)		487.4	(119.0)		368.4
Recorded in non-recurring income (loss)		9.4	(20.5)		(11.1)
Total charge (credit) to income statement		496.8	(139.5)		357.3

NOTE 15 - BONDS ISSUED

At December 31, 2003, outstanding Alcatel bonds amounted to € 4,804.5 million compared to € 5,324.7 at December 31, 2002. These amounts result from the following transactions in 2003:

(in millions of euros)	2002	Repayment of bonds maturing in 2003	Buy-backs and cancellations	New issuances	2003
Convertible bonds (OCEANE)					
– Bonds convertible into new or existing shares 2003-2011	–	–	–	1,022.4	1,022.4
Total Convertible bonds	–	–	–	1,022.4	1,022.4
Other bonds					
– FRF 2 billion bond 6.375% 1993-2003	284.4	(284.4)	–	–	–
– FRF 2 billion bond 5.75% 1994-2004	287.5	–	(103.6)	–	183.9
– FRF 1.5 billion bond 5.625% 1997-2007	228.7	–	(35.3)	–	193.4
– FRF 1 billion bond zero coupon 2006	152.4	–	–	–	152.4
– EUR 1,120 million bond 1999-2009	1,113.0	–	(103.2)	–	1,009.8
– EUR 500 million bond 1999-2004	500.0	–	(140.8)	–	359.2
– EUR 600 million bond 2000-2003	558.7	(271.5)	(287.2)	–	–
– EUR 1 billion bond 2000-2005	1,000.0	–	(206.6)	–	793.4
– EUR 1.2 billion bond 2001-2006	1,200.0	–	(110.0)	–	1,090.0
Total other bonds	5,324.7	(555.9)	(986.7)	–	3,782.1
Total	5,324.7	(555.9)	(986.7)	1,022.4	4,804.5

Convertible bonds issued (OCEANE)

On June 12, 2003, Alcatel issued 63,192,027 bonds having a nominal value of € 16.18 each, convertible into new or existing Alcatel common shares (OCEANE) for a total value of € 1,022.4 million. The bonds mature on January 1, 2011 and bear interest at 4.75% per annum.

2003 tender offer to repurchase bonds

Following the issuance of bonds convertible into new or existing Alcatel ordinary shares (OCEANE) referred to above, and with the aim of extending the maturity dates of its financial debt, Alcatel announced on June 16, 2003 a tender offer to bondholders to repurchase part of the bonds of three debt issues maturing in 2004 and 2005. By July 7, 2003, the expiration date of the offer, Alcatel had purchased € 352 million of bonds, having a nominal value of € 342.3 million. The difference between the purchase price and the nominal value has been included in non-recurring income (loss).

The outcome of the offer is set out in the following table:

(in euros)	Nominal value repurchased
5.75% FRF February 2004	72,722,746
5% EUR October 2004	108,912,000
5.875% EUR September 2004	160,701,000
	342,335,746

Other 2003 bond repurchases

In addition to the tender offer to repurchase bonds, several bonds were subject to buy-back and cancellation in 2003, amounting to € 642 million, corresponding to a nominal value of € 644.4 million, detailed as follows.

The difference between the repurchased amount and the nominal value was also included in non-recurring income (loss).

(in euros)	Nominal value repurchased
Maturity September 2003	287,167,000
Maturity February 2004	30,902,972
Maturity October 2004	31,855,000
Maturity September 2005	45,878,000
Maturity December 2006	110,025,000
Maturity March 2007	35,342,277
Maturity February 2009	103,250,000
	644,420,249

NOTE 16 - ANALYSIS BY MATURITY DATE OF LIABILITIES AND RECEIVABLES AND OTHER CURRENT ASSETS

(in millions of euros)	Amount at 12.31.2003	Less than one year	1-5 years	After 5 years	Out of which accruals
Financial debt					
– convertible bonds (OCEANE)	1,022.4	–	–	1,022.4	–
– other bonds	3,782.1	543.1	2,229.2	1,009.8	–
– bank loans and overdrafts	198.8	49.2	149.6	–	13.6
– miscellaneous borrowings	244.7	241.8	–	2.9	109.1
Tax and social liabilities	4.8	4.8	–	–	2.1
Other liabilities (after appropriation)	5,794.9	4,550.8	1,244.1	–	204.1
Total liabilities	**11,047.7**	**5,389.7**	**3,622.9**	**2,035.1**	**328.9**

Analysis of other liabilities at December 31, 2003

Advances from subsidiaries – Group's Treasury Convention	4,265.0
Tax consolidation suspense account	1,195.6
Accounts payable	220.5
Other	113.8
	5,794.9

(in millions of euros)	Amount at 12.31.2003	Less than one year	1-5 years	After 5 years	Out of which accruals
Tax and social receivables	14.2	14.2	–	–	–
Other accounts receivable and other current assets	10,753.7	10,669.0	84.7	–	77.6
Total accounts receivable and other current assets	**10,767.9**	**10,683.2**	**84.7**	**–**	**77.6**

Analysis of accounts receivable and other current assets at December 31, 2003

Advances to subsidiaries – Group's Treasury Convention	10,564.2
Accounts receivable	68.5
Other	121.0
	10,753.7

NOTE 17 - RELATED PARTY TRANSACTIONS

(in millions of euros)	Net balance sheet amount	Of which consolidated or related companies
Investments and other non-current assets		
– investments in subsidiaries and associates	9,738.9	9,727.6
– due from subsidiaries and associates	0.5	–
– other financial assets	1,760.1	1,759.0
– other investments	269.0	266.8
Accounts receivable	10,767.9	10,604.4
Marketable securities	1,275.7	–
Financial debt		
– convertible bonds and other bonds	4,804.5	–
– bank loans and overdrafts	198.8	–
– Miscellaneous borrowings	244.7	34.4

(in millions of euros)	Net income statement amount	Of which consolidated or related companies
Financial income (loss)		
– revenues from investments in subsidiaries and associates	103.1	102.2
– interest income and similar revenues	1,315.0	468.5
– interest expenses and similar expenses	(1,414.8)	(471.2)
– other financial revenues (expenses)	5,087.5	5 338.0

NOTE 18 - PENSIONS AND RETIREMENT INDEMNITIES

At December 31, 2003, Alcatel's pensions and retirement indemnity obligations were either reserved (the reserve amounts to € 17.8 million – see note 14) or were covered by insurance contracts.

NOTE 19 - CONTRACTUAL OBLIGATIONS AND DISCLOSURE RELATED TO OFF BALANCE SHEET COMMITMENTS

a) Commitment to buy investments in subsidiaries

In the context of the Alcatel Group's acquisition of Newbridge (renamed Alcatel Networks Corporation) in May 2000, and as provided for in the Sale and Purchase Agreement dated May 25, 2000 between Alcatel and Lubelec (a subsidiary of Coralec), Alcatel is committed to purchase from Lubelec, by May 30, 2005 at the latest, its investment in Alcatel Holding Canada Corp. This investment is to be acquired by Lubelec in exchange for Alcatel shares, which are to be contributed to pay for the Newbridge "exchangeable shares" held by former Newbridge shareholders. The price to be paid for the Alcatel Holding Canada Corp. shares is based on the initial issuance price of Alcatel bonds reimbursable in shares (ORAs) of € 50.16 per bond and on the exchange ratio to convert the Alcatel shares into Alcatel Holding Canada Corp. shares. € 2.6 billion has been reserved in the 2003 financial statements to cover this commitment.

b) Sale of carry-back receivable

In May 2002, Alcatel sold to a credit institution a carry-back receivable with a face value of € 200.6 million resulting from Alcatel's decision to carry back 2001 tax losses. The cash received from this sale amounts to € 149.3 million corresponding to the discounted value of this receivable that will mature in five years. The difference between the net cash proceeds and the nominal value is recorded over the five-year period as a financial expense, representing € 10.1 million for 2003.

Alcatel is committed to indemnify the purchaser in case of any error or inaccuracy concerning the amount or nature of the receivable sold. The sale will be retroactively cancelled in the event of a modification to the law or regulations that substantially changes the rights attached to the receivable sold.

c) SVF trust program

In 1999, Alcatel launched a program of securitization of vendor finance receivables which was amended and restated in June 2000 and further amended in May 2002 and May 2003.

The principal changes made in May 2003 are as follows:

– The revolving period of the program has been extended from May 14, 2004 to April 16, 2007.

– The program size was reduced to USD 698.4 million effective May 14, 2003 and will be further reduced on each anniversary date to the following amounts:
  – May 2004 USD 575 million
  – May 2005 USD 450 million
  – May 2006 USD 350 million

Subsequent to the amendment, Alcatel made a voluntary election to reduce the program size to USD 575 million as of December 31, 2003. The scheduled reductions in May 2005 and 2006 remain unaffected.

The program provides for various Alcatel guarantees, the principal ones being:

- a first loss guarantee up to 30% of:

– the program amount during the revolving period, or;

– the funded portion of the program during the amortization period (which is now less than one month);

- two portfolio diversification guarantees. To the extent that the portfolio of receivables held by the trust does not comply with its stated diversification criteria, Alcatel must provide a guarantee in excess of the 30% first loss guarantee described above, which could be as high as 100%. As an alternative to including non-compliant receivables in the calculation of this general pool guarantee, Alcatel has the option to elect to guarantee up to 100% of the receivables that are non-compliant. These guarantees only come into force at the end of the revolving period of the program or at an earlier termination event;
- a political risk guarantee that covers all receivables, with some limited exceptions, for up to 100% of principal and interest, in case of political risks including expropriation, political violence, inconvertibility and transfer risks;
- other specific guarantees concerning particularly currency risks (for receivables not denominated in USD), amortization of the SVF trust and contract completion risks.

The program provides for certain early termination events. These include a breach of certain financial covenants by Alcatel, which are identical to those in the € 1.4 billion syndicated bank facility (see note 10c – Syndicated facility). Adherence to these covenants is tested quarterly. Upon the occurrence of an early termination event, Alcatel is required to monetize its various guarantees within three days.

As of December 31, 2003, loan receivables held by SVF Trust amounted to USD 345 million (USD 428 million as of December 2002).

As of December 31, 2003, a reserve of € 42 million was booked by Alcatel to cover the risk on the guarantee given to the SVF Trust.

d) Guarantees on cash pooling

Guarantees given in respect to Alcatel's centralized treasury management amounted to approximately € 652 million at year-end 2003, corresponding mainly to guarantees granted to the banks implementing the Group's cash pooling arrangements. These guarantees cover the risk involved in any debit position that could remain outstanding after daily transfers between the Alcatel Central Treasury accounts and subsidiaries' accounts. The daily interest rate and currency swap transactions also entailed giving and receiving short-term revolving guarantees (see note 10).

e) Other commitments

Alcatel has also given the following guarantees with regard to the Group's general operations:

(in millions of euros)	**Amount at 12.31.2003**	**Less than one year**	**1-5 years**	**After 5 years**
Guarantees granted to subsidiaries or other Group companies *	199.7	199.7	–	–
Assets pledged to secure Alcatel's financial debt	–	–	–	–
Guarantees given on:				
– commercial contracts	2,649.8	383.5	1,321.7	944.6
– loans	40.5	40.5	–	–
– other items	739.6	221.7	190.2	327.7
Discounted receivables	–	–	–	–
TOTAL	3,629.6	845.4	1,511.9	1,272.3

* Of which € 175.6 million is recorded in financial risk reserves as of December 31, 2003.

NOTE 20 - CONTINGENCIES

Alcatel is involved in a certain number of legal proceedings related to the normal conduct of its business which management does not believe will result in any significant costs to the Group. In addition, Alcatel is involved in the following legal proceedings for which management has determined that no reserves are currently required in its financial statements without however entirely excluding the possibility that one or more of these proceedings may have an impact on Alcatel's financial statements in the future.

France Telecom

Since 1993, a legal investigation has been ongoing concerning "overbillings" which are alleged to have been committed in Alcatel CIT to the detriment of its principal customer, France Telecom, based on an audit of production costs conducted for the first time in 1989 in the transmission division, and for the second time in 1992 in the switching division.

The issue relating to the transmission division resulted in the signature of a settlement agreement with France Telecom. France Telecom, however, filed a civil complaint with the investigating magistrate regarding the switching activity without quantifying the amount of the alleged damages.

In April 1999, the Group learned that the criminal investigation had been extended to determine whether corporate funds of Alcatel CIT and Alcatel had been misused. As a consequence, both Alcatel CIT and Alcatel filed civil complaints to preserve their rights with respect to this investigation.

In January 2000, the investigating magistrate declared his investigation closed (it is unclear whether wholly or partially). Since then, the file has been the subject of several procedural developments. First, the "Cour de Cassation, Chambre Criminelle" rejected the essence of Alcatel's requests concerning the validity of the experts' reports. Additionally, several appeals relating to a former employee of Alcatel CIT, who has been indicted, have been filed and are not closed. It is unlikely that the investigating magistrate will be able to close his investigation before the last quarter of 2004 at the earliest.

Class A and Class O shareholders

Several purported class action lawsuits have been filed since May 2002 against Alcatel and certain of its officers and directors challenging the accuracy of certain public disclosures that were made in the prospectus for the initial public offering of Alcatel Class O shares and in other public statements regarding market demand for Optronics Division products.

The lawsuits purport to be brought on behalf of persons who (i) acquired Alcatel Class O shares in or pursuant to the initial public offering of the American Depositary Shares conducted by Alcatel in October 2000, (ii) purchased Alcatel Class A and Class O shares in the form of ADSs between October 20, 2000 and May 29, 2001 and (iii) purchased Alcatel Class A shares in the form of ADSs between May 1, 2000 and May 29, 2001.

The actions have been consolidated in the United States District Court, Southern District of New York. Alcatel is conducting a vigorous defense and denies any liability or wrongdoing with respect to this litigation.

Although it is not possible at this stage of these cases to predict the outcome with any degree of certainty, Alcatel believes that the ultimate outcome of these proceedings will not have a material adverse effect on its financial position. Alcatel is not aware of any other exceptional circumstances or proceedings that have had or may have a significant impact on the business, the financial position, the net income or the assets of Alcatel or the Group.

NOTE 21 - REMUNERATION OF DIRECTORS AND EXECUTIVE OFFICERS

Directors' fees for 2003 amounted to € 0.6 million (€ 0.6 million in 2002).

The 2003 remuneration of the eleven executive officers comprising Alcatel's Executive Committee amounted to € 7.5 million (€ 7.7 million in 2002) in respect of their functions either in Alcatel or in any of the consolidated subsidiaries.

NOTE 22 - INFORMATION RELATING TO SUBSIDIARIES AND ASSOCIATES

(in millions of euros)	Capital stock at year-end	Components of shareholders' equity other than capital stock [1]	Alcatel percentage of ownership (%)
Detailed information relating to subsidiaries and associates with book value in excess of 1% of Alcatel's capital stock			
A – Subsidiaries (at least 50% of capital stock held by Alcatel)			
CFA – Compagnie Financière Alcatel 54, rue La Boétie – 75008 Paris	4,426.8	1,161.0	100.0
Coralec – 12, rue de la Baume – 75008 Paris	8,586.4	(5,184.2)	100.0
Electro Banque – 12, rue de la Baume – 75008 Paris	106.0	664.0	99.9
SAFT Participations – 12, rue de la Baume – 75008 Paris	196.8	268.7	100.0
Alcatel Submarine Networks – Route de Nozay 91625 La Ville-du-Bois Cedex	106.4	19.4	100.0
Alcatel Norway A/S – Ostre Aker vei 33 Oker 0508 Oslo (Norway)	215.0	1,668.1	100.0
SIKL – Société Immobilière Kléber Lauriston 12, rue de la Baume – 75008 Paris	16.3	29.6	100.0
B – Associates (10% to 50% of capital stock held by Alcatel)			
Alcatel Space – 12, rue de la Baume – 75008 Paris	1,200.0	57.1	48.8
Alcatel Deutschland – Lorenzstrasse 10 – 70435 Stuttgart (Germany)	235.2	27.3	25.0
Information relating to other subsidiaries and associates			
A – Subsidiaries (at least 50% of capital stock held by Alcatel)			
a – French subsidiaries	–	–	–
b – Foreign subsidiaries	–	–	–
B – Associates (10% to 50% of capital stock held by Alcatel)			
a – French subsidiaries	–	–	–
b – Foreign subsidiaries	–	–	–

[1] Before appropriation.
[2] Last financial year.

Gross value of investments held	Net book value of investments held	Outstanding loans and advances	Guarantees given	Net sales (2)	Net income (loss) (2)	Dividends received in 2003 by Alcatel
8,274.0	4,110.7	982.1	–	275.8	(1,789.7)	–
8,726.6	3,390.0	707.9	–	–	(12.2)	–
581.3	581.3	–	1.0	41.3	21.8	99.9
539.9	539.9	–	–	–	6.0	–
1,282.6	361.8	–	–	205.3	(40.3)	–
164.8	121.9	–	–	775.0	(141.0)	–
155.1	48.0	–	–	–	1.9	–
795.0	241.2	476.4	–	1,079.1	(107.1)	–
295.9	295.9	–	–	–	(88.3)	–
47.2	43.1	–	–	–	–	2.3
5.1	5.1	–	–	–	–	0.1
–	–	–	–	–	–	0.7
–	–	–	–	–	–	0.1

INVESTMENT PORTFOLIO AT DECEMBER 31, 2003

		Number of shares held	Net book value (in thousands of euros)	Alcatel percentage of ownership	Alcatel Group percentage of ownership
I - Investments in subsidiaries and associates					
Compagnie Financière Alcatel	(TG)	632,395,681	4,110,698	100.0	100.0
Coralec	(TG)	572,428,045	3,390,000	100.0	100.0
Electro Banque	(TG)	10,592,213	581,303	99.9	100.0
SAFT Participations	(TG)	13,121,159	539,842	100.0	100.0
Alcatel Submarine Networks	(TG)	35,470,935	361,807	100.0	100.0
Alcatel Deutschland		1	295,926	25.0	100.0
Alcatel Space	(TG)	39,077,462	241,228	48.8	100.0
Alcatel Norway		8,400,000	121,883	100.0	100.0
SIKL	(TG)	214,623	47,983	100.0	100.0
Eurelec	(TG)	99,993	12,234	100.0	100.0
Radio Frequency Systems France	(TG)	15,351	7,560	100.0	100.0
Electro Re		6,650	5,100	95.0	100.0
Sardelec	(TG)	152,499	1,373	100.0	100.0
CGE	(TG)	29,874	455	99.6	100.0
FIPP		81,044	200	74.6	74.6
Other			449		
II - Other financial investments					
Alcatel		25,343,255	266,864	2.0	5.4
III - Investments in real estate companies			20,820		

(TG) subsidiary belonging to the French Tax Group

The French Tax Group also includes:

– Alcatel Participations (subsidiary of Compagnie Financière Alcatel)
– Alcatel Business Systems (subsidiary of Alcatel Participations)
– Alcatel CIT (subsidiary of Alcatel Participations)
– Nextenso (indirect subsidiary of Alcatel Participations)
– SAFT (subsidiary of SAFT Participations)
– SAFT Power Systems (subsidiary of SAFT Participations)

FIVE-YEAR SUMMARY OF FINANCIAL DATA

	Notes	2003	2002	2001	2000	1999
Capital stock at year-end						
a) Capital stock (in thousands of euros)		2,568,820	2,529,417	2,481,540	2,457,421	1,998,952
b) Number of A shares		1,284,410,224	1,239,193,498	1,215,254,797	1,212,210,685	199,895,247
c) Number of O shares		–	25,515,000	25,515,000	16,500,000	–
d) Total number of shares after division		1,284,410,224	1,264,708,498	1,240,769,797	1,228,710,685	999,476,235
Potential capital						
a) Capital stock (in thousands of euros)		3,170,035	2,974,011	2,688,391	2,530,046	2,028,211
b) Total number of shares		1,585,017,673	1,487,005,573	1,344,195,736	1,265,022,926	202,821,086
Results						
(in thousands of euros)						
a) Revenues from investments portfolio		103,101	280,502	393,542	1,077,056	810,223
b) Income (loss) before tax, depreciation, amortization and provisions		(8,126,141)	379,442	697,755	1,647,969	1,883,425
c) Income tax		165,356	(353,964)	(97,504)	95,420	215,815
d) Employee profit sharing		–	–	–	–	–
e) Income (loss) after tax, depreciation amortization and provisions		(3,255,426)	(14,710,546)	(2,966,106)	1,395,711	2,229,003
f) Dividends (including distribution tax)		– (1)	–	196,993	583,511	503,397
Earnings per Share						
(in euros)						
a) Income (loss) after tax, but before depreciation amortization and provisions	(2)	(6.46)	0.58	0.64	1.26	8.34
b) Income (loss) after tax, depreciation amortization and provisions	(2)	(2.53)	(11.63)	(2.39)	1.14	11.07
c) Dividend attributable to each A Share having a nominal value of euros 2		– (1)	–	0.16	0.48	2.20
c) Dividend attributable to each O Share having a nominal value of euros 2		– (1)	–	0.10	0.10	–
Personnel						
a) Average number of staff employed during the year		5	4	5	5	5
b) Payroll (in thousands of euros)		2,911	1,889	3,343	3,655	3,558
c) Social security and employee benefits (in thousands of euros)		1,662	955	779	933	829

(1) Proposal.
(2) This value takes into account the total of Alcatel shares (A shares and O shares) for the years 2000 to 2002.

AUDITORS' REPORT ON THE ANNUAL STATUTORY ACCOUNTS

This is a free translation into English of the statutory auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. The statutory auditors' report includes for the information of the reader, as required under French law in any auditor's report, whether qualified or not, an explanatory paragraph separate from and presented below the audit opinion discussing the auditors' assessments of certain significant accounting and auditing matters. These assessments were considered for the purpose of issuing an audit opinion on the annual accounts taken as a whole and not to provide separate assurance on individual account caption or on information taken outside of the annual accounts. Such report, together with the statutory auditors report addressing financial reporting in management's report on internal control should be read in conjunction and construed in accordance with French law and French auditing professional standards.

Dear Alcatel Shareholders,

In accordance with the mission entrusted to us by your Shareholders'Meeting, we are presenting our report for the year ended December 31, 2003, on the following:

– our audit of the annual accounts of the Alcatel company established in euros, as attached to this report

– the justification of our assessments

– the specific verifications and information prescribed by law.

These annual accounts have been prepared by the Board of directors. It is our responsibility, on the basis of our audit, to express an opinion on these accounts.

I. Opinion on the annual accounts

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

We hereby certify that the annual accounts prepared in accordance with accounting principles generally accepted in France present fairly, in all material respects, the results of the operations for the past year and the financial position and holdings of the company at the end of the year.

II. Justification of assessments

In accordance with the requirements of Article L.225-235 of the French Code de Commerce, relating to the justification of our assessments, introduced on 1 August, 2003 by the Loi de Sécurité Financière and applicable for the first time this year, we bring to your attention the following matters:

Your company's management makes estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying Notes. These assumptions are, by nature, subject to uncertainties, and actual results could differ from these assumptions. The accounts affected by significant accounting estimates include investment securities reported in the assets of your company's balance sheet and totalling € 9,738 million, as described in Note 7 to the financial statements.

Your company uses financial planning tools to elaborate multi-annual financial plans, which include different components (e.g. forecasted cash flow and taxable income in particular), to check, if necessary, the fair value of fixed assets.

We have examined the relevance of the methodology outlined in Notes 1b and 4 to the financial statements, examined the data and assumptions used in implementing this methodology and assessed the reasonableness of such estimates.

We have considered whether these estimates were reasonable. Thus, the assessment we provide is part of our audit procedures relating to the annual accounts, taken as a whole, and contributes to the unqualified opinion expressed above in the first part of this report.

III. Specific verifications and informations

We also carried out the specific procedures prescribed by law, in accordance with French professional standards.

We have nothing to report with respect to the fairness of information contained in the Director's report and its consistency with the annual accounts and other information presented to the shareholders concerning the financial position and annual accounts.

As legally required, we made certain that the various disclosures as to the identity of holders of the authorized capital or voting rights were made to you in the Director's report.

Neuilly-sur-Seine, March 30, 2004
The statutory auditors

DELOITTE TOUCHE TOHMATSU
Alain Pons

BARBIER FRINAULT & AUTRES
Christian Chiarasini

SPECIAL REPORT OF THE AUDITORS ON AGREEMENTS REGULATED BY LAW

This is a free translation into English of the statutory auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. Such report should be read in conjunction and construed in accordance with French law and French auditing professional standards.

Dear Alcatel Shareholders,

As statutory auditors of your Company, we are required to report on certain contractual agreements with certain related parties.

We are not required to ascertain whether any contractual agreements exist but to inform you, on the basis of the information provided to us, of the terms and conditions of agreements indicated to us. It is not our role to comment as to whether they are beneficial or appropriate. It is your responsibility, under the terms of Article 92 of the March 23, 1967 Decree, to evaluate the benefits resulting from these agreements prior to their approval.

Agreements authorized during the fiscal year:

We hereby inform you that we have not been notified of any agreements concluded during the fiscal year that might be covered by Article L. 225-38 of the Commercial Code

Agreements approved during prior fiscal years that continued in effect during this fiscal year:

In accordance with the March 23, 1967 Decree, we have been advised that the following agreements, approved in prior years, remained effective during the fiscal year just ended.

Agreements entered into with Thales (formerly Thomson-CSF)

The agreements approved in 1998 and strengthened in 1999 when Alcatel increased its stake in Thomson-CSF (Thales) in December 1999, apply mainly to the terms governing further cooperation between Alcatel and Thales in areas of mutual concern, such as strategy and operations (cooperation in terms of sales, marketing, purchasing, venture capital, property management and the like). Mr. Tchuruk is a Director of both Alcatel and Thales.

Support agreement with subsidiaries regarding research and development and industrial property costs

Contributions by Group companies to research and development and industrial property costs are paid in their entirety to Alcatel, which in turn is responsible for distributing such costs among the subsidiaries in accordance with their funding requirements. For fiscal year 2003, the income recorded by Alcatel came to Euro 690,061,000.

Charges due from Alcatel and its subsidiaries, in accordance with the principles stated above, came to Euro 727,879,000.

Agreement between Alcatel and one of its Directors

A consulting agreement was signed between Alcatel and Mr. Werner with an effective date of August 1, 2001, under which Mr. Werner will provide advice and support to Alcatel Management in the matters of strategy, finance and industrial operations, with special emphasis on external communications and brand name image aimed at promoting the Group in Europe and especially in Germany. For fiscal year 2003, during which the contract terminated, Mr. Werner has been paid a compensation of Euro 51,000.

We conducted our procedures in accordance with professional standards applicable in France; those standards require us to conduct a review to verify the consistency of the information provided to us with the relevant source documents.

Neuilly-sur-Seine, March 30, 2004

The statutory auditors

BARBIER FRINAULT & AUTRES	DELOITTE TOUCHE TOHMATSU
Christian Chiarasini	Alain Pons

GENERAL INFORMATION ABOUT THE COMPANY

GENERAL INFORMATION ABOUT THE COMPANY

LEGAL INFORMATION

Company identity

Corporate name and headquarters

Alcatel

54, rue La Boétie – 75008 Paris.

Legal form and applicable legislation

A French business corporation ("société anonyme") subject to the laws of France, particularly the provisions of the Commercial Code.

Date of incorporation and term

The company was incorporated on June 18, 1898 and expires on June 30, 2086, unless the company is dissolved or extended.

Corporate purpose (summary of Article 2 of the bylaws)

The purpose of the company in all countries is:

– the design, fabrication, operation and sale of equipment, hardware and software of all types for domestic, industrial, civilian, defense and other applications in the electricity, telecommunications, computer, electronics, space, nuclear power and metallurgical industries and, more generally, of all types of energy and communications production and transmission systems (cables, batteries and other components), as well as ancillary operations and services of all types relating to the operations and systems described above.

– the acquisition of equity interests in any and all companies, in any form, whether French or foreign partnerships or groups, and whatever their corporate purpose or business and, more generally, any industrial, commercial, financial, equity or real estate operations related directly or indirectly, in whole or in part, to any of the purposes described in the bylaws and to any and all similar or related purposes.

Trade Registration Number

The company is registered in the Paris Trade Register under Number 542 019 096. Its APE code is 741 J.

Corporate documents

The documents and information concerning the company may be consulted at the company's headquarters at 54, rue La Boétie – 75008 Paris.

Fiscal year

The fiscal year begins on January 1 and ends December 31.

Special provisions of the bylaws

Form and registration of shares and statutory thresholds – Declaration of thresholds – Identification of holders (Article 7 of the bylaws amended by the Combined Annual and Special Shareholders' Meeting of June 20, 1989)

All shares are registered until they are fully paid up.

Fully paid-up shares are registered or bearer at the shareholders' discretion, subject to the provisions of sub-paragraph (2) below. In addition to the legal obligation to inform the company of ownership of certain fractions of the capital, any individual or legal entity and/or any shareholders that comes to own a number of shares in the company equal to or greater than:

1- 0.5% of the total number of shares must, within a period of five days trading sessions (French Act no. 2003-706 of August 1, 2003 on financial security) after this threshold is exceeded, inform the company of the total number of shares he owns by letter, fax or telex. This declaration must be made every time that a new threshold of 0.5% is exceeded, up to and including ownership of 2.5%.

2- 3% of the total number of shares must, within five trading days after this percentage of ownership is exceeded, request registration of his shares. This registration requirement applies to all shares already held and to any shares acquired above this threshold. The copy of the request for registration, sent by letter or fax to the company within two weeks after said threshold is exceeded, constitutes a declaration that the threshold has been exceeded. Such a declaration must be sent each time a threshold of 0.5% is exceeded, up to and including ownership of 50%.

The number of shares that determine the thresholds stipulated in paragraphs (1) and (2) above shall include indirectly held shares and shares classified as owned shares, as defined by Articles L. 233-7 of the Commercial Code.

In each declaration described above, the declarer must certify that the declaration he is making includes all securities held or owned as defined in the preceding paragraph. He must also indicate the acquisition date or dates.

If the shareholder fails to comply with the provisions of (1) and (2) above, then he shall lose, under the conditions and within the limits defined by law, the voting rights to any shares exceeding the thresholds requiring declaration, at the request of one or more shareholders holding at least 3% of the stock.

Any shareholder whose stock falls below one of the thresholds stipulated in sub-paragraphs (1) and (2) above must also inform the company within the same period of five trading days and in the same manner.

Shares are represented by registration in an account in the name of their owner on the books of the issuing company or with an authorized intermediary.

Shares registered in an account shall be transmitted by transfer between accounts. Registrations, transfers and sales shall be executed under the conditions stipulated by law and the regulations in force.

In the event the parties are not exempt from these formalities under the legislation in effect, the company may require that the signature of declarations or transfer orders or transfers be certified under the conditions defined by the laws and regulations in force.

The company may, in accordance with applicable laws and regulations, request that information be communicated to any organization or authorized intermediary concerning its shareholders or holders of securities that confer an immediate or future voting right, the identity of such persons, the number of securities they hold, and any restrictions that may apply to the securities.

Shareholders' Meetings – (Article 21 of the bylaws amended by the Meeting of May 3, 2001)

1- Annual and Special Shareholders' Meetings are called and meet under the conditions specified by law.

   The duly constituted Annual Meeting represents all shareholders, and Meeting decisions are binding on all shareholders, including those who are absent or dissent.

2- The Meeting is held at the corporate headquarters or any other location cited in the notice of Meeting.

3- All shareholders may participate in the Meetings in person, through an agent, or by mail, with proof of identity and ownership of securities, either by registering the shares or by depositing the bearer shares at the location cited in the notice of Meeting. These formalities must be completed three days before the date of the Shareholders' Meeting. The Board of Directors may elect to shorten this time period.

   In accordance with regulations and with the procedures previously defined by the Board of Directors, shareholders may participate and vote in all Annual and Special Meetings by video conferencing or by any other telecommunications method that allows them to be identified.

4- Shareholders may, under the conditions set by law, send their proxy or mail voting forms for all Annual or Special Meetings, either on paper or, if approved by the Board of Directors and published in the notice of Meeting and the invitation, by e-mail.

   To be included in the vote, all votes by mail or proxy must be received at the company's headquarters or the location stated in the notices of Meeting no later than three days before the date of the Shareholders' Meeting. The Board of Directors may elect to shorten this time period. The instructions given by electronic transmission containing a proxy or power may be accepted by the company under the conditions and within the deadlines set by the regulations in force.

5- The proceedings of the Meeting may be broadcast by video conferencing and/or telecast. If so, this shall be announced in the notice of Meeting and the Meeting invitation.

6- Any shareholder who has announced plans to attend the Annual Meeting, sent in a vote by mail, or given a proxy by producing a certificate of non-transferability issued by the custodian of the shares, may, however, transfer all or part of the shares in connection with which he has announced plans to attend the Meeting, send in his vote or proxy, provided that he so informs the intermediary authorized by the company of the elements permitting the cancellation of his vote or his proxy, or changing the number of shares and corresponding votes, subject to the conditions and deadlines set by law and regulations.

7- The Meeting is chaired either by the Chairman or one of the Vice-Chairmans of the Board of Directors, or by a Director designated by the Board or by the Chairman.

   The Meeting shall name officers consisting of the Meeting Chairman, two tellers and a secretary.

   The duties of tellers are performed by the two members of the Meeting who represent the largest number of votes and, if they do not agree to do so, by the members with the next largest number of votes, and so on until the duties are accepted.

8- Copies or excerpts of the Meetings shall be validly certified either by the Chairman of the Board of Directors, or by the secretary of the Meeting, or by the director named to chair the Meeting.

Voting rights – (Article 22 of the bylaws, amended by the Combined Annual and Special Meeting of June 20, 1989)

Subject to the provisions below, every member of every Meeting has as many votes as the number of shares he owns or represents.

However, double voting rights attach to all registered, fully paid-up shares that have been registered in the name of the same owner for at least three years.

Double voting rights automatically end for any share that is converted to bearer form or transferred to another owner. However, any transfer of registered shares as the result of inheritance, whether or not intestate, or of the division of community property between spouses or as a gift inter vivos to a spouse or heirs, shall not interrupt the time period defined above and the shares shall retain all rights acquired.

Regardless of the number of shares owned directly and/or indirectly, a shareholder or proxy may not exercise single voting rights at an Annual or Special Shareholders' Meeting representing more than 8% of the votes attached to the total number of shares present or represented during a vote on any resolution of a Shareholders' Meeting. If a shareholder or proxy also holds double voting rights, the 8% limit may be exceeded to include only those additional voting rights, provided that the number of shares does not under any circumstances exceed 16% of the votes attached to the total number of shares present or represented. Indirectly held shares and shares classified as owned shares as defined by Articles L. 233-7 et seq. of the Commercial Code shall be included in determining these limits.

The limit defined in the preceding paragraph shall automatically become null and void when an individual or legal entity, acting alone or in concert with one or more individuals or legal entities, holds at least 66.66% of the total number of the company's shares as the result of a tender or exchange offer for all of the company's shares. The Board of Directors shall duly note that this limit is null and void upon publication of the results of the operation.

The limit defined in the fourth paragraph of this article does not apply to the Chairman of the Meeting, who casts a vote based on proxies received pursuant to the legal obligation defined in paragraph 7 of Article L. 225-106 of the Commercial Code.

The voting right belongs to the beneficial owner in all Annual or Special Shareholders' Meetings.

Appropriation of earnings – (Article 24 of the bylaws, amended by the Combined Annual and Special Shareholders' Meeting of April 17, 2003 which approved the elimination of special rights for Class O shares in the distribution of earnings).

The profit or loss for the year is the difference between income and expenses for the year, after provisions. Five percent is deducted from the profit, if applicable, minus any prior losses to form the legal reserve. This deduction ceases to be mandatory when the legal reserve equals one-tenth of the capital stock. It resumes when, for any reason, the reserve falls below this fraction.

Distributable earnings, consisting of earnings for the year, less prior losses and the deduction described above, plus retained earnings, shall be available to the Shareholders' Meeting, which may, at the Board of Directors' recommendation, retain all or part of the earnings, allocate all or part to general or special reserve funds, or distribute all or part as dividends.

In addition, the Shareholders' Meeting may elect to distribute sums taken from optional reserves, either to provide or to add to a dividend, or as an exceptional distribution. In this case, the resolution shall expressly indicate the reserve headings from which the sums are taken. However, dividends shall be paid first from distributable earnings for the fiscal year.

The Annual Meeting may grant a choice to each shareholder between payment of the dividend or interim dividend in cash or in shares for all or part of the distributed dividend or interim dividend.

In the case of an interim dividend, the Shareholders' Meeting or the Board of Directors shall determine the date of the dividend payment.

INFORMATION ON THE CAPITAL STOCK

Capital stock and voting rights vote

The capital stock at December 31, 2003 was € 2,568,820,448, represented by 1,284,410,224 shares with a par value of € 2. The shares composing the capital are shares of a single class since the decision of the Shareholders' Meeting of April 17, 2003 which approved the elimination of the special rights for Class O shares. The total number of voting rights as published by Alcatel in the Bulletin des annonces légales obligatoires of April 30, 2003 was 1,223,412,772.

Five-year summary of capital stock

	Number of shares		Capital	Share and conversion premiums
Date and type of operation	**A Shares**	**O Shares**		
CAPITAL AT 12/31/1998	198,710,296		1,211,727,574	10,800,043,010.49
Stock options exercised	4,300			252,379.35
Conversion of capital into euros by raising the par value of the shares and capitalization of reserves				(766,868,677.93)
CAPITAL AT 01/27/1999	198,714,596		1,987,145,960	10,033,426,711.91
Stock options exercised	1,180,651			100,289,835.51
CAPITAL AT 12/31/1999	199,895,247		1,998,952,470	10,133,716,547.42
After five-for-one stock split*	999,476,235			
Stock options exercised	2,849,428			43,608,924.84
Shares issued to remunerate Genesys shareholders in the Exchange Offer	33,683,865			1,367,564,919.00
Issue of shares reserved for employees	2,226,451			102,416,746.00
Redemption of Coralec bonds	173,974,706			8,378,621,840.96
Issue of Class O shares		16,500,000		1,315,936,118.76
CAPITAL AT 12/31/2000	1,212,210,685	16,500,000	2,457,421,370	21,341,865,096.98
Stock options exercised	752,186			8,450,266.69
Issue of shares reserved for employees	91,926			4,412,448.00
Redemption of Deborah Acquisition Ltd bonds (acquisition of Kymata Ltd)	2,200,000	9,015,000		72,332,590.00
Capital increase costs				(1,256,615.26)
CAPITAL AT 12/31/2001	1,215,254,797	25,515,000	2,481,539,594	21,425,803,786.43
Stock options exercised	7,577			89,353.92
Redemption of Coralec bonds:				
- acquisition of Astral Point Communications Inc.	8,783,396			126,568,736.36
- acquisition of Telera Inc.	15,147,728			49,381,593.28
CAPITAL AT 12/31/2002	1,239,193,498	25,515,000	2,529,416,996	21,601,843,469.99
Stock options exercised	108,632			619,778.80
Redemption of Deborah Acquisition Ltd bonds:				
- acquisition of Kymata Ltd		485,000		2,379,410.00
Redemption of Coralec bonds:				
- acquisition of iMagic TV Inc.	3,531,332			19,210,446.08
- acquisition of TiMetra Inc.	15,534,934			94,452,398.72
- acquisition of Astral Point Communications Inc.	40,000			576,400.00
Redemption of Alcatel bonds / 7.917%	1,828			6,105.52
Conversion of Class O shares to ordinary shares	26,000,000	(26,000,000)		
CAPITAL AT 12/31/2003	1,284,410,224	–	2,568,820,448	21,719,088,009.11

*The five-for-one stock split was approved by the Combined Annual and Special Shareholders' Meeting of May 16, 2000.

MARKET FOR ALCATEL SHARES

To the company's knowledge, the principal shareholders at December 31, 2003 were as follows:

	Shares		Votes	
Position in capital and voting rights	**Number**	**%**	**Number**	**%**
Caisse des Dépôts et Consignations	74,340,807	5.79	74,627,757	5.99
Employee Group Fund (FCP 3A)	24,967,354	1.94	39,529,274	3.17
Société Générale Group	11,672,805	0.91	18,955,310	1.52
Treasury stock	25,343,255	1.97	–	–
Shares held by subsidiaries	41,334,089	3.22	–	–
Public (1)	1,106,751,914	86.17	1,112,727,350	89.32
Total	1,284,410,224	100.00	1,245,839,691	100.00

(1) Including 0.03% held by members of the Board of Directors and Management.

As of December 31, 2003, a total of 28,106,811 shares were entitled to double voting rights, representing 2.2% of the capital and 4.51% of the voting rights.

In 2003, the received declarations that legal thresholds had been exceeded issued by certain intermediaries acting on behalf of their clients, were as follows:

– Brandes Investment Partners LLC declared, in its capacity as an investment advising company, that it had fallen below the threshold of 10% of the capital and existing voting rights on April 4, 2003, and stipulated that none of its clients individually held 5% or more of the capital of the company.

– In January 2003, JP Morgan Chase Investor Services, acting in its capacity as registered financial intermediary, declared that it had exceeded the threshold of 5% of the capital and voting rights and then dropped below this threshold, and then declared it had exceeded the threshold of 5% of the capital on February 4, 2003.

In addition, registered intermediaries or fund managers, such as Crédit Agricole Asset Management, Northern Trust, Compagnie d'Investissement de Paris and Atout France, informed the company that they had exceeded and/or dropped below the legal thresholds of 1% and 0.50% during 2003.

Since the beginning of the year 2004, the Caisse des Dépôts et Consignations has informed the company that it had fallen below the statutory thresholds of 5.5% of the capital and held more than 5.27% of the capital and 5.51% of voting rights.

To the company's knowledge, no shareholder other than the one indicated in the table above holds more than 5% of the capital or voting rights.

Alcatel has no knowledge of a shareholders' agreement.

The company estimates the total number of shareholders at 500,000. The Group received no information during 2003 implying that this estimate was inaccurate.

Three-year shareholding summary:

% Interest in capital	**2003**	**2002**	**2001**
Caisse des Dépôts et Consignations*	5.79	5,91	2,66
Employee Group Fund (FCP 3A)	1.94	1,36	1,39
Société Générale Group	0.91	0,90	0,92
Treasury stock	1.97	2.00	2.44
Shares held by subsidiaries	3.22	3.35	4.39
Public	86.17	86.48	88.20
Total	100.00	100.00	100.00

* Caisse des Dépôts et Consignations declared that it exceeded the threshold of 5% of the capital and voting rights in the company on September 16, 2002.

Five-year summary of dividends

Year	Share	Net dividend	Tax credit	Total return
2003 (1)	Ordinary share	–	–	–
2002	O share A share	–	–	–
2001	O share A share	EUR 0.10 EUR 0.16	EUR 0.05 EUR 0.08	EUR 0.15 EUR 0.24
2000 (2)	O share A share	EUR 0.10 EUR 0.48	EUR 0.05 EUR 0.24	EUR 0.15 EUR 0.72
1999	Common share	EUR 2.20	EUR 1.10	EUR 3.30

(1) It will be recommended to the Shareholders' Meeting on June 4, 2004 not to distribute a dividend for 2003.
(2) Five-for-one stock split approved by the Annual and Special Shareholders' Meeting of May 16, 2000.

Dividends not claimed within five years are paid to the French Treasury.

Trading by the company in its own shares

Alcatel has conducted no transaction under its share buyback program. A new authorization to purchase shares will be requested at the next Shareholders' Meeting.

At December 31, 2003, Alcatel held 25,343,255 shares, representing 1.97% of the capital stock. These shares were recorded at December 31, 2003 as a deduction from shareholders' equity.

Securities issued giving rights to capital

Stock options granted by Alcatel

On March 7, 2003, the Board of Directors decided to grant stock options to employees and executives, under two plans, involving 25,626,865 options for 23,650 beneficiaries and 827,348 options for 31,600 beneficiaries.

The Board also renewed the Chairman's power to grant stock options, under strictly defined conditions, in order to honor promises made when hiring new staff or to recognize exceptional situations.

During fiscal year 2003, between June 18, 2003 and December 1, 2003, the Chairman under this authority granted to certain employees of the Group 908,350 stock options that may be exercised at prices fixed on the basis of the value of the share in the days preceding the Chairman's decision, in this case within a range of € 7.60 to € 11.20.

Stock options for Class O shares, which have been granted by the company since the creation of this class of stock, were converted into options for ordinary shares at the end of the Shareholders' Meeting of April 17, 2003 which approved the elimination of the special rights for Class O shares.

As of December 31, 2003, they represented 718,485 options.

As of December 31, 2003, 115,654,538 options for new shares and 10,686,000 options for existing shares remained outstanding, with each option giving the right to one Alcatel share.

Given the expiration of the exercise period for the option plans of January 24, 1996 and December 11, 1996, the options still to be exercised by the beneficiaries, i.e. 2,737,380 options, became null and void as of January 1, 2004. Therefore, the total number of options outstanding at January 1, 2004 was 123,603,158.

However, at December 31, 2003, only 27,282,988 stock options had an exercise price lower than the market price of the Alcatel share on Euronext Paris on the basis of the high recorded in December 2003 (€ 11.20) and therefore offered a possibility of a gain for the beneficiaries.

On March 10, 2004, the Board of Directors decided to grant 18,094,315 stock purchase options to 14,810 employees and executives, giving them the right to subscribe for new Alcatel shares at a price of € 13.20 per share being the average share price over the 20 market trading sessions preceding the board meeting (with no discount).

These options may be exercised following a vesting period, which varies in length depending on the country where the employing company of the beneficiary has its head office. For employees of a company with its head office in France, the vesting period lasts four years and until March 9, 2012.

The 10 members of the Executive Committee as of January 1, 2004, were awarded 955,000 options and the Chairman and Chief Executive Officer was awarded 400,000 options under the same conditions.

The principal features of the options granted and outstanding at December 31, 2003 are described on the following page:

The principal features of the options granted and outstanding at December 31, 2003

Creation of the plan	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding: held by all employees and executives	Number of options outstanding: inc. Management [4]	Option exercise period [1]: From	Option exercise period [1]: To	Exercise price (in euros)	Discount	Options exercised in 2003
OPTIONS FOR EXISTING SHARES											
12.09.1998	2,025	11,602,500	0	1,370,250	10,232,250	485,000	12.09.2003	12.31.2005	20.52	0%	
09.08.1999	141	545,000	0	91,250	453,750		09.08.2004	12.31.2005	28.4	0%	
OPTIONS FOR NEW SHARES											
01.24.1996	998	9,069,500	5,811,370	656,000	2,602,130	60,500	07.01.1998	12.31.2003	12.96	0.92%	
12.11.1996	48	394,000	246,250	12,500	135,250	15,000	07.01.1998	12.31.2003	13.42	3.99%	
04.17.1997	961	8,199,500	107,000	600,000	7,492,500	450,000	05.01.2002	12.31.2004	19.27	4.97%	
12.10.1997	61	367,000	0	55,000	312,000	20,000	12.11.2002	12.31.2004	20.95	4.93%	
03.29.2000	3,887	15,239,250	13,000	1,986,195	13,240,055	880,000	04.01.2003	12.31.2005			
							12.31.2005	12.31.2007	48	0%	
03.29.2000 [3]	58,957	8,90580	4376	213,900	8,691,528	1,176	07.01.2003	07.01.2004			
							07.01.2005	06.30.2006	48	0%	
12.13.2000	478	1,235,500	0	202,650	1,032,850	15,000	12.13.2003	12.13.2005			
							12.13.2005	12.31.2007	65	0%	
12.13.2000 [2] [5]	340	306,700	0	95,121	211,579		12.13.2001	12.13.2008			
							12.13.2004	12.12.2008	64	0%	
03.07.2001 [2]	30,790	37,668,588	0	8,692,541	28,976,047	786,000	03.07.2002	03.06.2009			
							03.07.2005	03.06.2009	50	0%	
03.07.2001 [3]	2,024	275,778	0	3,318	272,460	300	07.01.2004	06.30.2005			
							07.01.2005	06.30.2006	50	0%	
04.02.2001 [2]	13	48,850	0	36,600	12,250		04.02.2002	04.01.2009	41	0%	
04.02.2001 [2] [5]	1	2,500	0	0	2,500		04.02.2002	04.01.2009	39	0%	
06.15.2001 [2]	627	977,410	0	160,305	817,105		06.15.2002	06.14.2009			
							06.15.2005	06.14.2009	32	0%	
09.03.2001 [2]	58	138,200	0	23,350	114,850		09.03.2002	11.11.2009			
							09.03.2005	09.02.2009	19	0%	
11.15.2001 [2] [5]	16	162,000	0	53,000	109,000		11.15.2002	12.18.2009			
							11.15.2002	11.14.2009	9	0%	
12.19.2001 [2]	25,192	27,871,925	0	4,800,944	23,070,981	1,025,000	12.19.2002	12.18.2009			
							12.19.2005	12.18.2009	20.8	0%	
12.19.2001 [3]	45 575	935,660	0	40,790	894,870	180	01.01.2005	12.31.2005			
							01.01.2006	12.31.2006	20.8	0%	
12.19.2001 [2] [5]	521	565,800	64,444	105,950	395,406		12.19.2002	12.18.2009			
							12.19.2005	12.18.2009	9.3	0%	64,444
02.15.2002 [2]	37	123,620	0	34,675	88,945	15,000	02.15.2003	02.14.2010			
							02.15.2006	02.14.2010	17.2	0%	
04.02.2002 [2]	24	55,750	0	14,000	41,750		04.02.2003	04.01.2010	16.9	0%	
05.13.2002 [2]	23	54,300	0	5,250	49,050		05.13.2003	05.12.2010			
							05.13.2006	05.12.2010	14.4	0%	

Creation of the plan	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding: held by all employees and executives	Number of options outstanding: inc. Management (4)	Option exercise period (1) From	To	Exercise price (in euros)	Discount	Options exercised in 2003
06.03.2002 (2)	176	281,000	0	31,750	249,250		06.03.2003 06.03.2006	02.06.2010 02.06.2010	13.3	0%	
09.02.2002 (2)	226	1,181,050	32,182	229,482	919,386		09.02.2003 09.02.2006	01.09.2010	5.2	0%	32,182
10.07.2002 (2)	16	30,500	853	9,138	20,509		10.07.2003 10.07.2006	02.06.2010 02.06.2010	3.2	0%	853
11.14.2002 (2)	26	111,750	3,375	4,250	104,125		11.14.2003 11.14.2006	13.11.2010	4.6	0%	3,375
12.02.2002 (2)	16	54,050	0	10,250	43,800		12.02.2003 12.02.2006	01.12.2010 01.12.2010	5.4	0%	
03.07.2003 (2)	23,650	25,626,865	7,750	1,583,230	24,035,885	1,340,000	03.07.2004 03.07.2007	06.03.2011 06.03.2011	6.7	0%	7,750
03.07.2003 (3)	31,600	827,348	28	17,193	810,127		07.01.2006 07.01.2007	30.06.2007 30.06.2008	6.7	0%	28
06.18.2003 (2)	193	338,200	0	0	338,200	5,000	06.18.2004 06.18.2007	17.06.2011	7.6	0%	
07.01.2003 (2)	19	53,950	0	0	53,950		07.01.2004 07.01.2007	30.06.2011	8.1	0%	
09.01.2003 (2)	77	149,400	0	0	149,400	50,000	09.01.2004 09.01.2007	31.08.2011	9.3	0%	
10.01.2003 (2)	37	101,350	0	0	101,350		10.01.2004 10.01.2007	30.09.2011	10.9	0%	
11.14.2003 (2)	9	63,600	0	0	63,600		11.14.2004 11.14.2007	13.11.2011	11.2	0%	
12.01.2003 (2)	64	201,850	0	0	201,850		12.01.2004 12.01.2007	30.11.2011	11.1	0%	
Total	228,906	153,766,048	6,286,628	21,138,882	126,340,538	5,148,156					108,632

(1) Four-year vesting period for employee beneficiaries of a company with registered offices in France (5 years for options granted before April 27, 2000).
(2) New vesting rules: rights are vested in successive tranches over 4 years at the level of 25% after one year from the date of the Board meeting, and 1/48th at the end of each month thereafter.
(3) Options created in a capital increase reserved for employees.
(4) Members of management at December 31, 2003.
(5) Options for Class O shares, which became ordinary shares.

Stock options granted by international subsidiaries

Options were granted by Alcatel USA Inc. in 2000 and 2001 to managers of the American and Canadian companies allowing them to purchase Alcatel ADS. These plans involved 25.7 million ADS in 2000 and 20.1 million ADS in 2001, i.e. 45.8 million shares. Under these plans, 13,419,081 options were still not exercised at December 31, 2003.

The option plans granted by the international companies acquired by Alcatel give the right to the allotment of Alcatel shares or ADS in a number defined by application of the exchange ratio used at the time of the acquisition to the number of shares of the company acquired to which the options gave the right.

The following table details for the American and Canadian companies that issued these plans the number of options outstanding that could be exercised at December 31, 2003, their average exercise price and the exercise period.

		Options outstanding			Options that may be exercised	
Issuing company	**Exercise price**	**Number existing at 12/31/2003***	**Weighted residual exercise period (numb. of years)**	**Weighted average exercise price**	**Number that may be exercised at 12/31/2003**	**Weighted average exercise price**
Packet Engines	USD 0.29-USD 0.86	14,372	3.89	0.50	14,372	0.50
Xylan	USD 0.05-USD 18.14	2,598,583	4.06	8.69	2,596,207	8.69
Internet Devices Inc	USD 0.26-USD 1.17	26,480	4.83	0.89	26,480	0.89
DSC	USD 16.57-USD 44.02	113,003	2.67	30.78	113,003	30.78
Genesys	USD 0.01-USD 41.16	4,066,893	5.27	20.41	4,048,505	20.32
Newbridge	USD 11.72-USD 52.48	6,331,420	3.76	33.35	6,331,420	33.35
Astral Point	EUR 0.29-EUR 58.71	439,540	7.44	17.08	308,395	19.57
Telera	EUR 0.43-EUR 6.36	273,596	7.06	5.44	196,757	5.13
iMagic TV	EUR 2.84-EUR 64.68	198,955	3.26	13.35	114,429	14.54
TiMetra	EUR 0.53-EUR 7.97	2,858,957	6.58	4.43	772,715	0.61
Total number of options		16,921,799			14,522,283	

* In number of Alcatel shares.

In total, the stock option plans granted in the United States and Canada that constitute a commitment of Alcatel USA Inc. to the beneficiaries involve 30,340,880 options not yet exercised at December 31, 2003. When the options are exercised, no new ADS are issued (and, therefore, no shares), as these options give the right to existing ADS, except for the companies Astral Point, Telera, iMagic TV and TiMetra.

The existing option plans in Alcatel Optronics UK Ltd (former Kymata Ltd), acquired in September 2001, gave the right to the allotment of 402,595 Class O Alcatel shares at an exercise price between € 0.80 and € 35.15. In the framework of the sale of the optical components business, the option plans were transferred to the purchaser, the company Avanex.

Bonds redeemable for shares

- *Issues to finance acquisitions*

During fiscal year 2003, Alcatel authorized two debt issues through its subsidiary Coralec, represented by bonds redeemable for Alcatel shares to allow the acquisition of iMagic TV Inc. (Canada) and TiMetra Inc (United States).

In the context of the acquisition of iMagic TV Inc., 3,717,254 bonds redeemable for Alcatel ordinary shares were issued at a unit price of € 7.44 and resulted, between the date of creation and December 31, 2003, in the issue of 3,531,332 Alcatel shares with a par value of € 2.

In the acquisition of TiMetra Inc., 17,979,738 bonds redeemable for Alcatel ordinary shares were issued at the unit price of € 8.08 and resulted, between the date of creation and December 31, 2003, in the issue of 15,534,934 Alcatel shares with a par value of € 2.

In 2002, Alcatel authorized two debt issues by its subsidiary Coralec, represented by bonds redeemable for Alcatel shares to allow the acquisition of Astral Point Communications Inc. (United States) and Telera Inc. (United States).

In the acquisition of Astral Point Communications Inc., 9,506,763 bonds redeemable for Alcatel ordinary shares (ORA) were issued at the unit price of € 16.41, and resulted in the issue of 40,000 shares with a par value of € 2 between January 1 and December 31, 2003, thus bringing the number of shares issued since the date of creation as repayment for these ORAs to 8,823,396 shares of Alcatel stock.

In the acquisition of Telera Inc., 15,547,728 bonds redeemable for Alcatel ordinary shares were issued at the unit price of € 5.26, and resulted in the issue of 15,147,728 Alcatel ordinary shares with a par value of € 2 between the date of creation and December 31, 2003; no bond was redeemed in 2003.

In fiscal year 2001, Alcatel authorized a debt issue by its subsidiary Deborah Acquisition Ltd, represented by bonds redeemable in Alcatel shares to allow the acquisition of Alcatel Optronics UK Ltd (former Kymata Ltd).

In the context of this acquisition, 9,500,000 bonds redeemable for Class O shares of Alcatel stock and 2,200,000 bonds redeemable for Class A shares of Alcatel stock were issued at the unit price of € 6.9060 and € 14.7750 respectively. Between January 1 and December 31, 2003, they resulted in the issue of 485,000 Class O Alcatel shares, which became Alcatel ordinary shares on April 17, 2003 with a par value of € 2. As of December 31, 2003, all these bonds had been redeemed.

As of December 31, 2003, a total of 3,714,093 bonds redeemable for Alcatel shares were outstanding. These bonds are not listed on any market.

- *Issues as part of financing activities*

> December 2002 ORANE

Under authority from the Alcatel Combined Annual and Special Shareholders' Meeting of April 18, 2002, and pursuant to the power granted to the Chairman by the Board of Directors on December 11, 2002, Alcatel issued debt on December 19, 2002, represented by bonds redeemable for new or existing Alcatel shares. The nominal amount of the issue was € 645 million, represented by 120,786,517 bonds redeemable for new or existing Alcatel shares with a unit value of € 5.34. At December 31, 2003, 2,338 bonds have been redeemed and resulted in the creation of 1,828 Alcatel shares with a par value of € 2.

The three-year bonds bear interest at an annual rate of 7.917%. The interest due was paid in full to the bondholders on January 2, 2003.

> June 2003 OCEANE

Under authority granted by the Alcatel Combined Annual and Special Shareholders' Meeting of April 17, 2003, and pursuant to the power granted to the Chairman by the Board of Directors on June 2, 2003, Alcatel issued debt on June 12, 2003, represented by bonds with an option for conversion and/or exchange for new or existing shares. The nominal amount of the issue was € 1,022 million, represented by 63,192,019 bonds redeemable for new or existing Alcatel shares with a unit value of € 16.18.

These bonds have a term of seven and a half years and bear interest at an annual rate of 4.75%.

The proceeds from this issue were intended primarily to partially redeem, through public offer, three bonds maturing in 2004 and 2005.

On December 31, 2003, a total of 183,976,198 ORANE and OCEANE, listed for trading on the Premier Marché of Euronext Paris SA, were outstanding.

Warrants (giving rights to existing securities)

The company Genesys, acquired by Alcatel in January 2000, had issued, before it was acquired, warrants to the companies Intel and MCI under two separate agreements. These warrants gave the holders rights to Genesys shares. The warrants issued to Intel were fully exercised on February 25, 2000. The warrants issued to MCI (449,664 warrants) were not exercised on the expiration date (January 21, 2003) and are, therefore, void.

The company Newbridge, acquired in May 2000 by Alcatel, had issued 285,000 warrants giving the right, based on the exchange parity, to the delivery of a maximum of 230,850 Alcatel ADS. No warrant was exercised in 2003.

Authorized capital increases

To date, the company has the following authorizations granted by the Shareholders' Meeting on April 18, 2002 and April 17, 2003:

Capital increase authorizations (in millions of euros)	**Maximum amount**	**Available balance** [1]	**Authorization date**	**Expiration date**
I – AUTHORIZATION WITH PREEMPTIVE RIGHT				
Shares only or any equity or securities [3] giving immediate or future rights to a fraction of the capital stock and capitalization of reserves [2]	750 [1]	580	04.18.2002	06.17.2004
II – AUTHORIZATION WITHOUT PREEMPTIVE RIGHT				
Shares only or any equity or securities [3] giving immediate or future rights to a fraction of the capital stock (including securities tendered in an exchange offer initiated by the company)	750 [1]	580	04.17.2003	06.17.2004
III – AUTHORIZATIONS FOR EMPLOYEES				
Issue of shares reserved for employees participating in a company savings plan or a P.P.E.S.V. [5] (Art L.443.1 et seq. of the Labor Code)	3% of the capital stock	3%	04.18.2002	06.17.2004
Issue of shares reserved to employees participating in a company savings plan (PEE) or a P.P.E.S.V.	3% of the capital increase completed under authorizations I and II	3%	04.18.2002	06.17.2004
Stock options for new [4] or existing shares	15% of the total number of shares	6%	04.18.2002	06.17.2005

(1) Up to a global ceiling of € 750 million for all issues with or without preemptive subscription rights combined. At the Shareholders' Meeting of April 17, 2003, the ceiling of issues without preemptive subscription right was increased to € 1 billion with a commitment from the Board of Directors to limit these issues to € 750 million.

(2) The maximum nominal amount of a capital increase by capitalization of reserves is limited to the total amount of the sums that may be capitalized.

(3) Issue of marketable securities representing debt giving the right to, or attached to, an equity security, for which the maximum nominal amount is limited to € 6 billion.

(4) Limit of 15% applicable to stock options for new shares.

(5) Voluntary employee partnership savings plan.

Securities not representing capital stock

These securities are ordinary bond issues: the balance of these issues was € 3,782 million at December 31, 2003.

Nine of these issues are listed for trading on the Premier Marché of the Paris Stock Exchange:

– 6.375% bond issued in 1993,

– 5.625% bond issued in 1997,

– zero coupon bond issued in 1998,

– 4.375% bond issued in 1999,

– variable rate bond (3-month Euribor + 15 basis points – issue 2000),

– fixed rate 4.375% bond, issue 2001,

– 5.75% bond issued in 1994 (due February 2004),

– 5% bond issued in 1999 (due October 2004),

– fixed rate 5.875% bond, issue 2000 (due September 2005).

In order to extend its debt maturities, Alcatel partially redeemed, through a public offering, bonds previously issued at the time of the last three borrowings listed above maturing in 2004 and 2005. At the end of this offering, open between June 17 and July 2, 2003, Alcatel redeemed bonds for a nominal amount of € 342.4 million. The offer closed on July 7, 2003.

Two debt issues in 2001 under the Euro Medium Term Notes program established on July 27, 2001, are listed on the Luxembourg Stock Exchange:

– the fixed rate 4% borrowing, issue 2001,

– the 7% fixed rate borrowing, issue 2001.

Alcatel did not issue any ordinary bond in 2003.

On March 17, 2004, Alcatel launched an offer to exchange bonds in a strategy primarily to lengthen its average debt maturity. On March 30, 2004, Alcatel announced that bonds with a nominal value of € 365 million, coming from Alcatel's 7% bond issue of € 1.2 billion, due 2006, had been exchanged by the holders for new euro bonds having a nominal value of € 412 million, due 2014. The new bonds bear interest at 6.375% per annum and produce a return of 6.49%. As a result, including additional bonds having a nominal value of € 50 million that were issued at the same time, the total nominal value of the new issue, due 2014, amounts to € 462 million.

This issue was made under the authorisation granted by the Shareholders' Meeting of April 18, 2002 to issue bonds of up to a maximum nominal amount of € 10 billion.

The renewal of this authorization will be proposed at the next Shareholders' Meeting.

The Alcatel share

Shareholders

Form of shares in 2003

Registered 8%

Bearer 92%

Five-year summary of dividend per share

Alcatel (in euros)	**2003***	**2002**	**2001**	**2000****	**1999****
Dividend distributed	–	–	0.16	0.48	0.44
Tax credit	–	–	0.08	0.24	0.22
Total dividend	–	–	0.24	0.72	0.66

* It will be recommended to the Shareholders' Meeting of June 4, 2004 that no dividend be paid for fiscal year 2003.
** Five-for-one stock split approved by the Annual and Special Shareholders' Meeting of May 16, 2000.

Alcatel O (in euros)	**2003***	**2002**	**2001**	**2000**
Dividend distributed	–	–	0.10	0.10
Tax credit	–	–	0.05	0.05
Total dividend	–	–	0.15	0.15

* Pursuant to the resolution adopted by the Shareholders' Meeting of April 17, 2003, the O shares were converted into ordinary shares.

Listings

The Alcatel share is listed on the Premier Marché of the Paris Stock Exchange, ISIN code 130007 and Reuters code CGEP.PA, on the other Euronext financial markets in Amsterdam and Brussels, on the SWX Swiss Exchange (Basle, Geneva, Zurich), Frankfurt and Tokyo, and on the SEAQ in London. The security is also listed on the New York Stock Exchange (code ALA) in the form of American Depositary Shares (ADS).

Each Alcatel ADS (American Depositary Share) listed in the United States on the New York Stock Exchange represents one Alcatel ordinary share.

In addition, the shares representing the capital are shares of a single class since the decision of the Shareholders' Meeting of April 17, 2003, which approved the elimination of the special rights for Class O shares. As a result of the conversion of these shares to ordinary shares, there is only one listing line for the ordinary shares.

The Alcatel share is included in the CAC 40 index of the Paris Stock Exchange Market and in the DJ Euro Stoxx 50.

Transactions on the Paris Stock Exchange (Alcatel ordinary shares, in euros) and on the New York Stock Exchange (ADS in U.S. dollars)

	High		Low		Closing price		Number of shares traded over the month	
	Paris	**New York**	**Paris**	**New York**	**Paris**	**New York**	**Paris**	**New York**
2003								
January	7.25	7.45	4.16	4.60	6.74	7.26	568,239,000	74,901,800
February	7.59	8.09	5.79	6.48	6.69	7.09	367,008,000	31,827,300
March	7.31	7.75	5.42	6.09	6.27	6.89	296,892,000	25,484,000
April	8.10	8.75	6.10	6.82	7.34	8.06	342,155,000	28,470,700
May	7.90	9.35	6.52	7.65	7.79	9.24	247,671,000	45,479,800
June	8.54	10.15	7.53	8.72	7.85	8.95	345,217,000	44,698,400
July	8.94	10.04	7.56	8.27	8.92	9.85	283,815,000	41,235,700
August	10.12	10.96	8.50	9.65	9.90	10.89	185,908,000	24,240,800
September	11.89	13.20	9.80	11.16	10.17	11.83	372,241,000	48,263,000
October	11.67	13.68	9.89	11.78	11.35	13.18	307,206,000	40,444,600
November	11.62	13.42	10.24	12.21	10.89	13.02	204,465,000	22,702,600
December	11.20	13.45	9.95	12.27	10.21	12.85	181,239,000	19,588,100
2002								
January	21.62	19.15	16.46	14.45	17.60	15.39	234,940,000	19,342,700
February	18.18	15.48	14.62	12.88	16.05	13.69	209,180,000	17,228,400
March	18.72	16.37	15.63	13.55	16.36	14.17	186,540,000	17,997,800
April	16.58	14.70	13.33	12.26	13.88	12.61	198,530,000	21,098,400
May	14.60	13.25	11.95	11.08	12.70	11.51	185,100,000	16,440,300
June	12.78	12.00	6.80	6.82	7.04	7.11	243,300,000	35,432,100
July	7.68	7.48	4.70	4.44	5.36	5.21	399,970,000	30,442,600
August	6.30	6.00	4.32	4.25	5.18	5.03	224,220,000	14,602,000
September	5.23	4.82	2.05	2.03	2.35	2.33	452,380,000	19,075,100
October	5.54	5.44	2.28	2.20	5.04	4.89	537,770,000	26,424,300
November	6.00	5.92	4.40	4.56	5.75	5.71	382,770,000	29,133,100
December	6.65	6.44	4.14	4.30	4.18	4.44	358,830,000	49,578,100

Source: REUTERS

Transactions on the Paris Stock Exchange (Alcatel O share, in euros) and on the Nasdaq (ADS in U.S. dollars)

	High		Low		Closing price		Number of shares traded over the month	
	Paris	**New York**	**Paris**	**New York**	**Paris**	**New York**	**Paris**	**New York**
2003								
January	4.44	4.75	3.13	3.25	4.04	4.59	2,910,626	162,105
February	7.58	8.10	4.01	4.23	6.67	7.07	16,459,254	465,702
March	7.26	7.61	5.40	5.94	6.32	6.79	3,794,878	100,068
April	7.81	8.30	6.10	6.66	7.52	8.25	2,250,998	1,005,617
2002								
January	9.62	8.70	7.71	6.57	7.85	6.95	1,008,430	217,400
February	8.00	6.95	5.00	4.35	5.91	5.22	1,880,511	436,000
March	7.41	6.50	5.90	5.05	6.20	5.31	1,181,082	168,400
April	6.20	5.59	4.89	4.35	4.95	4.38	1,489,848	256,800
May	5.44	4.76	4.05	3.77	4.07	3.77	937,678	420,500
June	4.15	3.87	1.71	1.75	1.85	1.80	2,233,987	244,100
July	2.65	2.30	1.61	1.50	2.33	2.05	3,136,349	224,350
August	3.20	3.00	2.40	2.20	2.81	2.60	2,572,351	134,300
September	2.85	2.70	1.63	1.62	1.96	2.15	2,235,826	73,700
October	3.09	2.95	1.70	1.62	2.90	2.81	3,130,849	430,400
November	4.44	4.35	2.83	2.85	3.90	4.03	4,081,984	143,990
December	4.45	4.60	3.05	2.85	3.15	3.21	2,045,245	106,140

Source: Paris listing – REUTERS/New York listing - Bank of New York.

SUSTAINABLE DEVELOPMENT AND RISK MANAGEMENT

SUSTAINABLE DEVELOPMENT

A SHARED COMMITMENT

Alcatel has implemented a sustainable development strategy as part of a move towards progress. This strategy involves its main stakeholders, namely employees, partners and customers and applies to the three main components of sustainable development: economic, social and environmental. The strategy is described in the following documents: the Statement on Business Practices has defined the Group's rules of business behavior since 1997. In 2003, the Alcatel social charter was added codifying Alcatel's socially responsible business practices. Furthermore, since 1992, an Environmental Charter embraces all Alcatel's commitments in terms of environmental protection and a Customer Commitment Charter sets forth Alcatel's collective commitment to its customers. In 2003, the Group joined the United Nations Global Compact, renewing its commitment to sustainable development and agreeing to abide by nine principles related to human rights, workers' rights and the environment.

Environment – a progressive approach

Ten years ago, Alcatel instituted an environmental management system at its plants. The system has evolved into third party certification, which has been awarded to most of the Group's plants. In 2003, all the plants sold by the Group were ISO 14001-certified. At the same time, Alcatel agreed to better integrate environmental concerns into the design of its products and to keep its customers informed by means of ecodeclarations. In 2003, Alcatel undertook to make its products compliant with EU directives on waste and hazardous substances. As committed by the Group, the new products are consuming less and less energy.

Digital divide – telecommunications to promote development

Information technologies are closely tied to social and economic development. Alcatel is aware of its responsibilities in this area, as illustrated by its "Digital Bridge" initiative introduced in 2001 to reduce the digital divide. This divide can result from inequalities between developed and developing countries. It also exists in developed countries in isolated, sparsely populated regions.

With its satellites, mobile networks, fiber optics, ADSL and services, Alcatel has one of the broadest arrays of technology of any equipment-maker, and can therefore offer the most suitable solutions for any problem based on the budget available. With its product offerings and technical know-how, Alcatel is working increasingly in partnership with public, private and non-governmental agencies to complete vital development projects in all continents. Alcatel's numerous achievements in 2003 attest to the strength of this approach. They included expanding networks, broadband access, satellite access, as well as on-line education, on-line administration and on-line medical care.

A new structure

In 2003, the Group set up a new organization to accompany its sustainable development commitment. The Group's Corporate Communications Department defines and coordinates Alcatel sustainable development policy and action plans. The work of the Department is supervised by a steering committee with representatives from all the Group's functional departments. A network of around 40 "sustainable development" correspondents has been established worldwide.

For the second straight year, Alcatel is publishing a "sustainable development" report to assess what has been achieved. It can be reviewed on-line at the website www.alcatel.fr or on request from the Investor Relations and Public Affairs Department.

Social and environmental data

Social data

The data presented below pursuant to Article L.225-102-1 paragraph 4 of the Commercial Code, cover the French units of Alcatel, representing 95% of the Group's workforce at year-end 2002 and 98% of the workforce at year-end 2003 in France.

The 2002 data include the following companies: SAFT, Optronics Coutances and Saintes. These companies were sold in 2003 and hence are not included in the 2003 social data. They represented 12% of the workforce in France at year-end 2002, which may explain the sometimes significant changes in certain data between 2002 and 2003.

1. Employment

1.a) Workforce

	December 31, 2003	December 31, 2002	December 31, 2001
Total workforce	18,519	24,229	27,050
Permanent workforce	17,222	22,703	23,215
Number of employees on fixed-term employment contracts at December 31	279	124	88
Number of employees hired on open-ended contracts	205	1,186	3,263
Number of employees hired on fixed-term contracts	224	96	66
of which intra-Group transfers	175	1,065	1,071

Most of the new hires in 2002 and 2003 consisted of transfers between the Group's entities.

1.b) Departures

	2003	2002	2001
Resignations and end of trial periods	122	272	632
End of fixed-term contracts	64	232	276
Of which fixed-term contracts converted to open-ended contracts	3	29	61
Other departures, comprising disposal of businesses, transfers and dismissals	5,521	2,288	744
Total	**5,710**	**2,821**	**1,713**

The reduction in workforce in France resulted from:

Sale of businesses and plants:

– sale of the SAFT battery business to Doughty Hanson, a private European investment company specializing in the acquisition and development of industrial companies,

– sale of opto-electronics component business in May 2003 to Avanex, a specialized manufacturing company,

– sale of Saintes to GMD in June 2001,

– sale of Coutances plant under an LMBO (Leveraged Management Buyout) in April 2002.

Workforce reductions are coordinated with the employee representatives at the plants of the units concerned:

– individual or collective relocations

Alcatel prefers relocation as a solution, such as, for example: working with the company Solutions Plastiques to relocate 115 workers on a voluntary basis from the Alcatel Optronics plant in Lannion

– A hiring freeze since 2001.

– Non-renewal of temporary-hire or fixed-term contracts.

– Termination of subcontracts (SSII) and consulting contracts.

– Early retirement leave.

2. Organization of work schedule

■ *Working week*

The 35-hour working week, as required by law, is in effect at all Alcatel sites in France, in accordance with the terms and conditions negotiated with each company.

	2003	2002	2001
Number of employees working part-time	1,207	1,129	1,209

■ *Absenteeism*

In days	2003	2002	2001
Absences due to illness	100,579	130,255	131,385
Absences due to work-related accidents	4,593	6,889	5,942
Absences due to travel accidents	1,487	1,399	1,666
Maternity leave	31,366	25,050	29,741
Absences due to strikes	1,287	446	546
Other	17,314	22,104	23,138
TOTAL DAYS	156,626	186,143	192,418

The reduction in the number of days of absenteeism is largely due to changes in the Group structure.

■ *Partial unemployment*

	2003	2002	2001
Number of employees placed on partial leave	565	1,786	629
Number of days of partial leave compensated	10,499	67,952	5,002

3. Compensation

The increase in average monthly compensation between 2002 and 2003 results from a change in the weighting of the various of employee categories following the change in Group structure (the engineering workforce increased by 3% as previously indicated).

Alcatel maintains an equitable hiring and compensation policy based on employee merit without regard to sex, culture or origin. Despite the slump in the telecommunications sector, Alcatel makes every effort to guarantee competitive compensation terms to its employees. Management of the compensation policy is decentralized, so as to take into account the conditions specific to each unit. The policy is primarily designed to be sufficiently attractive to recruit high-level specialists.

(in euros)	December 31, 2003	December 31, 2002	December 31, 2001
Average monthly compensation	3,655	3,365	3,317

4. Labor relations

■ *The European Group Committee*

The European Committee for Information and Dialogue (ECID) established in 1996 is designed to facilitate an exchange of information on the Group's strategy, its structure and its economic and social position. Its members include 30 employee representatives from 15 countries. The Committee meets in full session twice a year.

■ The France Group Committee

The Alcatel France Group Committee was formed in 1983 and represents employees from all Alcatel's operations in France. It comprises 35 members and 35 alternates appointed by the unions from the elected representatives of the Works Council. The number of delegates from each union is proportional to the number of votes obtained in the Works Council elections according to the three electoral colleges. In 2003, this Committee met in September and December.

5. Health and safety conditions

In electronic high-technology companies, the problems of worker safety are relatively limited. In the telecommunications sector, however, certain special risks require special attention. Alcatel shares its experience with French partners like EDF, RTE, TDF and the wireless network operators, in order to harmonize the recommendations concerning employee exposure to electromagnetic (EM) fields. This collaboration has led to a professional recommendation guide approved by the Technical Union of Electricity and Communications (UTE).

6. Training

	2003	2002	2001
Number of employees trained	11,172	16,254	18,967
Number of paid training hours	429,243	564,678	773,294

7. Disabled employees

	2003	2002	2001
Number of disabled employees	301	405	387

The reduction in the number of disabled staff is due to the sale of companies that included 99 disabled employees.

8. Scope of subcontracting

	2003	2002	2001
Average number of temporary workers per month	183	545	1,583
Number of trainees (training agreements)	1,193	1,601	1,959

The number of temporary workers dropped significantly in 2003.

■ *Environmental Data*

Environmental Indicators	Units	2003 Full scope[(1)]	2002 Scope: Europe, USA
Consumption of electric power (electricity purchased)	GWh MWh/ employee	747 12.3	1,118 18.1
Other energy consumption (fossil energy)	GWh MWh/ employee	310 5.1	577 9.4
Total energy consumption	GWh MWh/ employee	1,056 17.5	1,695 27.5
CO_2 emitted (only for operations performed by Alcatel and its employees) calculated or estimated using the reporting methodology recommended by the GHG Protocol*: – indirect emissions of CO_2 linked to electricity purchase – direct emissions of CO_2 linked to fossil energy	 Ton Ton/employee Ton Ton/employee	 264,000 4.36 83,000 1.37	 329,710 5.3 123,617 2
Consumption of drinking water	m^3 m^3/employee	2,356,000 39	3,644,000 159.1
Production of toxic waste	Ton kg/employee	3,090 51	7,264 118
% of toxic waste reused for energy or material purposes, i.e., not released and not burned without energy recovery	%	85.7%	51%
Production of non-toxic waste	Ton kg/employee	24,620 407	35,894 582
% of non-toxic waste recycled	%	65%	53%
% of production plants with ISO 14001 certification	%	50%	70%
Metric tons of solvents released into the air	Solvents are no longer widely used by Alcatel as cleaning agents, in particular for printed circuits and final assembly before testing. The so-called bleaching agents have generally replaced chlorinated solvents, as they have in the whole of the telecommunications industry.		
Other gases released into the air (halogenated hydrocarbons, etc.)	Halogenated hydrocarbons have been eliminated from production since 1996. The only CFC emissions are from cooling equipment, and they are not significant, since they are brief (leaks) and do not depend directly on Alcatel's business or operations. They are monitored in accordance with local regulations.		
Discharge into water (heavy metals)	Discharges of heavy metals into water are not significant for Alcatel's final assembly operations or for testing of telecommunications equipment.		
% of new products covered by ecodeclaration (95% by year-end 2005)	Scope: 100%	83%	20%
% of purchasing volume for production covered by ecodeclarations or questionnaires	Scope: Europe	65%	30%

(1) Changes in reporting scope: worldwide in 2003 but restricted to Europe and the United States in 2002.
* GHP: Greenhouse Gas Protocol.

Internal control

As required under Article L.225-37 of the Commercial Code, the internal control procedures and responsibilities introduced by the company at the Group level for the purpose of meeting the objectives set by it and the standards followed are discussed in a report by the Chairman, which is repeated below.

The overall internal control system

Objectives

The Group has an internal control system aimed at optimizing controls within the Group, to monitor primarily that there exist no material items liable to call into question the reliability of the parent company and consolidated financial statements.

One of the objectives is to prevent and control any risks resulting from the company's operations as well as any risk of error or fraud, particularly in the area of accounting and finance. Like any control system, however, it cannot provide an absolute guarantee that such risks have been totally eliminated.

Active in 130 countries, the Alcatel Group is organized into three core businesses focused on a market approach. The Group owes its unity to coordination and control by Senior Management and to head office operations, backed by its internal control system, which in turn is based on a set of control guidelines prepared by a recognized body, the COSO (Committee of Sponsoring Organizations). This system, which was introduced by the Board of Directors, senior executives and employees, is designed to provide reasonable assurance that the following objectives will be met:

– operations are completed in an optimal manner,

– financial data is reliable,

– the laws and regulations in force are complied with.

The system is based on three guiding principles:

– shared responsibility: Internal control is based on the resources of each company and on the responsibilities of each employee at his or her level, backed by a system of delegated responsibilities in terms of implementing the Group's policies. Managers are responsible for overseeing efficiently the operations placed under their authority,

– defining and complying with common standards and procedures: formalizing standards and procedures and communicating COSO guidelines within the Group are an essential step in the internal control process,

– segregation of duties: the general architecture of the system must reflect the distinction between those persons responsible for operations and those responsible for checking them.

Internal control system – Responsibilities

■ *Senior Management*

The Senior Management is directly responsible for the internal control system. The Chairman and Chief Executive Officer is responsible for effective control measures within the Group. He defines the internal control guidelines and supervises implementation of the details. Within each company, this responsibility is delegated to the senior executives.

■ *Audit Committee*

The Audit Committee, which is made up of four members of the Board of Directors, all of whom are independent, checks that internal procedures have been defined for collecting and controlling financial data and for ensuring its reliability. Twice a year, it reviews the Group's internal auditing plan and the operation and organization of the auditing department. This Committee also reviews any risks to which the Group may be exposed, and checks the monitoring of these risks.

■ *The Internal Audit Department*

The responsibilities of the Internal Audit Department are to assist senior management in assessing the efficiency of risk management, auditing and corporate governance systems. These responsibilities are carried out by a staff of fifty auditors, and are centralized at the Group level and directly attached to the office of the Chairman and Chief Executive Officer. The internal auditing plan is defined every six months with the approval of the Chairman and Chief Executive Officer and the Audit Committee. The Chief Internal Auditor reports to them on the work of his department, and to the Disclosure Committee on relevant matters.

Management is constantly seeking ways to improve the quality of service, as recognized by "ISO 9001:2000" certification in 2001, and by the "Commitment to Quality Improvement" awarded twice – in 1999 and 2002 – by the Institute of Internal Auditors Inc. (IIA).

■ *The Finance Department*

Within the Finance Department, the Financial Controls and Consolidation and Accounting Procedures departments also play a role in the internal control system.

The Financial Controls department is in charge of preparing the budget, the monthly, quarterly and annual consolidated financial statements, as well as forecast financial data. Working with the operating and financial departments of the business divisions and the subsidiaries, this department monitors all transactions by the Group on a regular basis.

The Consolidation and Accounting Procedures department is responsible for designing and disseminating the relevant accounting procedures in the Group, and for ensuring that they are in compliance with the accounting laws and standards in effect regarding the preparation and publication of financial statements, and for publishing the parent company and consolidated financial statements.

The Risk Assessment Committee (RAC), which reports to the Chief Financial Officer, has a central office at the company's headquarters and regional offices. Members of the Committee include the Chief Counsel, the Corporate Controller and the Director of Project Finance under the chairmanship of the Chief of Projects and Contracts. Its mission is to review all material contracts and commitments that any Group company plans to sign and to verify that the terms and conditions are acceptable. All commitments above € 30 million fall within its responsibilities. Other contracts are reviewed by the regional RACs. For example, off-balance sheet commitments can be signed by only a limited number of people, after following a strict review procedure resulting in the mutual agreement of the Legal Department and the RAC concerning projects whose commitments are guaranteed.

■ *The Information Systems and Information Technology Department*

Reporting to Senior Management, this department consists of a Corporate Information Systems and Information Technology team, which is in charge of setting IT standards, defining policy and checking all applications and infrastructure for consistency, and of supervising three regional offices responsible for developing and maintaining applications and for systems and network operations.

In applications, a high degree of control and transaction integrity is achieved by respecting development standards that are regularly audited and through the use of commercial software.

We use cutting-edge intrusion detection and protection technologies to maintain the security of our systems and network. Back-up measures are also used for the major applications and financial consolidation applications so that they can be retrieved in the event of a major malfunction. Furthermore, a security unit is responsible for defining procedures and ensuring their implementation.

■ *Disclosure Committee*

This Committee is responsible for assisting the Chairman and Chief Executive Officer and the Chief Financial Officer to ensure that they have reliable information on any significant event so that the company can release documentation or a statement that reliably reflects the Group's financial position. It also assists them to form an opinion on the effectiveness of the internal control system and on its adaptation to the organization of the Group.

The members of this Committee include representatives of corporate functions, the Chief Financial Officer, the Head of the Financial Communications and Investor Relations Department, the Chief Counsel, the Corporate Controller, the Head of the Consolidation and Accounting Procedures department, the Secretary of the Board of Directors, and the Chief Internal Auditor, who chairs the meetings.

Charters and Procedures

To support its internal control policy, Alcatel has introduced a set of rules, which are applicable to all Group companies and which are posted on the Alcatel intranet.

■ *Alcatel's Statement of Business Practices*

Published for the first time in 1997, the statement was updated in March 2003. The Group's vision of appropriate business behavior covers not only business ethics and corporate governance, but also human rights and environmental protection. These rules are designed to eradicate corruption, guarantee transparency and prevent conflicts of interest and insider trading.

The Statement of Business Practices, which applies to all Alcatel employees, has been sent to all Alcatel units to raise awareness of it in their relationships with customers, suppliers, subcontractors and shareholders.

An Ethics Committee has been formed to ensure compliance with the Statement of Business Practices, to ensure that it is updated and to propose the necessary steps in the event of any clear violation reported to it. It comprises members of Senior Management and its chairman is a member of the Board of Directors. The Ethics Committee reports directly to the Chairman and Chief Executive Officer.

In addition, under the SEC rules resulting from the Sarbanes-Oxley Act, a code of good conduct specifically designed for unit chief financial officers in the Alcatel Group was introduced in early 2004. This code, which has been approved by the Audit Committee and submitted to the Board of Directors, defines the rules of good conduct for anyone involved in the preparation and release of financial statements.

■ *The internal audit charter*

Drafted in August 2002 under the authority of the Chairman and Chief Executive Officer, the charter formally defines the mandate, powers and responsibilities of internal audit in accordance with current professional standards.

■ *Accounting procedures*

The Group's accounting procedures and organization are summarized in a manual for use in understanding and controlling the accounting system. The procedures, which are prepared under the responsibility of the Chief Financial Officer, are updated regularly based on changes in accounting standards and regulations applicable to the Group, and are reviewed by the Auditors before release. This applies also to the other procedures designed to control risks, and in particular those relating to the Risk Assessment Committee, and to off-balance sheet items.

■ *The internal control manual*

To ensure that internal control is consistently applied throughout the Group, the Internal Audit Department has developed the above manual for both internal auditors and operational management. For each of the company's business processes, the stakeholders are defined, as well as the data flows, the principal risks and best practices for monitoring and controlling such risks.

■ *Financial Reporting System*

This system is concerned more specifically with the system of internal control underlying the preparation of financial statements and the use of accounting and financial data. This subject is reported upon by the Chairman and by the Auditors.

The existing system

The Finance Department is responsible for preparing statutory and consolidated financial statements. These statements are used internally to monitor and analyze the performance of the Group's businesses. The historical and forecast financial data are analyzed and serve as a basis for regular discussions with financial or line managers of the business divisions and subsidiaries.

During these discussions, the principal financial data are reviewed and all sensitive subjects are openly examined. Sensitive subjects are summarized in note form, designed mainly to ensure control over the financial data coming from the subsidiaries.

The Consolidation and Accounting Procedures Department is responsible for verifying the fairness of the data included in the statutory accounts and consolidated financial statements and the compliance thereof with the Group's rules and procedures. This department is in charge of publishing the parent company and consolidated financial statements and of ensuring at each accounting period-end that the statements are in compliance with standards applicable to companies listed.

The Finance Department is responsible for normal business transactions (e.g., sales, purchases and cash transactions), preparing accounting estimates (e.g., evaluating goodwill), and processing specific operations (e.g., financing transactions, changes in group structure, etc.). The analyse carried out jointly by the Financial Controls and Consolidation and Accounting Procedures departments enable the Finance Department to reinforce internal control over financial and accounting information communicated to shareholders. These two departments report to the Disclosure Committee at the end of each quarter.

Twice a year, the Internal Audit Department conducts a risk analysis of all the Company's business processes, based on interviews at different management levels (regional, Group, divisional and corporate levels), which are compared with the previous audit findings.

Internal audit engagements linked directly or indirectly to financial reporting represent a growing proportion of the internal audit plan for fiscal 2003 compared with fiscal 2002. The purpose of these engagements is to ensure that relevant controls exist and that they are functioning. Recommended corrective actions are systematically followed up by the internal auditors.

Strengthening the system of internal control.

Section 404 of the Sarbanes-Oxley Act, which will apply to Alcatel as from fiscal year 2005, requires the Chairman and Chief Executive Officer and the Chief Financial Officer to make an annual assessment of the effectiveness of the internal controls and procedures designed to ensure reliability of published financial data.

These executives are required to attest their responsibility for setting up an appropriate internal organization and applying suitable internal control procedures for the presentation of financial information.

In 2003, to meet these new requirements, a new internal controls procedure was initiated and introduced, which defines the responsibilities of the persons involved and the methods to be applied. This procedure is designed to provide a reasonable degree of assurance for the certification of the system of internal controls by the Chairman and Chief Executive Officer and the Chief Financial Officer along with the audits performed. The essence of this procedure is based on a self-evaluation process by 110 units for fiscal year 2003.

To that end, the Consolidation and Accounting Procedures, Financial Controls and Reporting Departments, working with the Internal Audit Department, produce an annual risk assessment to identify key controls that should be subject to the self-evaluation process. The main criteria applied to determine the key controls is the probability that the absence or failure of such a control will lead to incorrect reporting.

A self-evaluation questionnaire was designed based on the results of this assessment. For fiscal 2003, 87 control points were selected, based on the five COSO guidelines, as listed below:

- control environment – the control culture within the company,
- risk assessment – evaluation of the internal and external factors liable to affect the performance of the company,
- control operations – the rules and procedures under which risk management actions established by senior management are applied,
- information and communications – the process whereby relevant data are identified and communicated in real time on request,
- management – process designed to make certain that internal controls are adequately designed, effectively applied and relevant to the organization.

The Internal Audit Department is responsible for distributing the questionnaire and conducting the self-evaluation process in the Group companies. This self-evaluation process is conducted under the reponsibility of the Chief Financial Officer of each individual company, who designs action plans for any weakness identified during the self-evaluation process, and who should in the future implement and document such plans before the end of every calendar year.

The questionnaire reported to the Head of the Internal Audit Department is completed and certified by each Chief Financial Officer. Based on this self-evaluation, an annual declaration is made under the signature of the Chairman and Chief Executive Officer and the Chief Financial Officer of every significant company in the Group regarding the adequacy and performance of the internal control system in their company.

The purpose of this system, which comes under the authority of the Disclosure Committee, is to provide Alcatel's Chairman and Chief Executive Officer and its Chief Financial Officer with the assurance that the procedures in force in the Group relating to the reliability of financial data are appropriate.

During every audit engagement in the companies concerned, the auditors evaluate the quality of the self-evaluation process, as well as the results and action plans introduced by Senior Management. Any weaknesses identified are monitored by the Internal Audit Department to make certain that corrective actions are taken in a timely manner.

Backed by a strong internal auditing culture, Alcatel plans to expand its procedures in response to the requirements of the new applicable regulations, making the quality and reliability of financial data a top priority. The above report on the overall organization and internal control procedures illustrates the progressive approach being taken by Alcatel.

■ *Auditors' Report*

The Auditors report on that part of the Chairman's report which deals with the internal control procedures relating to the preparation and processing of financial and accounting data.

AUDITORS REPORT ON THE INTERNAL CONTROL PROCEDURES (DECEMBER 31, 2003)

This is a free translation into English of the statutory auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. Such report should be read in conjunction and construed in accordance with French law and French auditing professional standards.

Statutory auditors' report, prepared in accordance with article L. 225-235 of the Commercial Code, on the report prepared by the President of the Board of Alcatel, on the internal control procedures relating to the preparation and processing of financial and accounting information.

Dear Alcatel Shareholders,

In our capacity as statutory auditors of Alcatel Company, and in accordance with article L. 225-235 of the Commercial Code, we report to you on the report prepared by the President of your company in accordance with article L. 225-37 of the Commercial code for the year ended December 31, 2003.

Under the responsibility of the board, it is for management to determine and implement appropriate and effective internal control procedures. It is for the President to give an account, in his report, of the conditions in which the tasks of board of directors are prepared and organized and the internal control procedures in place within the company.

We performed our procedures in accordance with professional guidelines applicable in France. These require us to perform procedures to assess the fairness of the information and assertions set out in the President's report on the internal control procedures relating to the preparation and processing of financial and accounting information. These procedures notably consisted of:

– obtaining an understanding of the objectives and general organization of internal control, as well as the internal control procedures relating to the preparation and processing of financial and accounting information, as set out in the President's report.
– obtaining an understanding of the work based on which information were given in the President's report.

On the basis of the procedures we have performed, we have no matters to report in connection with the information and the assertions given on the internal control procedures relating to the preparation and processing of financial and accounting information, contained in the President of the board's report, prepared in accordance with article L. 225-37 of the Commercial code.

Neuilly-sur-Seine, March 30, 2004
The statutory auditors

Deloitte Touche Tohmatsu	Barbier Frinault & Autres
Alain Pons	Christian Chiarasini

Risk Management

Alcatel continues to follow a proactive risk management policy aimed at protecting its employees, assets and the environment, while at the same time ensuring the growth and continuity of its business. The Group's risk management policy consists of the following components:

– an on-going process to identify and quantify risks, or mapping, especially any risks inherent in Alcatel's operations and development;

– a loss prevention policy to minimize the occurrence and control the magnitude of those risks;

– an appropriate level of risk retention;

– a coordinated approach for cost-effective risk transfer or alternative risk coverage for risks that are not self-insured;

– emergency plans in the event of a crisis.

For physical assets and operations, a special corporate staff is responsible for defining, communicating and implementing the risk management policy. For companies in which Alcatel owns 50% or more, loss prevention and insurance are closely coordinated between the company concerned and the Group.

Special attention is paid to acquisitions and disposals. The policy is to apply the programs to recently acquired companies and to remove any companies sold on the disposal date.

Since 2001, global risk-mapping has been updated regularly in order to strengthen the risk management program. It is based on global studies of losses (i.e., in terms of frequency, severity, etc.) for all risks insured, supplemented by regular interviews with business division staff to assess as early as possible all the industrial risks to which the Group is exposed.

This allows the Group to prevent significant risks that might affect any of its tangible or intangible assets, by raising the level of insurance for those risks that can be insured.

Prevention of losses and industrial risks

The Group continues to audit and review its plants in order to detect potential deficiencies and to anticipate future exposure to some risks more effectively. In France, none of the Alcatel plants was directly affected by the Law of July 30, 2003 on the prevention of technological and natural risks and on the payment of damages.

An engineering process known as HPR (Highly Protected Risk) has been implemented for physical damage, in accordance with internationally recognized standards, in all Alcatel's principal production plants around the world, based on a program of regular surveys of plants valued at over € 5 million. These surveys, which are made by a specialized outside consultant, began in 1987 and have been continuously improved since then.

Under this program, 120 surveys were conducted in 2003, and as a result, 85% of the total insured value has been brought up to the desired HPR protection value (compared with 42% in 1987).

Environmental risks

Using an internal engineering process introduced in the major production plants in 1992, the Group got a head start on meeting the requirements under international standard ISO 14001 published in 1996 governing environmental management systems. By year-end 2003, 19 production plants in eight countries had been awarded third party certification under this standard. The reason for the reduction in the number of plants certified compared to 2003 is the same as in 2002, namely that several plants were sold during the year.

In cases of disposals or acquisitions, environmental assessments are always made of the different plants by outside consultants. Hence, complete detailed evaluations conducted at the time SAFT was sold (evaluations covering the Environment, Health and Safety because of the specific risks inherent in the battery business) did not reveal any problems for which Alcatel might be held materially liable after sale. This also proved to be true of the printed circuit manufacturing business in France (Coutances) and the metal cabinet business (Saintes) sold in 2003.

Alcatel also established an environmental oversight body consisting of a network of around 20 experts throughout the world. Their responsibilities include ensuring that action plans are implemented following new European directives regarding prohibition of the use of dangerous substances such as lead (RoHS directive that takes effect on July 1, 2006) and scrap management for electrical and electronic equipment (WEEE directive that takes effect on August 13, 2005).

Insurance

Implementing the risk management program in a coordinated manner involves the following:

– proactive risk engineering, including a general and world mapping of risks and, in 2003, a more specific analysis by division (fixed, mobile and private communications, optical transportation, space and integration and services);

– extending loss prevention to nearly all types of risks (direct damage and operating losses, civil liability, transportation and installation);

– organizing the retention of frequent losses at Group level through its consolidated reinsurance subsidiary;

– insuring major risks on the world insurance market.

Based on this program, Alcatel checks on an on-going basis to ensure that its insurance (based on insurance availability on the world market) covers the real risks it faces.

Since January 2001, the following lines have been included in a single insurance policy: direct damages and loss of profits, general and product liability, professional liability, space and aeronautical product liability, transportation and installation, management liability, fiduciary liability, fraud and embezzlement.

With this policy, Alcatel was able to avoid the consequences of the upheaval in the insurance market following the events of September 11, 2001 until it ended in late 2003.

A new integrated policy covering all the insurance lines listed above was renegotiated on January 1, 2004 with a limited number of reinsurers and insurers, with the Group's reinsurance subsidiary still playing a vital role. This policy applies worldwide, and general risk-mapping was a major factor in the negotiation process.

Thus, the Group has coverage that compares favorably, in terms of scope and limits, to the coverage of other businesses of comparable size with comparable activities.

Legal Exposure

The Group is not subject to any special regulations that may affect the normal course of business. However, Alcatel' operator customers work in the telecommunications industry and are subject to regulations issued by independent national authorities, which are not without consequences for Alcatel's operations.

The Group itself does not require legal, regulatory or administrative approval to operate its business.

Some of the companies in the Group are required to maintain the confidentially of their operations because of the nature of these operations and because they are working under confidentiality agreements with international organizations and with the authorities in some countries in charge of defense or industrial development programs. Under these agreements, the companies involved and their employees must restrict access to the locations and facilities used in such operations and to any information pertaining to them.

Contingencies

Contingencies are discussed on page 101 (note 20).

Market Risks

Market risks are discussed on page 23 (part: Risk factors in Alcatel's markets)

CORPORATE GOVERNANCE

BOARD OF DIRECTORS

Prompted by the release of the AFEP-MEDEF reports on corporate governance of listed companies, the "Sarbanes-Oxley Act" and SEC regulations in the United States, Alcatel has been careful to abide by the best corporate governance practices in terms of the proper operation of its Board of Directors and improved financial reporting. In 2003, this led to the approval of amendments to the Directors' Charter and to the adoption of new internal rules for the Board of Directors and its Committees.

Structure of the Board

The Board has the same number of directors as last year. Among its 14 members, four are citizens of foreign countries, and two are Alcatel employees proposed by the Alcatel Employee Investment Fund.

In the past year, changes were made owing to the end of the term of office of Messrs. Jean-Marie Messier and Helmut Werner. Two new directors were appointed at the April 17, 2003 Shareholders' Meeting – Messrs Philippe Germond and Daniel Lebègue, for a term of four years.

At the same meeting, the terms of office of Messrs. Serge Tchuruk, Daniel Bernard and Marc Viénot were renewed for a period of four years each, until the end of the Shareholders' Meeting approving the fiscal year 2006 financial statements.

The maximum term of office for directors was reduced to four years instead of the statutory six years, by decision of the May 16, 2000 Shareholders' Meeting.

On recommendation from the Nominating and Compensation Committee that met on March 10, 2004, the Board of Directors has proposed to the annual Shareholders' Meeting to be held in June 2004 that it renew the term of office of Mr. Jozef Cornu as director for a period of four years.

The average age of the directors is 61.

Appointments of new directors are made under strict selection rules. Members of the Board of Directors must possess expertise in Alcatel's businesses, which involve a high degree of technical complexity, as well as sufficient financial expertise to make independent, well-informed decisions on the Group's financial statements and on its compliance with accounting standards, and, lastly, they must have unquestionable independence with respect to the company's management, based on the criteria listed below.

The criteria for independence adopted by the Board of Directors are founded on the definition proposed by the AFEP-MEDEF reports and on the provisions of the "Sarbanes-Oxley Act," and also on the general rule under which a director, regardless of the period of time in which he has held his position, is independent if he has no direct or indirect relationship with the company or group or the management thereof that could compromise the exercise of his freedom of judgment.

According to these criteria, the Board of Directors in its December 10, 2003 meeting, confirmed the independence of eight of its members, that is, over half the Board as of January 1, 2004 – Messrs Daniel Bernard, Philippe Bissara, Frank W. Blount, David Johnston, Daniel Lebègue, Pierre-Louis Lions, Peter Mihatsch and Marc Viénot.

Without recognizing them as independent directors according to the corporate governance criteria, the Board of Directors considers, however, that Messrs Thierry de Loppinot and Bruno Vaillant, employee directors and members of the Alcatel Employee Investment Fund ("FCP 3A"), enjoy total freedom of opinion based on the manner of their election and their status.

Responsibilities of the Board of Directors

The internal rules adopted by the February 3, 2003 Board of Directors meeting included a number of new corporate governance rules that enable the Board to exercise its authority fully to ensure an effective contribution from every Director.

The mission of the Board of Directors and its powers are based on three major principles: its duties in terms of administration, review and prudence.

Excerpts from the internal rules

"The Board of Directors must decide regularly on the Group's strategies, on any internal restructuring operations and plans for any major investments in organic growth."

"The Board of Directors deliberates on significant acquisitions and sales of equity interests and assets outside the scope of the strategy it has defined. It also approves any transaction or commitment that could have a material impact on the Group's earnings or substantially change the structure of the balance sheet. It must also meet to discuss any envisaged operation that represents more than 10% of shareholders' equity."

"The Board of Directors is also informed regularly, either directly or through its committees, of any significant event in the company's business. It may also request information at any time on any significant changes in the company's financial or cash position, and on any commitments made by the company."

Preparation, organization and operation of the Board of Directors

The Board of Directors met eight times in 2003, with nearly 90% of its members present at every meeting. It has met twice since January 1, 2004.

Board and Committee meetings are planned at the end of the year for the following year; this does not rule out the possibility of special meetings if necessary.

Prior to every board meeting, except for emergencies, the Directors receive a formal notice of the meeting with the minutes of the previous meeting attached, and the documentation and information needed to carry out their duties based on the agenda prepared.

Depending on the agenda of these meetings and the subjects to be discussed, the Chairman of the Board may request that any of the three official Board Committees meet beforehand.

Excerpt from the internal rules

"In the exercise of its duties, the Board of Directors may form specialized committees, composed of directors appointed by it, to investigate any business that comes under the authority of the Board and to submit to the Board their opinions and suggestions in accordance with the internal rules governing them. These committees, which shall consist of no more than three to five Directors, shall be chaired by one of them, to be appointed by the Board of Directors."

Any information needed for the proceedings of the Board shall be sent a few days before the meeting in accordance with any confidentiality rules applied to the transmission of privileged information, giving the Directors time to review the information thoroughly before the meeting. This rule shall also apply to any committees formed by the Board of Directors.

The Board meetings responsible for approving the annual, mid-year and quarterly financial statements are generally preceded by a review of such statements by the Audit Committee meeting.

The file submitted to the Board of Directors' meeting contains complete papers on the agenda items. In general, every point is accompanied by internal or external documentation, depending on the subject, and may also be accompanied, as appropriate, by a draft resolution of the Board. The file also contains a draft press release by the Board that is generally released the day after the Board meeting and before the Paris Stock Exchange opens, according to the recommendations of the French Financial Markets Regulator (Autorité des marchés financiers).

The file also contains a list of the principal contracts and agreements entered into since the last meeting as well as data on changes in the Alcatel share price.

In some cases, Directors are given the opportunity to participate in Board meetings via videoconference. In such cases, they are deemed to be in attendance for quorum and voting purposes except when the board is required to review certain agenda items for which this possibility is expressly prohibited by law.

The average length of the meetings is three hours. Meetings are normally preceded by a meeting with the company's Senior Executives.

The members of the Board of Directors are invited to meet regularly with the company's principal operating managers, to familiarize themselves with the Company's strategy and business developments. They can request the opinions of Senior Executives on any subject deemed appropriate, in accordance with the internal rules of the Board of Directors.

In addition, the Board members receive relevant information concerning the company, particularly press articles and financial analysis reports.

Deliberations of the Board

The deliberations of the Board are based on presentations by Senior Management and proposals by the Chairman, which are freely discussed among the Directors. These discussions cover the following points:

Financial statements

The Board approved the parent company and consolidated financial statements at December 31, 2002, and the budget for the current year, and proposed the appropriation of earnings. It also reviewed the quarterly and mid-year consolidated financial statements and the consolidated financial statements for fiscal 2003. At each of these meetings, the financial statements were reviewed in the presence of the Auditors, and the Audit Committee made a report.

The Group's business

The Board reviewed Alcatel's position in the market, the Group's strategy and the proposal to focus on core businesses. It also received the Strategy Committee's conclusions on these strategies and their impact on the Group.

It approved the acquisition of the companies iMagic TV Inc. (Canada) and TiMetra Inc. (USA) and authorized its subsidiary Coralec to issue bonds redeemable for Alcatel shares to finance the acquisitions. The Board also authorized as part of an internal reorganization the contribution of all the shares in Alcatel USA Inc., Alcatel USA Holdings Corp. and Alcatel NA Cable Systems to Compagnie Financière Alcatel.

In addition, it approved the sale of the optical components business to Avanex in consideration for an exchange of shares which gave Alcatel on completion of the sale 28% of the equity in that company, and the sale of the batteries division represented by the SAFT group.

It also reviewed various divestment and acquisitions still in the planning stages.

Financial position and transactions

The Board of Directors decided to refer to a vote by the Shareholders' Meeting the elimination of special rights attached to Class O shares and the conversion of these shares into Alcatel ordinary shares on a one-for-one basis. This resolution was approved by the April 17, 2003 Shareholders' Meeting.

The Board monitored changes in the Group's cash position, as well as the implementation of restructuring and cost-cutting plans and measures that led to a noticeable improvement in working capital.

In particular, the Board authorized a bond issue convertible or redeemable for new or existing shares, for a nominal amount of € 1,022 million. The proceeds from this bond issue were allocated primarily to finance a tender offer to redeem three bond issues maturing in 2004 and 2005.

Powers of the Chairman

Pursuant to the bylaws, the Board decided in its April 24, 2002 meeting not to separate the duties of Chairman of the Board of Directors from those of Chief Executive Officer. Following the renewal of Mr Serge Tchuruk's term of office as Director at the Shareholders' Meeting on April 17, 2003, the Board renewed its confidence in him by appointing him Chairman of the Board of Directors and Chief Executive Officer of the company for a period expiring at the end of the annual Shareholders' Meeting to approve the financial statements for the year ending December 31, 2005.

The Chairman and Chief Executive Officer performs his duties without any particular restrictions, subject to the powers expressly granted to the Board of Directors by law, the bylaws, and the internal rules.

The Board also renewed the Chairman's powers of delegation with regard to bond issue guarantees and pledges that can be made by the company.

Corporate governance

Pursuant to the new corporate governance rules, the Board adopted the rules for the Board and its Committees, outlining their operating procedures, as well as for the Directors' Charter.

In compliance with the new SEC (Securities and Exchange Commission) rules on auditor independence, the Board approved an amendment to the Audit Committee's internal rules requiring the Committee to authorize beforehand special engagements assigned to the auditors outside the scope of their mandate to audit the financial statements of the company and the Group.

The Board reviewed the proposals by the Nominating and Compensation Committee on plans to grant stock options for new shares for fiscal year 2003, and on the compensation of the Chairman and Chief Executive Officer.

Shareholders' Meetings

The Board convened the Annual and Special Shareholders' Meeting of the holders of Class O shares and approved the documents to be submitted to the Shareholders' Meeting, including the agenda. It also convened a meeting of the holders of bonds redeemable for new or existing Alcatel shares in order to submit to them an amendment to the issue agreement and certain resolutions presented at the Shareholders' Meeting.

The Board also reviewed the questions raised by shareholders during the written questions procedure defined by Article L. 225-108, Paragraph 3 of the Commercial Code.

All resolutions proposed to the above meetings were approved.

Evaluation of the Board of Directors

The Board reviewed the report evaluating its operations prepared at the end of 2002 by an independent firm, following the example of what had been done in 2000. According to the firm's findings, the Board of Directors has the necessary independence with respect to senior management, and the Directors contribute effectively to the discussions.

Pursuant to the internal rules of the Board of Directors, the Directors met to discuss the operations of the Board of Directors and the independence of its members.

The meeting continued without the presence of those Directors serving as executives or employees in the company, in order to assess the performance of Messrs Serge Tchuruk and Philippe Germond as executives of the Company.

In addition, since the beginning of 2004, the Board has met on two occasions, principally to approve the parent company and consolidated financial statements for the year ended December 31, 2003, to convene the annual Shareholders' Meeting and to decide on a new stock option plan.

Committees of the Board

For several years, three committees have been in existence: the Audit Committee, the Nominating and Compensation Committee and the Strategy Committee.

At its February 3, 2003 meeting, the Board of Directors redefined the composition and responsibilities of each committee and approved regulations determining their respective duties and operating procedures.

Strategy committee

This Committee is made up of three members appointed or renewed by the Board of Directors on the recommendation of the Nominating and Compensation Committee. As of January 1, 2004, the members were Messrs. Serge Tchuruk, Chairman of the Committee, Pierre-Louis Lions and Peter Mihatsch, both independent Directors. The Strategy Committee intervenes in the definition of the Group's growth policies, in the selection of investments and in the management of the Group's performance.

The Committee met in September 2003 to review strategic options and prospects for expansion open to Alcatel. This meeting developed a set of proposals made to the Board in December 2003 on the Group's businesses.

Nominating and compensation committee

The Committee is made up of three members appointed or renewed by the Board of Directors. As of January 1, 2004, the members were Messrs Daniel Bernard, Chairman of the Committee, Philippe Bissara and Frank W.Blount. All are independent Directors.

The Chairman of the Board may be involved in the discussions and work of the Committee.

The Committee has three major responsibilities. The first is to study all issues related to the composition, organization and operation of the Board of Directors and its committees (establishing a procedure for nominating new members, evaluating the independence of Directors, etc.).

It is also responsible for making recommendations to the Board regarding compensation of executives and corporate officers, including compensation of the Chairman, stock option plans (setting option plan policies and timetables) and capital increases reserved for employees.

The Committee met twice in 2003 and since the beginning of 2004 has met once, with all its members in attendance.

It reviewed the company's stock option plans of March 2003 and March 2004, the method used to calculate the compensation of the Chairman and Chief Executive Officer and the Chief Operating Officer and the amount of the variable portion of their remuneration in respect of 2003.

It also reviewed the position of each Director based on the criteria defined by the Board in light of the new corporate governance recommendations. It also prepared the decisions of the Board related to the evaluation of the Board and the performance of the Chairman and Chief Executive Officer.

At the beginning of 2004, it also proposed the renewal of the term of office of Mr Jozef Cornu as Director.

The Chairman of the Committee reported on its work to the Board of Directors, which then discussed it.

Audit committee

This Committee is made up of four members, all of whom are independent and appointed or renewed on the recommendation of the Nominating and Compensation Committee. As of January 1, 2004, the members were Messrs Daniel Lebègue, Chairman of the Committee, Marc Viénot, Daniel Bernard and David Johnston. The April 17, 2003 meeting of the Board of Directors appointed Mr Daniel Lebègue, a new Director of the company, as Chairman and member of the Audit Committee to replace Mr Marc Viénot.

The Committee has four areas of responsibilities: accounting principles, internal control, financial statements and financial situation and the independent Auditors.

The Committee monitors the relevance and consistency of the principles used. It examines the extent of the consolidated group, the applicable accounting standards and the parent company and consolidated financial statements. It verifies that internal audit procedures and plans have been defined and reviews the Group's significant off-balance sheet risks or commitments and all issues of a financial or accounting nature.

In addition, the Audit Committee manages the procedures for appointing the Statutory Auditors and controls their independence by setting as applicable any rule governing work assigned to them. It also gives an opinion on the level of their fees.

The members of the Committee met six times in 2003. Over 90% of the members attended the meetings. Since the beginning of 2004, the Committee has met twice primarily to review the parent company and consolidated financial statements for the year ended December 31, 2003.

The Chairman of the Committee reported on its work to the Board of Directors:

Accounting principles

The Committee was informed of the principles applied in preparing the reconciliations to arrive at the U.S. GAAP financial statements and the differences in accounting treatment compared to the financial statements prepared in accordance with French accounting principles.

It also reviewed the change in accounting policies to comply with IFRS, the first implementation of which is planned for the first quarter of 2005, and approved the Group's deliberations on the impact of their implementation.

Internal control

The Committee received the annual internal audit report for 2002 and the internal audit plan for 2003. During the review of internal audits carried out, it consulted with the internal Audit Department and reviewed its resources.

The Committee duly noted the creation of a Disclosure Committee, as required under the "Sarbanes-Oxley Act," responsible for ensuring that procedures for preparing and auditing the financial statements are properly followed in order to publish reliable information on the Group.

Financial statements and financial position

In 2003, the Committee performed a preliminary review of the parent company and consolidated financial statements for the year ended December 31, 2002, the U.S. GAAP financial statements, the consolidated mid-year financial statements and the quarterly consolidated financial statements. At each of these meetings, the Committee interviewed Senior Management, the Finance Department and the Auditors and reviewed, in the presence of the Auditors, the principal points discussed with the Finance Department when the financial statements were prepared.

The budget and financial forecasts for 2003 were presented to the Committee.

The Committee duly noted the improvement in certain financial ratios, which enabled the Group not to be in breach of its financial covenants with the banks.

It noted significant improvements in the presentation of certain information in the notes to the financial statements, in particular those relating to provisions and off-balance sheet commitments.

Auditors

The Committee proposed to the Board of Directors that it amends some provisions of the regulations regarding Auditor independence and that it adopts arrangements enabling the Group to be in compliance with the new SEC regulations, most of which came into effect in May 2003.

The Committee approved and introduced a procedure that requires prior approval of audit engagements and defines the principles and the nature of allowed engagements. It also set the thresholds that are calculated based on total fees paid to the Auditors for the statutory audit, above which any engagement must be authorized by the Audit Committee.

The Committee has been notified of all the engagements conducted by the Auditors since the beginning of the year.

MANAGEMENT COMPENSATION

Chairman and Chief Executive Officer

The Chairman and Chief Executive Officer's annual compensation, like that paid to all the Group's managers and senior executives, consists of a fixed portion and a variable portion. The annual compensation is fixed by The Board of Directors on the recommendation of the Nominating and Compensation Committee.

Every year, the Board examines the method for determining the variable portion, which is based on the outlook and expected Group results for the following year. The variable portion is also fixed by the Board on the recommendation of the Nominating and Compensation Committee. It is paid in the year following the fiscal year to which it relates, after the Shareholders' Meeting has approved the financial statements for the year then ended.

No variable compensation was paid in 2003 (as was the case in 2002). As a result, the overall gross annual compensation paid in 2003 amounted to € 1,524,490, corresponding to the fixed portion, which has not increased since 2000.

With regard to the variable portion that will be paid in 2004 in respect of fiscal 2003, the Board fixed the gross amount at € 770,000 in consideration for the Chairman and Chief Executive Officer's performance with regard to the restructuring of the Group and to the operating income achieved in a difficult context.

In addition, Mr Tchuruk does not receive any Director's fees from any of the directorships he exercises in Group companies or from those in which he is a director as a result of Alcatel's shareholding in those companies. He has the use of a company car, for which the benefit in-kind was valued at € 9,982 for fiscal 2003.

Finally, pursuant to the rules adopted when he was appointed, the Chairman and Chief Executive Officer shall, on leaving the company, unless such departure is justified by an act contrary to the company's interests, be entitled to a payment equal to twice his compensation. He also benefits from a supplementary pension scheme that will allow him to receive, from all pension schemes combined, a pension equal to a maximum of 40% of his compensation.

Senior Executives

In 2003, Senior Management, represented by all eleven members of the Executive Committee at December 31, 2003, received total compensation from Alcatel, or from the companies controlled by Alcatel, amounting to € 7.5 million (compared with a total of € 7.7 million paid in 2002). Executive compensation includes a fixed portion and a variable portion based on the company's performance and individual performance, according to criteria reviewed by the Nominating and Compensation Committee.

Of the total amount of compensation paid in 2003, the fixed portion amounted to € 5.8 million, and the variable portion, which is partly tied to the results of fiscal 2002, amounted to € 1.7 million, or 23% of the total amount. In addition, directors' fees that are received by the Executives from different companies for their duties at Alcatel are deducted from their salaries.

Directors' compensation

Total annual Directors' fees allocated to Board members is set at € 600,000 as decided by the combined Shareholders' Meeting of May 16, 2000. As approved by the Board of Directors and set forth in the internal rules, the fees are allocated as follows:

- Mr Tchuruk, Chairman of Alcatel, and Mr Germond, Chief Operating Officer, do not receive directors' fees;
- Directors' fees are divided into two equal parts, a fixed portion and a variable portion, distributed as follows:
  - the fixed portion is distributed equally to Directors;
  - the variable portion is distributed among the members of the Board based on their attendance at Board Meetings and at Meetings of the Committees on which they serve;
- payments are made in two installments: the first one after the Annual Meeting, and the second one at the end of the year,
- a total of € 600,000 in Directors' fees was paid out for fiscal 2003.

The compensation and benefits in-kind paid to the members of the Board of Directors in 2003 are summarized below:

(in euros)	Compensation	Directors' fees (3)	Benefits in-kind
Serge Tchuruk [1]	1,524,490	–	9,982
Philippe Germond [1]	750 000	–	5,496
Daniel Bernard	–	64,169	–
Philippe Bissara	–	53,309	–
Frank W.Blount	–	42,901	–
Jozef Cornu [1]	271,674	47,880	33,465
Jean-Pierre Halbron [2]	453,315	47,880	199
David Johnston	–	43,960	–
Daniel Lebègue	–	41,959	–
Pierre-Louis Lions	–	49,390	–
Thierry de Loppinot	93,772	47,880	–
Peter Mihatsch	–	40,941	–
Bruno Vaillant	75,593	47,880	–
Marc Viénot	–	54,819	–

(1) Amount corresponding to the annual fixed portion paid in 2003; no variable portion was paid in 2003 for fiscal year 2002.
(2) Mr Halbron received a retirement indemnity of € 1,950,872 when his employment contract ended.
(3) The amount of Directors' fees paid to the Directors whose term of office ended in 2003 came to a total of € 59,940 for Mr Helmut Werner and € 8,092 for Mr Jean-Marie Messier.

Mr. Philippe Germond qualifies for the same terms and conditions (benefits in-kind, retirement indemnity) as those granted to the Chairman and Chief Executive Officer. He also qualifies for the supplementary pension scheme granted to approximately 80 of the Group's senior executives.

Equity interests of the senior executives

Shares held

Pursuant to Article 12 of the company bylaws, Directors must own at least 500 shares in the company. In the spirit of the rules established to promote corporate governance, the Directors' Charter recommends that the number of shares held be significant, and that if a Director does not own any shares when his term begins, he must invest at least one year of Directors' fees to acquire shares.

As of December 31, 2003, the members of the Board of Directors together held 373 045 Alcatel shares (including through units held in the FCP 3A and American Depository Shares), representing 0.03% of Alcatel's equity capital and voting rights (see breakdown of Directors' holdings).

Directors must comply with the Company's stock trading rules and refrain from trading in the stock of companies for which, in connection with their duties, they may possess information not yet made public. In addition, Directors may trade in the company's stock only between the date the quarterly results are released and the end of the quarter in progress. Pursuant to the recommendations from stock exchange authorities, each Director reports to the company every six months all transactions carried out on securities issued by Alcatel. In this respect, an overall report is filed for all members of the Board of Directors with the "Autorité des marchés financiers" (French Financial Markets Regulator).

Excerpt from the directors' charter

"Directors shall refrain from trading in the stock of companies on which, in connection with their duties, they may possess information not yet made public (annual, mid-year and quarterly financial statements, acquisition and divestment plans, sales or financial agreements, strategic plan or budget, and more generally, any information liable to influence the stock price of any security or securities concerned."

As for the senior executives and employees of the Group who, in connection with their duties, may be in possession of information not yet made public, the members of the Executive Committee must comply with the same rules designed to prevent insider trading.

As of December 31, 2003, the members of the Executive Committee owned a total of 112,902 Alcatel shares (including units held in the FCP 3A and American Depository Shares), representing 0.01% of Alcatel's equity capital and voting rights.

Stock options

A total of 751,256 stock options were granted to the members of the Board of Directors in 2003. The Chairman and Chief Executive Officer and the Chief Operating Officer received 500,000 and 250,000 stock options respectively. The employee Directors representing the FCP 3A, Messrs Thierry de Loppinot and Bruno Vaillant, were granted 1,028 and 228 stock options respectively.

These options were granted by the Board of Directors on March 7, 2003 under two plans, involving a total of 26.5 million stock options, entitling the holder to subscribe for Alcatel shares at the price of € 6.70, corresponding to the average market price of the Alcatel share during the twenty stock market trading sessions preceding the decision by the Board.

The options granted under the annual plan amounted to 751,200 options that can be exercised by the beneficiaries between March 7, 2007 and March 6, 2011 after a vesting period of four years from the date granted.

The 56 options granted under the second plan can be exercised by the beneficiaries for a period of one year between July 1, 2007 and June 30, 2008 after the same vesting period.

No stock options were exercised by the members of the Board of Directors in 2003.

The eleven members of the Executive Committee as of December 31, 2003 received in 2003 stock options exchangeable for 1,395,000 new shares representing 5.1% of the total number of options granted in 2003. These stock options meet the general conditions of the March 7, 2003 annual plan and can be exercised at an average weighted price of € 6.80. No options were exercised by the members of the Executive Committee in 2003.

Stock options granted to senior executives and to the Chairman and Chief Executive Officer in 2004 are described on page 115.

Agreements regulated by law

Agreements that were authorized in prior years were continued in 2003. They involve agreements between Alcatel and Thales, the Group companies and one Director.

Agreements entered into with Thales (former Thomson-CSF)

The agreements made in 1998 and reinforced in 1999 at the time Alcatel raised its stake in Thales (former Thomson-CSF) in December 1999 deal primarily with the terms and conditions for closer cooperation between Alcatel and Thales in areas common to both companies, such as strategic or operational areas (commercial cooperation, procurement, venture capital, property management, etc.).

Assistance to subsidiaries

Although not formally covered by the provisions of Article L.225-38 of the Commercial Code, but in the interest of informing shareholders, the Board of Directors authorized Group companies to contribute to the costs of research and development and of intellectual property. The sums due are paid in full to Alcatel, which is responsible for distributing them among its subsidiaries based on their financing needs. For fiscal 2003, income recorded by Alcatel amounted to € 690,061. The expense owed by Alcatel to the subsidiaries amounted to € 727,879.

Agreement between Alcatel and one of its Directors

A consulting contract was signed between Alcatel and Mr Werner, under which Mr Werner was assigned, as from August 1, 2001, to assist the Alcatel Senior Management with regard to strategic, economic and industrial matters, particularly in terms of outside communications and brand image aimed at promoting the Group in Europe, especially in Germany. Under this contract, which ended in 2003, Mr Werner received fees of € 51,000.

Employee profit-sharing schemes

In addition to the stock option plans described above, Group Companies have put in place profit-sharing plans and employee savings plans, in accordance with the recommendations by Senior Management. Foreign subsidiaries are establishing profit-sharing schemes for their employees where allowed under applicable laws.

Capital increases reserved for employees

During the past five years, the company made capital increases available to all the Group's employees in 2000 and 2001. Under the last capital increase reserved for employees, accompanied by stock options approved by the Board of Directors' meeting of March 7, 2001, a total of 91,926 shares were issued on June 29, 2001. Every share subscribed entitled the holder to three stock options at an exercise price of € 50, that is, a total of 275,778 options exercisable during a one-year period after a three-year waiting period (four-years period in France).

It has not been decided since, by the Board of Directors, in accordance with article L.225-129-VII alinea 2 of the commercial code, to proceed with other capital increases reserved to employees.

Policy for granting stock options

The main guidelines for granting stock subscription options or stock purchase options were set by the Board of Directors meetings on January 27 and September 29, 1993, March 29 and December 13, 2000, and more recently, by the Board meeting held on December 19, 2001. The awarding of stock options is approved by the Board of Directors on the recommendation of the Nominating and Compensation Committee. Stock subscription and stock purchase plans were created in order to involve in the growth and profitability of the company those executives and employees who play a key direct or indirect role in the achievement of those results. Consequently, stock options represent a form of long-term profit-sharing for the beneficiaries.

In this regard, Alcatel's policy is to remain competitive worldwide compared to its competitors' practices. Under the policy described above, the number of beneficiaries for each annual plan increased noticeably (from 1,000 in 1996 to 23,650 in 2003). The Board sets the number of options to be allocated and the conditions for exercising them, based on an analysis of the plans implemented by companies in the same business sector, on the practices of each country and on the levels of responsibility of the beneficiaries.

Since 1998, the exercise price of the options has not included a discount or reduction from the average trading price in the twenty days preceding the award date. Since December 2000, annual stock option plans have been governed by rules under which the beneficiaries acquire firm rights over the options granted to them up to one quarter of the number of options after one year and up to one forty-eighth of that same number after each subsequent month.

The options granted to corporate officers, senior executives and the Chairman are in strict compliance with the same terms as those governing the options granted to the other beneficiaries.

In 2003, the total number of stock options granted to those senior executives and employees of the Group who are not corporate officers, and who received the ten highest amounts, totaled 425,650 and these options can be exercised at an average weighted price of €6.70. The total number of options exercised by those senior executives and employees who are not corporate officers, representing the ten largest numbers exercised, comprising the same number of options, amounted to 43,714, and those Alcatel stock options were exercised at a weighted average price of €5.08.

Alcatel's stock subscription and stock purchase option plans are presented on page 115-116.

Information on Directors

	Appointed/ Expiration	Apppointments and duties in fiscal year 2003
SERGE TCHURUK Chairman and Chief Executive Officer Nationality: French, age 66 Owns 105,450 shares and 208 units in FCP 3A	1995/2007	In France: Director - Thales, Total, Société Générale* and the Pasteur Institute, Member of the Board of Directors of the école Polytechnique. Abroad: Chairman of the Board of Directors of Alcatel USA Holdings Corp. (former Alcatel NA, Inc.), Member of the Supervisory Board of Alcatel Deutschland GmbH.
DANIEL BERNARD Independent Director Nationality: French, age 58 Owns 141,125 shares	1997/2007	In France: Chairman and CEO of Carrefour, Director - Saint-Gobain, Erteco, Comptoirs Modernes*, Manager of SISP. Abroad: Chairman of Presicarre, Vice-President of DIA SA., Vice-President of Vicour, Director - Grandes Superficies de Colombia, Centros Comerciales Carrefour, Finiper, GS, Carrefour Commercio e Industria and Carrefour Argentina.
PHILIPPE BISSARA Independent Director Nationality: French, age 62 Owns 53,645 shares and 4,469 units in FCP 3A	1997/2005	In France: General Representative of ANSA (National Association of Joint Stock Companies), Honorary Legal Advisor to the Conseil d'État, Director - Société d'Oxygène et d'Acétylène d'Extrême-Orient, Member of the Board of Directors of the French Branch of the International Tax Association, Member of the Accounting Academy, Vice-President of EALIC (European Association for Listed Companies).
FRANK W. BLOUNT Independent Director Nationality: U.S., age 65 Owns 1,000 American Depositary Shares	1999/2005	Abroad: Chairman of JI Ventures Inc., Director - Entergy Corporation USA, Caterpillar Inc., Adtran Inc., and Hanson Plc.
JOZEF CORNU Director Nationality: Belgian, age 59 Owns 20,500 shares and 1,734 units of FCP 3A	2000/2004	In France: Adviser to the Chairman of Alcatel, Director - Alcatel CIT. Abroad: Chairman of the Board of Directors of Alcatel Bell NV, Tijd NV, Member of the Supervisory Board of Alcatel SEL AG, Director - Taïwan International Standard Electronics Ltd, Barco, KBC, and Agfa Gevaert.
PHILIPPE GERMOND Director Nationality: French, age 47 Owns 500 shares	2003/2007	In France: Chief Operating Officer of Alcatel, Director - Essilor, Ingenico, and Atos Origin. Abroad: Director - Alcatel USA Inc., Member of the Supervisory Board of Alcatel Deutschland GmbH.
JEAN-PIERRE HALBRON Director Nationality: French, age 67 Owns 21,020 shares and 1,968 units in FCP 3A	1999/2005	In France: Director - Electro Banque, Chairman of Alcatel's Ethics Committee. Abroad: Chairman of the Board of Directors of Alcatel Finance Inc.*, of Alcatel USA Inc.*, Member of the Supervisory Board of Alcatel Deutschland GmbH*, Director - Alcatel Finance Australia Ltd*, Alcatel USA Holdings Corp.* (former Alcatel NA, Inc.).

	Appointed/ Expiration	Terms and duties in fiscal year 2003
DAVID JOHNSTON Independent Director Nationality: Canadian, age 62 Owns 1,000 shares	2001/2005	Abroad: President of the University of Waterloo (Canada), Director - CGI, Open Text, Masco, and EMCO*.
DANIEL LEBÈGUE Independent Director Nationality: French, age 60 Owns 500 shares	2003/2007	In France: Director - Thales, Scor, and Technip, Member of the Supervisory Board of Areva, Director - Gaz de France (a state-owned establishment), President of the French Institute of Directors "IFA" (an Association).
PIERRE-LOUIS LIONS Independent Director Nationality: French, age 47 Owns 520 shares	1996/2005	In France: Professor at the Collège de France and the école Polytechnique, President of the INRIA Evaluation Commission, Chairman of the EDF Advisory Board and the CEA-DAM Scientific Board, Member of the Academy of Technologies, Member of the Academy of Sciences, the Academia Europea, the Defense Scientific Board, the Mathematical Society of France, the Society of Applied and Industrial Mathematics, Consultant to EADS – Launch Vehicles, Paribas, CAI. Abroad: Member of the American Mathematical Society and the European Mathematical Society, the International Association in Mathematical Physics and the Instituto Lombardo.
THIERRY DE LOPPINOT Employee Director Nationality: French, age 60 Owns 4,430 shares And 4,250 units in FCP 3A	1997/2005	In France: Legal counsel at Alcatel's corporate offices, Chairman of the Advisory Board of the Alcatel Employee Share Saving fund (FCP 3A), Chairman and CEO of Formalec, Director - Société Immobilière Kléber-Lauriston "SIKL".
PETER MIHATSCH, Independent Director Nationality: German, age 63 Owns 500 shares	2002/2005	Abroad: Chairman of the Supervisory Board of Giesecke and Devrient Munich, Member of the Supervisory Board of Vodafone GmbH, of Vodafone-Mobilfunk, of ARCOR-Vodafone and Daimler Chrysler Services*.
BRUNO VAILLANT Employee Director Nationality: French, age 60 Owns 1,100 shares and 4,176 units in FCP 3A	1997/2005	In France: Engineer at Alcatel Space (Information Systems Division), Director - Caisse de Prévoyance Haussmann, Member of the Supervisory Board of the Alcatel Employee Share Savings Fund (FCP 3A), Expert with the Toulouse Court of Appeals.
MARC VIÉNOT Independent Director Nationality: French, age 75 Owns 4,950 shares	1987/2007	In France: Honorary Chairman and Director - Société Générale, Chairman of the Paris Europlace Association*, Director - Ciments Français, Member of the Supervisory Board of Aventis, Member of the Board of the French Private Enterprise Association. Abroad: Director - Société Générale Marocaine de Banque.

* Term of office expired in 2003 or 2004.

ORDINARY AND EXTRAORDINARY SHAREHOLDERS' MEETING

AGENDA

– Management report of the Board of Directors and reports of the statutory auditors on the annual parent company financial statements and the consolidated financial statements of Alcatel for the fiscal year ended December 31, 2003.
– Special reports of the statutory auditors on regulated agreements and on the powers to be delegated to the Board of Directors to reduce the capital, to issue securities with or without preferential subscription rights and to increase the capital for the benefit of participants in a company savings plan.

Matters to be considered by the Ordinary Shareholders' Meeting

1. Approval of the parent company financial statements for the fiscal year ended December 31, 2003.
2. Approval of the consolidated financial statements for the fiscal year ended December 31, 2003.
3. Result for the fiscal year – Appropriation.
4. Approval of regulated agreements.
5. Renewal of the term of Mr. Jozef Cornu as Director.
6. Authorization to be given to the Board of Directors to issue debt securities, and particularly bonds.
7. Authorization to be given to the Board of Directors to allow the company to purchase and sell its own shares.

Matters to be considered by the Extraordinary Shareholders' Meeting

8. Authorization to be given to the Board of Directors to reduce the capital of the company.
9. Delegation of power to the Board of Directors to increase the capital of the company, either by the issuance of shares, warrants and/or securities conferring an immediate or future right to shares of the company, with preservation of preferential subscription rights, or by the capitalization of premiums, reserves, profits or other funds.
10. Delegation of power to the Board of Directors to increase the capital of the company, by the issuance of shares, warrants and/or securities conferring an immediate or future right to shares of the company, with cancellation of preferential subscription rights.
11. Limitation of the overall amount of issues to be made pursuant to the 9th and 10th resolutions.
12. Delegation of power to the Board of Directors to increase the capital of the company, by the issuance of shares reserved to participants in a company savings plan in accordance with the provisions of the Commercial Code and of Articles L. 443-1 and following of the Labor Code, including in the event of the use of the authorizations to effect a capital increase.
13. Powers to implement the decisions of the Shareholders' Meeting and to carry out the corresponding formalities.

REPORT BY THE BOARD OF DIRECTORS

The resolutions submitted for the approval of the shareholders are to be considered by the Ordinary Shareholders' Meeting and by the Extraordinary Shareholders' Meeting.

Resolutions to be considered by the Ordinary Shareholders' Meeting

I – Financial statements for fiscal year 2003, appropriation and regulated agreements (1st, 2nd, 3rd and 4th Resolutions)

The Ordinary Shareholders' Meeting will be asked, principally:

- by voting in favor of the first resolution, to approve the annual parent company financial statements of Alcatel at December 31, 2003, which reflect a net loss of € 3,255,425,911.04.
- by voting in favor of the second resolution, to approve the consolidated financial statements of Alcatel at December 31, 2003.
- by voting in favor of the third resolution, to approve the proposed appropriation of the result for the fiscal year, so that the losses for the fiscal year plus previous losses that had been carried forward would be posted to the line items "Other reserves" and "Additional paid-in capital," with the line item "Retained earnings" being reduced to zero.
- by voting in favor of the fourth resolution, to approve the agreements covered by Article L. 225-38 of the Commercial Code which remained in force during the fiscal year and which are described for you in detail in the special report of the statutory auditors included in the annual report, it being noted that no new such agreements were entered into in 2003.

II – Renewal of the term of Mr. Jozef Cornu as Director (5th Resolution)

The purpose of this resolution is to renew Mr. Jozef Cornu's term as Director for a period of four years, that is, until the Shareholders' Meeting called to approve the financial statements for the fiscal year ending December 31, 2007. Mr. Cornu, 59, brings to the Board the benefit of his recognized experience in the telecoms field, and makes an important contribution when the group has to make decisions concerning choices with respect to technologies.

III – Authorization to be given to the Board of Directors to issue debt securities, and particularly bonds (6th Resolution)

The sixth resolution relates to issuances of any securities representing debt of the company, and particularly bonds or bonds with warrants attached, or representing the right to subscribe for or purchase securities representing debt of the company, or similar debt instruments.

It provides for the cancellation of any unused balance of the authorization to issue bonds given to the Board of Directors by the Shareholders' Meeting held on April 18, 2002, and confers a new authorization, valid for a period of 26 months, allowing the Board to issue bonds, potentially coupled with options to subscribe for bonds, up to a maximum nominal amount of € 10 billion, or the equivalent of this amount in another currency.

Such sum would, in particular, allow the company to meet its current financing needs, whether or not such financing be subordinated, or to address the need for structured issues satisfying specific requirements of investors.

This authorization, which was not used in 2003, allowed the Board in 2004 to issue € 462 million in new bonds, bearing interest at 6.375% and maturing in 2014. These bonds were issued for the most part in exchange for existing 7% bonds maturing in 2006, thus lengthening the maturity of the debt on satisfactory financial terms.

IV – Authorization to buy back shares (7th Resolution)

The purpose of the seventh resolution is to renew the authorization, given to the Board of Directors by the Shareholders' Meeting held on April 17, 2003, to buy back shares of the company. Alcatel did not effect any purchases or sales of its own shares during 2003.

This resolution provides for the company to be able to purchase its shares within the legal limit of 10% of the number of shares comprising the capital of the company on the date such purchases are effected, and subject to the limitation that the maximum number of shares held after such purchases may not exceed 10% of the capital of the company. This authorization would be valid for a period of 18 months, expiring in any event on the date of the Annual Shareholders' Meeting called to approve the financial statements for the fiscal year ending December 31, 2004.

It is proposed that the maximum purchase price and minimum sale price be set at € 40 and € 2, respectively.

The purpose of the share purchase program is set forth in detail in the prospectus relating thereto, which will be reviewed by the French stock exchange and securities regulator (Autorité des marchés financiers).

These purchases could allow Alcatel to optimize the profitability of its shareholders' equity and to effect transactions that enhance earnings per share, or to ensure that the company holds the shares needed in the context of the group's external growth transactions.

Resolutions to be considered by the Extraordinary Shareholders' Meeting

V – Cancellation of shares purchased in the context of the company's share purchase program (8th Resolution)

In this resolution, it is proposed that the shareholders vote to renew the authorization given to the Board, if it deems it advisable, to cancel company shares held by the company pursuant to the share purchase programs, subject to the limitation that the resulting capital reductions may not exceed 10% of the capital of the company over a 24-month period. This power was not used during the last fiscal year.

VI – Authorizations relating to issuances (9th, 10th and 11th Resolutions)

In order for the Board of Directors to be in a position to seize opportunities which may present themselves either in the French market or in foreign markets to raise the funds necessary for the development of the Group, and in order to accomplish this, to have the power at any time to issue securities of various kinds, the Shareholders' Meetings held on April 18, 2002 and April 17, 2003 granted global delegations of power which will expire at the end of the Shareholders' Meeting called to approve the financial statements for the fiscal year ended December 31, 2003.

These delegations of power make it possible for the board to act in the best interests of the company.

These delegations of power relate either to the issuance of shares, with or without preferential subscription rights, warrants or securities conferring an immediate or future right to a share of the capital, or to capital increases by the capitalization of premiums, reserves, profits or other funds, whether by increasing the nominal value of the shares or by means of a free share distribution.

It is proposed to you that these global delegations of power be renewed and consequently that any unused balance of the existing delegated powers be cancelled.

The delegation of power relating to issuances where the preferential subscription right is maintained has not been used since it was granted by the Shareholders' Meeting held in April 2002 (9th resolution).

The delegation of power relating to issuances of shares, warrants or securities conferring a right to the capital with cancellation of preferential subscription rights, and which was the subject of a new authorization given at the Shareholders' Meeting held on April 17, 2003 (12th resolution), was used for the purpose of a financial transaction and in the context of the acquisition of two companies outside of France.

Thus, in June 2003 Alcatel issued debt in the form of bonds convertible and/or exchangeable into new or existing shares, for a nominal amount of € 1,022.5 million, representing a maximum of 63.2 million Alcatel shares at maturity, or 4.9% of the capital of the company as of December 31, 2003.

The acquisitions of the companies iMagic TV Inc. In Canada and TiMetra in the United States gave rise to the issue by the Group's subsidiary Coralec of bonds redeemable in Alcatel shares for a total nominal amount of € 172.9 million, representing a maximum of 21.7 million Alcatel shares at maturity, or 1.7% of the capital of the company as of December 31, 2003. On that date, 2.6 million bonds were still outstanding.

These transactions were the subject of prospectuses approved by the French securities regulator (Commission des Opérations de Bourse)* and explaining the company's objectives and the terms of the issuances. These prospectuses are available at the registered office of the company and on Alcatel's website.

Consequently, the overall amount of debt securities issued which confer a right to, or are attached to, an equity security, is € 1,195.40 million, representing 20% of the total amount authorized by the Shareholders' Meeting. These instruments may give rise, at maturity, to the issue of shares in the company for a total nominal amount of € 169.8 million, representing 23% of the total amount authorized by the Shareholders' Meeting and 6.6% of the current capital of the company.

The renewal of these global delegations of power would have the effect of canceling the unused balance of the authorizations still in force.

The maximum nominal amount of shares that the Board of Directors might decide to issue in the event that these delegations of power are renewed would be € 750 million, and the amount of debt securities which might be issued would be € 6 billion, it being noted that this limit would not apply to increases in the share capital by the capitalization of reserves or other funds.

These new delegations of power would be valid for a period of 26 months.

The Board of Directors draws the attention of the shareholders to the fact that the preferential subscription right maintained in the 9th resolution relates only to securities or instruments issued pursuant to this delegated power, but not to the shares to which such securities confer rights in the future. This delegated power automatically entails the express waiver by the shareholders of their preferential right to subscribe for such shares.

The renewal of these authorizations is viewed as essential to allow external growth transactions to be effected, since the success of these transactions often depends upon the speed with which they can be executed, as part of all the terms examined by the Board of Directors, in each case keeping in mind the interests of the Group and its shareholders.

The principal characteristics of these securities, and the terms upon which they might eventually confer a right to a portion of the capital of the company, are not determined until the date on which the decision to effect the issuance is made, and at the appropriate time, in accordance with article 155-2 of the decree dated march 23, 1967, a supplemental report will be prepared, describing the final terms of the transactions contemplated.

This report will be made available to shareholders within fifteen days of the Board of Directors' decision to effect the issuance, and will be brought to the attention of the shareholders at the first Shareholders' Meeting following the date on which the Board, or the Chairman acting pursuant to delegated powers, makes the decision to issue securities.

Pursuant to the delegated powers conferred to it by either of these two resolutions, the Board of Directors would therefore decide upon the exact terms of the issuances authorized, as well as the terms of any conversions, exchanges or redemptions, or of the exercise of any warrants, at the time the decision to make the primary issue is made, depending in particular on market conditions at that time, and in compliance with the legal and regulatory provisions then in force.

By voting in favor of the 11th resolution, you will limit the nominal amount of the issuances, with or without preferential subscription rights, that the Board of Directors may decide upon pursuant to these new delegated powers, to € 750 million in the case of issuances of shares, whether immediately and/or in the future, and to € 6 billion in the case of issuances of debt securities.

VII – Employees' shareholdings (12th resolution)

The Shareholders' Meeting held on April 18, 2002 had authorized the Board of Directors to increase the capital through issuances reserved to employees of the group, subject to the limitation that the maximum global nominal amount of the capital increases which might be made should not exceed 3% of the capital of the company existing at the time of each issue.

The 12th resolution is intended to renew for a period of 26 months the delegation of power granted to the Board of Directors by the Shareholders' Meeting held on April 18, 2002, which expires now, and which has not been used since it was granted.

Taking into account the fact that the incentives provided to employees to participate in the development of the business are an essential factor in the prosperity of the group, it is proposed to set the limit on the maximum global nominal amount of capital increases which may be made at 3% of the capital of the company existing at the time of each issue.

This resolution is intended to allow the issue of new shares and, if necessary, the distribution of shares or other securities giving access to the capital of the company, to participants in a company savings plan, including in the event of the use of the authorizations to increase the share capital (9th and 10th resolutions), pursuant to the provisions of the commercial code and particularly articles L. 225-138 and L. 225-129-vii thereof, and, separately, of articles L. 443-1 and following of the Labor Code.

The resolution would contain an express waiver by the shareholders of their preferential subscription rights, in favor of the beneficiaries.

The price at which beneficiaries would subscribe for shares could not be more than 20% lower, nor higher, than the average of the opening prices quoted on the First Market of Euronext Paris SA during the twenty trading sessions preceding the date on which the Board of Directors made its decision to increase the share capital and to issue the corresponding shares.

Text of the Resolutions

Matters to be considered by the Ordinary Shareholders' Meeting

FIRST RESOLUTION

Approval of the parent company for the fiscal year ended December 31, 2003

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders, having read the reports of the Board of Directors and of the statutory auditors, approve in their entirety the management report of the Board and the annual parent company financial statements for the fiscal year ended December 31, 2003 as prepared and presented to them, and which reflect a loss of € 3,255,425,911.04.

The shareholders expressly approve the amount of non-deductible charges (Article 39-4 of the Tax Code) mentioned in the accounts presented by the Board of Directors.

SECOND RESOLUTION

Approval of the consolidated financial statements for the fiscal year ended December 31, 2003

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders, having read the reports of the Board of Directors and of the statutory auditors on the consolidated financial statements for the fiscal year ended December 31, 2003, approve those consolidated financial statements as prepared and presented to them by the Board of Directors.

THIRD RESOLUTION

Result for the fiscal year – Appropriation

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders approve the appropriation of the result for the fiscal year ended December 31, 2003 proposed by the Board of Directors, and resolve to post the loss for the fiscal year, namely € 3,255,425,911.04, plus the previous losses which had been carried forward, namely € 11,066,369,514.06, for an aggregate amount of € 14,321,795,425.10, as follows:

- € 165,120,200.99 to be posted to the line item "Other reserves" which will be reduced to zero,
- € 14,156,675,224.11 to be posted to the line item "Additional paid-in capital" which will thus be reduced from € 21,719,088,009.09 to € 7,562,412,784.98.

The line item "Retained earnings" will thus be reduced from € 11,066,369,514.06 to zero.

Consequently, no dividend will be distributed to shareholders in respect of fiscal year 2003.

The shareholders note the dividends which have been distributed in respect of the three previous fiscal years:

Fiscal year	Class of shares	Number of shares	Amount distributed to shareholders	Net dividend per share	Tax credit per share	Total income per share
2002	–	–	–	–	–	–
2001	O shares	25,515,000	€ 2 551 500,00	€ 0.10	€ 0.05	€ 0.15
2001	A shares	1,215,254,797	€ 194 440 767.52	€ 0.16	€ 0.08	€ 0.24
2000	O shares	16,500,000	€ 1 650 000,00 FRF 10 823 290.50*	€ 0.10 FRF 0.65*	€ 0.05 FRF 0.32*	€ 0.15 FRF 0.98*
2000	A shares	1,212,210,685	€ 581,861,128.80 FRF 3,816 758 804.64*	€ 0.48 FRF 3.15*	€ 0.24 FRF 1.57*	€ 0.72 FRF 4.72*

* Amounts in French francs, rounded to the nearest cent, are included for information, by conversion into francs of amounts denominated in euros.

FOURTH RESOLUTION

Approval of regulated agreements

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders, having read the special report of the statutory auditors on the agreements covered by Article L. 225-38 of the Commercial Code, approve the agreements entered into or which remained in force during the fiscal year, together with the transactions mentioned therein.

FIFTH RESOLUTION

Renewal of the term of Mr. Josef Cornu as Director

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders renew Mr. Jozef Cornu's term as Director for a period of four years, to expire in any event at the end of the Shareholders' Meeting called to approve the financial statements for the fiscal year ending December 31, 2007.

SIXTH RESOLUTION

Authorization to be given to the Board of Directors to issue debt securities, and particularly bonds

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors:

- cancel the balance of the authorization given to the Board of Directors by the 6th resolution of the Shareholders' Meeting held on April 18, 2002 that remains unused at the date of this meeting;
- authorize the Board of Directors. with power to delegate:
  – to issue on the French market or on international markets, on one or more occasions and at such times as it shall determine, in euros or in any other currency and for a maximum nominal amount of 10 billion euros or the equivalent of such sum in another currency, any securities representing debt of the company (and particularly bonds, bonds with warrants attached, or securities conferring the right to subscribe for or buy securities representing debt of the company or similar debt instruments, such as subordinated, redeemable or perpetual notes), with or without guarantee, secured or otherwise, in such proportions and forms, at such rates, and subject to such issuance and repayment conditions as it may deem advisable,
  – to attach to such debt securities warrants for the purchase of shares which are part of the portfolio of the company or of shares of any other company with which the necessary agreements shall have been entered into.
- set the period of validity of this delegated power at 26 months starting from the date of this Shareholders' Meeting;
- therefore, give all necessary powers to the Board of Directors:
  – to effect such issuance, on one or more occasions, at the times and in the proportions it may deem advisable; to set the terms and conditions of such issuance or of each of its tranches, and in particular the issue price, the terms

of payment upon subscription and the manner of repayment of the bonds; and to set the characteristics of the securities to be issued, and in particular the fixed, variable, adjustable or indexed interest rate, the timing of the interest payments and the date or dates of repayment of principal (with or without premium), the subordination clauses, if applicable, which may affect either the right to repayment or the right to interest (and with or without the ability to postpone the payment of interest in the event that no profit is distributed by the company), or both at the same time; and to set the characteristics of the securities and of any rights which might be attached thereto, whether such rights may be detachable or not. For issuances in another currency, the amount charged to the authorization above shall be based on the exchange rate for such currency on the date of the issuance in question. The amount of the fixed or variable redemption premium, if any is provided for, shall be added to the total amount of the bonds which may be issued pursuant to this authorization.

– to delegate any of these powers, and to take any measures and carry out any of the formalities required by this or these issuances.

SEVENTH RESOLUTION

Authorization to be given to the Board of Directors to allow the company to purchase and sell its own shares

Voting under the quorum and majority requirements of an Ordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the prospectus approved by the French stock exchange and securities regulator (Autorité des marchés financiers) relating to the purchase by the company of its own shares, authorize the Board of Directors, in accordance with Articles L. 225-209 and following of the Commercial Code, to purchase and sell on the stock exchange or otherwise shares of the company, under the following conditions:

- maximum purchase price per share: € 40
- minimum sale price per share: € 2

The total number of shares that the company may purchase shall not exceed 10% of the total number of shares comprising the capital of the company on the date such purchases are effected, and the maximum number of shares held after such purchases shall not exceed 10% of the capital of the company.

Pursuant to Article 179-l of the Decree dated March 23, 1967 relating to corporations, the theoretical maximum number of shares that could be purchased, based on the number of shares existing at December 31, 2003, is 128,441,022, for a theoretical maximum amount of € 5,137,640,880, without taking into account shares already held.

In the event of transactions affecting the capital of the company, and more particularly in the event of a capital increase by capitalization of reserves and a free distribution of shares, as well as in the event either of a stock split or of a reverse stock split, the prices indicated above shall be adjusted by a multiplier equal to the ratio between the number of shares comprising the capital before the transaction and the number of such shares after the transaction.

The purpose of this authorization is to allow the company to use the possibility of buying and selling its own shares:

- to stabilize the price of its shares;
- to transfer its shares to employees and directors within the Group on the terms and conditions provided by law (share purchase options, employee profit sharing, sale of shares reserved to employees);
- to exchange its shares in the context of external growth transactions initiated by the company, by way of tender offer or otherwise;
- to ensure the economic and financial management of its capital and more generally the active management of its shareholders' equity, taking into account its financing requirements, or to optimize its earnings per share, which, subject to the adoption of the eighth resolution set forth below, may result in the cancellation of treasury shares by way of a capital decrease within the limitations set by law:
- to retain, exchange, assign or transfer the shares by any means;
- to allow the company to purchase and sell its shares on the stock exchange or otherwise, for any other authorized purpose, or for any purpose which may be authorized in the future by law or regulations.

The shares may at any time, including during a public offering, and within the limitations of the regulations in force, be purchased, sold, exchanged or transferred, whether on the market, in a private transaction or otherwise, by any means and particularly by block trades, by way of options or by the use of any derivative products. The maximum portion of the capital of the company that may be purchased or sold in the form of block trades shall be the entire amount of shares purchased pursuant to the purchase program or programs successively implemented by the company pursuant to this authorization or previous authorizations. In the event of a purchase with a view to the granting of options to purchase shares pursuant to the provisions of Articles L. 225-l77 and following of the Commercial Code, and as an exception to what is set out above, the rules relating to price shall be those defined by the provisions of that Article applicable to share purchase options.

This authorization is given for a maximum period of 18 months, expiring in any event on the date of the Shareholders' Meeting called to approve the financial statements for the fiscal year ending December 31, 2004.

With effect from the date of this meeting, it cancels and replaces the authorization previously granted to the Board of Directors by the 10th resolution of the Joint Shareholders' Meeting held on April 17, 2003.

In order to ensure the implementation of this authorization, all necessary powers are granted to the Board of Directors, with power to subdelegate, to place any order on the stock exchange, to enter into any agreement, particularly for the purpose of keeping registers of purchases and sales of shares, to make any declarations to the French stock exchange and securities regulator (Autorité des marchés financiers) and any other governmental body, to carry out any other formalities and in general, to take all necessary action.

Matters to be considered by the Extraordinary Shareholders' Meeting

EIGHTH RESOLUTION

Authorization to be given to the Board of Directors to reduce the capital of the company

Voting under the quorum and majority requirements of an Extraordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the report of the statutory auditors, authorize the Board of Directors in accordance with Article L. 225-209, paragraph 4, of the Commercial Code, for a maximum period of 18 months starting from the date of this meeting but expiring in any event on the date of the Shareholders' Meeting called to approve the financial statements for the fiscal year ending December 31, 2004:

- to cancel, in its sole discretion, on one or more occasions, the shares of the company which it holds as a result of the implementation of the purchase programs decided on by the company, subject to a limit of 10% of the total number of shares comprising the capital of the company per 24-month period, and to reduce the capital by a corresponding amount, charging the difference between the purchase price of the cancelled shares and their nominal value to available premiums and reserves, including, up to an amount of 10% of the cancelled share capital, to the legal reserve,
- to record the completion of the reduction or reductions in capital, to make the corresponding amendments to the articles of incorporation and bylaws and to carry out any necessary formalities,
- to delegate any powers necessary for the implementation of its decisions, all in accordance with applicable law in force at the time this authorization is used.

NINTH RESOLUTION

Delegation of power to the Board of Directors to increase the capital while maintaining preferential subscription rights

Voting under the quorum and majority requirements of an Extraordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the report of the statutory auditors:

1/ cancel the authorization given to the Board of Directors by the 9th resolution of the Shareholders' Meeting held on April 18, 2002, but without retroactive effect and only with respect to the balance of such authorization remaining unused as of the date of this meeting;

2/ delegate to the Board of Directors in accordance with the legal and regulatory provisions governing corporations, and particularly those of the third paragraph of Article L. 225-129 III of the Commercial Code, the powers necessary to increase the capital on one or more occasions, in such proportions and at such times as it may deem advisable:

a) by the issue, in euros or in any other currency or in any unit of account established by reference to a basket of currencies, of shares and/or warrants and/or securities conferring an immediate or future right, at any time or on a fixed date, to shares of the company, whether by way of subscription, conversion, exchange, repayment, presentation of warrants or in any other manner, to the exclusion, however, of preferred shares without voting rights or investment certificates, or

b) by the capitalization of premiums, reserves, profits or other funds, the capitalization of which is permitted by law and under the articles of incorporation and bylaws, accompanied by a free distribution of shares or an increase in the nominal value of the existing shares;

3/ set the period of validity of this delegated power at 26 months starting from the date of this meeting;

4/ resolve to set the maximum amount of the issuances which might be decided upon by the Board of Directors pursuant to this delegated power as follows:

- in the event of capital increases carried out in the context of issuances covered by 2(a) above:

a) the maximum nominal amount of the shares which may be issued directly or upon presentation of securities, whether representing debt or not, shall not exceed € 750 million or the equivalent of such amount in other currencies, increased by the nominal amount of the capital increase resulting from the issuance of shares which may need to be effected in order to preserve the rights of holders of such securities in accordance with law;

b) the maximum nominal amount of securities representing debt of the company which may be issued in this manner may not exceed € 6 billion or the equivalent of such amount in other currencies;

- in the event of the capitalization of premiums, reserves, profits or other funds, the maximum nominal amount of capital increases which may be effected in this way may not exceed the total amount of the sums which may be capitalized, it being noted that the amount of such capital increases shall not count towards the limit set in 4(a) above;

5/ in the event that the Board of Directors uses this delegated power in the context of issuances covered by 2(a) above:

- resolve that the issuance or issuances shall be reserved on a preferential basis to the shareholders who may subscribe for such shares as of right;
- confer on the Board of Directors the power to grant shareholders the right to subscribe ratably for shares in excess of those to which they may subscribe as of right, in proportion to the subscription rights which they hold, and in any event within the limits of their requests for subscription;
- resolve that if subscriptions as of right and, if applicable, the ratable subscriptions for excess shares, do not absorb the entirety of the issuance, the Board of Directors may, under the conditions provided by law, and in such order as it may deem appropriate, use one and/or another of the following powers:

– to limit the capital increase to the amount of the subscriptions, subject to the condition that this amount be equal to at least three-quarters of the approved capital increase,

– to distribute all or part of the issued and unsubscribed shares as it deems appropriate,
– to offer all or part of the issued and unsubscribed shares to the public on the French market and/or the international markets.

- resolve that any issuance of share subscription warrants of the company may be the subject either of an offer to subscribe under the conditions provided above, or of a free distribution to the owners of the existing shares;
- resolve that the amount of the consideration paid or which may subsequently be paid to the company for each of the shares issued in the context of this delegated power shall be at least equal to 80% of the average opening prices for the shares quoted on the First Market of Euronext Paris SA on ten consecutive trading days chosen from among the twenty last trading days preceding the commencement of the issuance of the shares and/or of the securities conferring rights thereto, as the case may be. This average shall be corrected, if necessary, in the event of a difference between the dates as of which the shares are entitled to dividends. In the event of the issuance of share subscription warrants of the company, the sum received by the company when the warrants are subscribed shall be taken into account in this calculation;
- formally notes, and resolves insofar as necessary, that this delegated power shall automatically entail the express waiver by shareholders of their preferential subscription rights in respect of the shares to which the securities being issued confer a right, in favor of the holders of the securities being issued.

6/ resolve that the Board of Directors shall have all necessary powers, with power of sub-delegation to its Chairman, to implement this delegated power under the conditions set by law and, in particular:

- to determine the terms of the capital increase(s) and/or of the issuance(s):
- for any issuance covered by 2(a) above:

– to determine the number of shares, warrants and/or securities to be issued and their issue price, together with the amount of the premium, if any, that will be required to be paid at the time of issuance,
– to determine the dates and terms of the issuance and the nature, form and characteristics of the securities to be created, which, in particular, may be (but do not necessarily have to be) subordinated securities or of securities with a fixed term,
– to determine the manner of payment for the shares and/or for the securities issued,
– if applicable, to set the terms of exercise of the rights attached to the securities issued or to be issued and, in particular, to determine the date, which may be a retroactive date, as of which the new shares will be entitled to dividends, together with all the other terms and conditions under which the issuance(s) shall be effected,
– to set the terms pursuant to which the company shall, if applicable, have the option to purchase or exchange on the stock exchange the securities issued or to be issued, at any time or during set periods,
– to provide for the power, if appropriate, to suspend the exercise of the rights attached to the securities during a maximum period of three months,
– to set the terms pursuant to which the rights of holders of securities conferring a future right to shares in the company shall, if applicable, be preserved in accordance with the legal and regulatory provisions,
– in its sole discretion, to charge the expenses of the capital increase or increases to the amount of the premiums relating thereto and to deduct from that amount the sums necessary to increase the legal reserve to one tenth of the new capital after each increase;

- in the case of any capitalization of premiums, reserves, profits or other funds:

– to set the amount and the nature of the sums to be capitalized,
– to set the number of shares to be issued or the amount by which the nominal value of the shares comprising the capital of the company shall be increased,
– to determine the date, which may be a retroactive date, as of which the new shares will be entitled to dividends, or the date on which the increase in the nominal value of the shares shall take effect,
– to resolve, if necessary, and by way of exception to the provisions of Article L. 225-149 of the Commercial Code, that fractional rights shall not be negotiable, and that the corresponding shares shall be sold, the proceeds from such sale being allocated to the holders of the rights at the latest thirty days after the date of registration in their account of the number of whole shares allocated;
– in general, to enter into any agreement (in particular to ensure the successful implementation of the issuance or issuances contemplated), to take any necessary measures and carry out any formalities necessary for the issuance of the securities and in order to comply with the financial obligations arising from the securities issued pursuant to this delegated power, as well as for the exercise of the rights attached thereto; formally to record the completion of each capital increase and make the corresponding amendments to the articles of incorporation and bylaws.

TENTH RESOLUTION

Delegation of power to the Board of Directors to increase the capital with cancellation of preferential subscription rights

Voting under the quorum and majority requirements of an Extraordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the report of the statutory auditors:

1/ cancel the authorization given to the Board of Directors by the 12th resolution of the Shareholders' Meeting held on April 17, 2003, but without retroactive effect and only with respect to the balance of such authorization remaining unused as of the date of this meeting;

2/ delegate to the Board of Directors in accordance with the legal and regulatory provisions governing corporations, and particularly those of the third paragraph of Article L. 225-129 III of the Commercial Code and of Articles L. 225-148, L. 225-150 and L. 228-93 of that Code, the powers necessary to increase the capital on one or more occasions, in such proportions and at such times as it may deem advisable, by the issuance, in euros or in any other currency or in any unit of account established by reference to a basket of currencies, and sale in a public offering:

- of shares, warrants and/or securities conferring an immediate or future right, at any time or on a fixed date, to shares of the company, whether by way of subscription, conversion, exchange, repayment, presentation of warrants or in any other manner, to the exclusion, however, of preferred shares without voting rights or investment certificates, it being noted that such securities may be issued as consideration for securities transferred to the company in the context of a public exchange offer satisfying the conditions set forth in Article L. 225-148 of the Commercial Code;
- and/or of the securities indicated above, in connection with the issuance by any of the companies in which Alcatel owns directly or indirectly more than half of the capital, and in agreement with such company:

– either of bonds with warrants to subscribe for shares of Alcatel,

– or of any other securities conferring a right at any time or on a fixed date to the allocation of securities, by way of subscription, conversion, exchange, repayment, presentation of warrants or in any other manner, which are outstanding or will be issued for this purpose, and which represent a share of the capital of Alcatel, it being noted that these securities may take the form of shares with share subscription warrants, bonds convertible into shares, bonds repayable in shares or any other form which is not incompatible with applicable law;

3/ further delegate to the Board of Directors the powers necessary to authorize or decide upon the issuance by the company or any of its subsidiaries of any hybrid securities conferring a future right to the capital of the company, whether by way of subscription, exchange, repayment, conversion or in any other manner, to the exclusion, however, of preferred shares without voting rights or investment certificates, for the purpose of effecting an external growth transaction and in particular, in order to acquire any company in exchange for shares of Alcatel, or any of its subsidiaries, to be delivered immediately or over time;

4/ set the period of validity of this delegated power at 26 months starting from the date of this meeting;

5/ resolve to cancel the preferential right of shareholders to subscribe for the securities issued pursuant to this delegated power, whether such securities are issued by the company itself or by a subsidiary in which the company directly or indirectly owns more than half the capital, while preserving the right for the Board of Directors at its option if it deems it advisable, to grant to the shareholders, for a period and on such terms as it shall determine, in respect of all or part of an issuance made, a non-negotiable priority subscription right, it being understood that the Board shall have the power to define the characteristics of such priority right and in particular, to decide to limit the number of securities as to which such subscription right is exercisable, in relation to each subscription order placed;

6/ resolve to set the maximum amount of the issuances which might be decided upon by the Board of Directors pursuant to this delegated power as follows:

- the maximum nominal amount of the shares which may be issued directly or upon presentation of securities, whether representing debt or not, shall not exceed € 750 million or the equivalent of such amount in other currencies, increased by the nominal amount of the capital increase resulting from the issuance of shares which may need to be effected in order to preserve the rights of holders of such securities in compliance with law;
- the maximum nominal amount of securities representing debt of the company which may be issued in this manner may not exceed € 6 billion or the equivalent of such amount in other currencies;

7/ formally note, and resolve insofar as necessary, that this delegated power shall automatically entail the express waiver by shareholders of their preferential subscription rights in respect of the shares to which the securities being issued confer a right, in favor of the holders of the securities being issued;

8/ resolve that the amount of the consideration paid or which may subsequently be paid to the company for each of the shares issued or to be issued in the context of this delegated power, shall be at least equal to the average opening prices of the shares quoted on the First market of Euronext Paris SA on ten consecutive trading days chosen from among the twenty last trading days preceding the commencement of the issuance of the shares and/or of the securities conferring rights thereto. This average shall be corrected, if necessary, in the event of a difference between the dates as of which the shares are entitled to dividends. In the event of the issuance of share subscription warrants of the company, the sum received by the company when the warrants are subscribed shall be taken into account in this calculation;

9/ resolve that the Board of Directors shall have all necessary powers, with power of sub-delegation to its Chairman, to implement this delegated power under the conditions set by law and, in particular:

- to determine the terms of the issuance or issuances, if applicable in agreement with the Board of Directors of the companies involved;
- to determine the number of shares, warrants and/or securities to be issued and their issue price, together with the amount of the premium, if any, that will be required to be paid at the time of issuance;
- to determine the dates and terms of the issuance and the nature, form and characteristics of the securities to be created, which, in particular, may be (but do not necessarily have to be) subordinated securities or securities with a fixed term;
- to determine the manner of payment for the shares and/or for the securities issued;
- if applicable, to set the terms of exercise of the rights attached to the securities issued or to be issued and, in particular, to determine the date, which may be a retroactive date, as of which the new shares will be entitled to dividends, together with all the other terms and conditions under which the issuances shall be effected;

- to set the terms pursuant to which the company shall, if applicable, have the option to purchase or exchange on the stock exchange the securities issued or to be issued, at any time or during set periods;
- to provide for the power, if appropriate, to suspend the exercise of the rights attached to the securities during a maximum period of three months;
- to decide that any balance of the issuance which has not been subscribed for shall be distributed by the Board in whole or in part as it deems appropriate, or that the amount of the issuance shall be limited to the amount of the subscriptions received, it being noted that the Board of Directors may use the above powers in such order as it sees fit, or only one of them;
- more particularly, in the event of the issuance of securities for the purpose of delivering them against the securities tendered in the context of a public exchange offer:
  - to approve the list of securities tendered in the context of the exchange,
  - to determine the terms of the issuance, the exchange ratio and, if necessary, the amount of the balance to be paid in cash,
  - to determine the terms of the issuance in the context either of a public exchange offer, a purchase or exchange offer being made in the alternative, or of a public offer that is mainly a purchase or an exchange offer, coupled with a public exchange offer or a public purchase offer of a more limited scope;
- in its sole discretion, to charge the expenses of the capital increases to the amount of the premiums relating thereto and to deduct from that amount the sums necessary to increase the legal reserve to one tenth of the new share capital after each increase;
- in general, to enter into any agreement (in particular to ensure the successful implementation of the transaction or transactions contemplated), to take any necessary measures and carry out any formalities necessary for the issuance of the securities and in order to comply with the financial obligations arising from the securities issued pursuant to this delegated power, as well as for the exercise of the rights attached thereto; formally to record the completion of each capital increase and to make the corresponding amendments to the articles of incorporation and bylaws.

ELEVENTH RESOLUTION
Limitation of the overall amount of issuances to be made pursuant to the 9th and 10th resolutions

Voting under the quorum and majority requirements of an Extraordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the report of the statutory auditors, resolve to set the following limits on the amounts of the issuances which could be decided upon pursuant to the powers delegated to the Board of Directors by the 9th and 10th resolutions of the meeting held today:

1/ the maximum nominal amount of the shares which may be issued, whether directly or upon presentation of securities representing debt or not representing debt, shall not exceed € 750 million or the equivalent of such amount in other currencies, increased by the nominal amount of the capital increase resulting from the issuance of shares which may need to be effected in order to preserve the rights of holders of such securities in compliance with law, it being noted that this limit shall not apply to capital increases by capitalization of premiums, reserves, profits or other funds,

2/ the nominal maximum amount of securities representing debt of the company which may be issued shall not exceed € 6 billion or the equivalent of such amount in other currencies.

TWELFTH RESOLUTION
Delegation of power to the Board of Directors to increase the capital by the issuance of shares reserved to participants in a company savings plan

Voting under the quorum and majority requirements of an Extraordinary Shareholders' Meeting, the shareholders, having read the report of the Board of Directors and the report of the statutory auditors:

1/ cancel the authorization given to the Board of Directors by the 12th resolution of the Shareholders' Meeting held on April 18, 2002, but without retroactive effect and only with respect to the balance of such authorization remaining unused as of the date of this meeting;

2/ authorize the Board of Directors in the context of the provisions of Articles L. 225-138 and L. 229-129 VII of the Commercial Code, and of Article L. 443-5 of the Labor Code, to increase the capital on one or more occasions, at its sole initiative, by the issue of new shares to be paid in cash, and, if applicable, by the free distribution of shares or other securities conferring a right to the share capital under the conditions set by law, and reserved to participants in a company savings plan. Such a decision shall entail the express waiver by the shareholders of their preferential subscription rights in favor of the beneficiaries;

3/ resolve that the beneficiaries of the capital increases authorized hereby shall be participants in a company savings plan of Alcatel or of the companies associated with Alcatel within the meaning of Article L. 225-180 of the Commercial Code, and who further satisfy any conditions that may be set by the Board of Directors;

4/ fix the period of validity of this delegated power at 26 months starting from the date of this meeting;

5/ resolve to limit the maximum number of shares of the company which may be issued on one or more occasions for the benefit of the beneficiaries described in paragraph 3 of this resolution pursuant to Articles L. 225-138 and L. 225-129 VII of the Commercial Code and Article L. 443-5 of the Labor Code, to 3% of the capital of the company at the time of each issuance;

6/ resolve that the subscription price for the shares to be paid by the beneficiaries referred to above, pursuant to this delegated power, shall not be more than 20% lower, nor higher, than the average opening prices of the shares quoted on the First market of Euronext Paris SA during the twenty trading sessions preceding the date on which the Board of Directors makes its decision to increase the capital and to issue the corresponding shares, such average being corrected, if necessary, in the event of a difference between the dates as of which the shares are entitled to dividends;

7/ authorize the Board of Directors, pursuant to this authorization, to issue any security conferring a right to the capital of the company which might be authorized in the future by the laws or regulations then in force;

8/ resolve that, in the event that pursuant to the powers delegated to the Board of Directors by the shareholders pursuant to the ninth and tenth resolutions of this Shareholders' Meeting, the Board should decide on a capital increase to be subscribed in cash immediately, it shall issue its opinion on the appropriateness of increasing the capital, as required by Article L. 443-5 of the Labor Code; and authorize the Board of Directors, with power of sub-delegation to its Chairman, to make such capital increases reserved to the beneficiaries referred to in paragraph 3 above, subject to a maximum limit of 3% of the capital increase that it has decided upon pursuant to the powers delegated to it by the aforementioned ninth and tenth resolutions;

9/ resolve that the Board of Directors shall have all necessary powers, with the power of sub-delegation to its Chairman, to implement this delegated power, subject to the limitations and under the conditions specified above, in order, in particular:
- to set the conditions to be satisfied by the beneficiaries of the new shares issued pursuant to capital increases authorized by this resolution,
- to set the terms of the issuance,
- to decide on the amount to be issued, the issue price, the dates and terms of each issuance, and in particular, to decide whether the shares shall be subscribed directly, through an investment fund or by means of another entity in accordance with applicable law,
- to decide and set the manner of allocation of free shares or of other securities conferring a right to the capital of the company pursuant to the authorization conferred above,
- to set the period granted to subscribers to pay in full for their securities,
- to set the date, which may be a retroactive date, as of which the new shares will be entitled to dividends,
- formally to record the completion of the capital increase, or to cause the completion to be recorded, for the number of shares actually subscribed, or to decide to increase the amount of the capital increase so that all of the subscription requests received may be satisfied,
- at its sole initiative, to charge the expenses of the capital increases to the amount of the premiums relating thereto and to deduct from that amount the sums necessary to increase the legal reserve to one tenth of the new share capital after each increase;
- in general, to take any measures necessary to complete the increases in the share capital, to carry out any formalities arising therefrom and to make the corresponding amendments to the articles of incorporation and bylaws arising out of such capital increases.

THIRTEENTH RESOLUTION

Powers to implement the decisions of the Shareholders' Meeting and to carry out the corresponding formalities

The Shareholders' Meeting confers all necessary powers to the holder of an original, a copy or an extract of the minutes of this meeting to carry out all filings and other formalities, as necessary.

FINANCIAL COMMUNICATION AND SHAREHOLDER RELATIONS

Financial Communication

The Financial Communications and Shareholder Relations Department will assist any shareholders who would like information about the Group. Alcatel regularly publishes reports, including the Shareholders' Newsletter (Lettre aux Actionnaires). These publications are available on request from:

Alcatel

Shareholder Relations Department

54, rue La Boétie – 75382 Paris Cedex 08
France

Telephone: 33 (1) 40 76 10 10

Shareholders can also contact this department at the following e-mail address: finance@alcatel.com.

Person responsible for the information: Claire Pedini

Draft timetable for 2004

April 30, 2004:	Q1 2004 earnings
June 4, 2004:	Annual Shareholders' Meeting
July 29, 2004:	Q2 and mid-year 2004 earnings
October 28, 2004:	Q3 2004 earnings

In addition, investors can log on to the Alcatel website under Shareholders/Investors at www.alcatel.com or www.alcatel.fr. to review all the Group's financial data, such as earnings announcements, annual and quarterly reports and presentations to the financial community.

PERSON RESPONSIBLE FOR THE REFERENCE DOCUMENT

Responsibilities

Audit Reports are prepared by the company's Statutory Auditors on the Alcatel parent company and consolidated financial statements:

	Appointment*	Renewal*	Expiration
STATUTORY AUDITORS			
Deloitte Touche Tohmatsu, Represented by Mr Alain Pons 185, avenue Charles-de-Gaulle 92203 Neuilly-sur-Seine Cedex	06/18/1998	05/16/2000	2006
Barbier Frinault et Autres (Ernst & Young), Represented by Mr Christian Chiarasini 41, rue Ybry – 92576 Neuilly-sur-Seine Cedex	06/23/1994	05/16/2000	2006
ALTERNATES			
Mr Olivier Azières, 185, avenue Charles-de-Gaulle 92203 Neuilly-sur-Seine Cedex	06/18/1998	05/16/2000	2006
Mr Philippe Peuch-Lestrade, 41, rue Ybry 92576 Neuilly-sur-Seine Cedex	06/23/1994	05/16/2000	2006

* Date of the Annual Shareholders' Meeting.

Fees received – fiscal year 2003

	2003				2002			
	Deloitte (Deloitte Touche Tohmatsu Network)		Barbier Frinault & Autres (Ernst & Young Network)		Deloitte (Deloitte Touche Tohmatsu Network)		Barbier Frinault & Assoc. (Ernst & Young Network)	
	K€	%	K€	%	K€	%	K€	%
1- Audit								
Statutory audits, certification, review of Company and consolidated financial statements	5.288	79.1 %	3.959	50.1 %	7.610	86.4 %	2.605	57.4 %
Other ancillary assignments and audits	890	13.3 %	2.819	35.7 %	376	4.3 %	1.841	40.6 %
Sub-total	6.178	92.4 %	6.777	85.8 %	7.986	90.7 %	1.446	98.0 %
2- Other services								
Tax	366	5.5%	1.040	13.2%	–	0.0%	40	0.9%
Information technologies					636	7.2 %		
Other	143	2.1 %	79	1.0 %	187	2.1 %	50	1.1 %
Sub-total	509	7.6 %	1.119	14.2 %	823	9.3 %	90	2.0 %
TOTAL	6.688	100.0 %	7.896	100.0 %	8.809	100.0 %	4.536	100.0 %

Statement by the person responsible for the reference document

To the best of my knowledge, the data in this document are in keeping with the facts. They include all the information necessary for investors to form their opinion on the assets, the business, the financial position, the results and the outlook for the company and the Group. They do not contain any omissions liable to alter the scope thereof.

SERGE TCHURUK

Chairman and Chief Executive Officer

STATEMENT BY THE PERSON RESPONSIBLE FOR THE REFERENCE DOCUMENT

This is a free translation into English of the statutory auditors' certificate issued in the French language and is provided solely for the convenience of English speaking readers. The statutory auditors' reports include for the information of the reader, as required under French law in any auditor's report, whether qualified or not, an explanatory paragraph separate from and presented below the audit opinions discussing the auditors' assessments of certain significant accounting and auditing matters. These assessments were considered for the purpose of issuing an audit opinion on the annual accounts and on consolidated financial statements taken as a whole and not to provide separate assurance on individual account caption or on information taken outside of the annual accounts or consolidation financial statements. Such certificate, together with the statutory auditors report addressing financial reporting in management's report on internal control, should be read in conjunction and construed in accordance with French law and French auditing professional standards. In addition, the procedures and practices utilized by the statutory auditors in France with respect to such financial statements included in a reference document, may differ from those generally accepted and applied by auditors in other countries.

As Statutory Auditors for Alcatel and in accordance with COB (Commission des Opérations de Bourse) Rule 98-01 and generally accepted practices in France, we have verified the information on the financial position and the historical financial statements of the company presented this "Reference Document".

This reference document was prepared under the responsibility of the Chairman of the Board of Directors of Alcatel. It is our responsibility to issue an opinion on the fairness of the information presented in the Reference Document concerning the financial position and financial statements.

We have conducted our work in accordance with professional standards in France. Those standards required that we assess the fairness of the information on the financial position and financial statements and their consistency with the financial statements on which we have issued a report. Our mission also included reading the other information contained in the Reference Document in order to identify any material inconsistencies with the information on the financial position and the financial statements, and to report any clear misstatement of facts that we may have found on the basis of our general knowledge of the company obtained during the course of our work. With respect to the selected forward-looking date resulting from an organized process, our reading took into consideration the assumptions used by management and the resulting figures.

In accordance with generally accepted practices in France, we have audited the annual accounts and the consolidated financial statements for each of the fiscal years ended December 31, 2003, 2002, 2001, as approved by the Board of Directors, and certified them without qualification.

In the reports on the annual accounts and the consolidated financial statements for the year ended December 31, 2002, and without calling into question our conclusions, we have expressed an observation on the change in method resulting from the first application as of starting January 1, 2002, of CRC Rule N° 2000-06 governing liabilities.

In accordance with the requirements of Article 225-235 of the French Code de Commerce, relating to the justification if our assessments, introduced on 1 August, 2003 by the Loi de Sécurité Financière and applicable for the first time this year, we disclosed in our audit reports on the annual accounts and on the consolidated financial statements the following justification of our assessments:

■ Which regards to the annual accounts as of December 31, 2003

Your company's management makes estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying Notes. These assumptions are, by nature, subject to uncertainties, and actual results could differ from these assumptions. The accounts affected by significant accounting estimates include investment securities reported in the assets of your company's balance sheet and totalling million € 9,738 million, as described in Note 7 to the financial statements.

Your company is equipped with long-term financial planning tools with various components, including cash flows and result forecasts, used to confirm the fair value of fixed assets, if applicable.

We have examined the relevance of the methodology outlined in Notes 1b and 4 to the financial statements, examined the data and assumptions used in implementing this methodology and assessed the reasonableness of such estimates.

We have considered whether these estimates were reasonable. Thus, the assessment we provide is part of our audit procedures relating to the annual accounts, taken as a whole, and contributes to the unqualified opinion expressed above in the first part of this report.

■ Which regards to the consolidated financial statements as of December 31, 2003

Your company's management makes estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying Notes. These assumptions are, by nature, subject to uncertainties, and actual results could differ from these assumptions. The accounts affected by significant accounting estimates are deferred tax assets, goodwill, fixed assets and reserves for liabilities and charges.

As stated in notes 7, 9, 11, 1 f) and 1 k) of the notes to the financial statements, your company reports in the balance sheet deferred tax asset amounting to € 2,011 million, goodwill amounting to € 3,839 million, and fixed assets amounting to € 1,500 million.

Your company uses financial planning tools to elaborate multi-annual financial plans, which include different components (e.g. forecasted cash flow and taxable income in particular), to check, if necessary, the fair value of fixed assets and the recoverable amount of deferred tax assets.

We have examined the relevance of the methodology outlined in notes 1 f) and 1 k) to the financial statements and the amounts and assumptions used in its implementation.

Your company reports in the balance sheet other reserves for liabilities and charges amounting to € 3,049 millions. We considered the basis for providing such amounts, examined the approval procedures carried out by the Management and reviewed the relating documentation.

We have considered whether these estimates were reasonable. Thus, the assessment we provide is part of our audit procedures relating to the consolidated financial statements, taken as a whole, and contributes to the unqualified opinion expressed above in the first part of this report.

Based on our work, we have no comment to make concerning the fair presentation of the information relating to the financial position and financial statements of Alcatel as provided in this Reference Document.

Neuilly-sur-Seine, March 31, 2004
The statutory auditors

DELOITTE TOUCHE TOHMATSU	BARBIER FRINAULT & AUTRES
Alain Pons	Christian Chiarasini

COMPARISON TABLE

To facilitate reading this document, which has been filed with the French securities market regulator, the principal information required by the regulator with regard to its regulations and instructions is set forth in the comparison table below.

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This reference document has been filed with
the French “Autorité des Marchés Financiers” (AMF) on April 1, 2004 under n°D.04-379.
It may be used to support a financial operation only if it is completed
by an offering circular approved by the AMF.

This document is a free translation from French into English and has no other value than an informative one.
Should there be any difference between the French and the English version, only the text in French language shall be deemed authentic and considered as expressing the exact information published by Alcatel.

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