

ANNUAL REPORT  
2004



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# PROFILE

ALCATEL DEVELOPS AND INTEGRATES TECHNOLOGIES, APPLICATIONS, AND SERVICES TO OFFER INNOVATIVE GLOBAL COMMUNICATIONS SOLUTIONS. THESE SOLUTIONS ENABLE TELECOM OPERATORS, INTERNET ACCESS PROVIDERS, COMPANIES, AND PUBLIC ADMINISTRATIONS TO DELIVER THE MULTIMEDIA SERVICES (TELEPHONY, FAST INTERNET ACCESS, AND VIDEO) THEIR CUSTOMERS OR USERS NEED IN A BROADBAND WORLD.

THESE HIGH VALUE-ADDED SERVICES ARE MADE POSSIBLE BY TECHNOLOGICAL INNOVATION AND A STRONG POSITION ON THE FIXED, MOBILE, AND SPECIALIZED COMMUNICATIONS MARKETS: THE COMPANY IS A WORLD LEADER IN BROADBAND ACCESS AND OPTICAL TRANSMISSION, A RECOGNIZED PLAYER IN NEW GENERATION MOBILE NETWORKS AND IP TECHNOLOGIES, A PIONEER OF VIDEO SOFTWARE APPLICATION DEVELOPMENT, AND AN INTEGRATOR OF SATELLITE TELECOMMUNICATIONS SOLUTIONS AND SIGNALING NETWORKS FOR TRANSPORT SOLUTIONS. THANKS TO THE VARIETY OF ITS TECHNOLOGY PORTFOLIO AND INTEGRATION CAPABILITIES, ALCATEL IS ABLE TO OFFER ITS CUSTOMERS A UNIQUE RANGE OF SERVICES.

IN 2004, WITH OPERATIONS IN 130 COUNTRIES, AND A 56,000 WORKFORCE, ALCATEL EARNED € 12.3 BILLION EUROS IN SALES WITH A NET PROFIT OF € 281 MILLION.

## > CHAIRMAN'S MESSAGE

Dear Shareholders,

In 2004, Alcatel fulfilled its commitment to return to growth and profitability. Sales have increased by 6%, despite the dollar's substantial depreciation against the euro. At constant exchange rate, our growth rate approached 10%. Our operational income has practically doubled with an 8% sales margin, resulting in a net income of 689 million euros before goodwill amortization. The company is in a healthy financial state with a year-end net cash position of 752 million euros.

Several factors have contributed to these positive results: strong commercial momentum, the persistence and the pertinence of our innovation efforts, continued internal cost-reduction efforts, and our teams' ability to adapt to the changes resulting from the fundamental transformation of the Group's activity.

Strong commercial momentum justified our strategic decisions. A massive R&D effort plays a key role, which allows us to bring ever more innovative products and solutions to the market. This is how we Alcatel became a global leader in two essential technologies: broadband access and fiber optic networks. Now we can also evaluate the dramatic evolution of the mobile networks and applications market, where Alcatel has become a recognized actor. In 2004, Alcatel also took a leap forward in another key area, IP-based technologies, by successfully integrating Timetra, acquired in 2003.

In addition to highlighting the dimensions of our R&D efforts – 16,000 engineers are working in our various research and development centers throughout the world – I want to point to our teams' proven capacity for innovation. More than 700 patents have been filed in 2004. We have achieved global technological breakthroughs, such as optic fiber transfer rates of 40 billion bits per second over a distance of 11,220 km. Our engineers were the first to believe in the capacity of telecom networks to carry image data in economically viable conditions, resulting in TV over ADSL and

now "Triple Play" service, which is transforming old-fashioned telephone networks into multimedia, voice, data, and image distributors. If Alcatel is now the world's leading provider of Triple Play services, which constitute a market with great potential, it is certainly due to our ability to anticipate and to innovate. "No less remarkable is the diversity of talented European, American, and Asian researchers, who bring their skills and expertise, working together for a common purpose." In order to ensure the long-term success of our company in the very competitive communications technologies market we must maintain our capacity for innovation. This is an essential task that we keep in the center of our attention.

Improved internal efficiency, and consequently reduced operating costs, is the result of a thorough process initiated three years ago. All aspects of company management have been improved: we have reviewed purchasing, logistics, IT, and production, simplifying and streamlining these processes in an effort to bring them in line with the new company structure, to make it more competitive in the long-term.

No less noteworthy is our teams' ability to adapt to changes in their environment. In the wake of the crises, the market has continued to evolve dramatically, shaping the communication and information industries according to completely new rules.

Consumer expectations for greater simplicity, diversity, and continuity in broadband communication services are driving several types of convergence: between telecom, audiovisual, and IT industries; within telecom companies, between fixed and mobile services, and between the business world and network operators. These different types of convergence are made possible by new technologies, all focused on IP and optics for a broadband world. The performance of communication networks is continuously improving, opening up new opportunities for both leisure and business productivity applications. Mobility is no longer an option, it has become the norm.

Interactivity, the capacity of users to communicate with their network, is no longer an exception, it has become the founding element of communications.

At the same time, the dynamism of developing countries has redrawn the map. Strong economic growth in these countries has made it possible to meet their extensive infrastructure needs. Today, 1 billion people have yet to gain access to telephone services. In addition, economic growth is driven by information and communication technologies, making them an investment priority – today China is the best example.

From a geographical standpoint, in 2004, Alcatel bolstered its traditional positions (Western Europe, United States, China) and continued to strengthen its hold in developing markets, where our know-how is increasingly visible and looked-up to. This was the year of Russia, Brazil, India, and West Africa, especially for mobile communications. Developing countries are becoming valuable markets for operators, just like developed countries: among our ten largest customers, four operate in emerging countries. This is due to high-quality sales representation and a true partnership-based approach to working with operators undergoing rapid regional growth, who are eager to offer services that are optimally suited to their customers' wide range of needs, from the most simple to the most sophisticated types of services.

With regard to sector-specific activity, in 2004, Alcatel has continued to increase its presence in certain vertical markets for which communication services are of key, even strategic, importance: space and defense, transport, energy, and local governments. With an annual growth rate of over 20% for the second year in a row, Alcatel has won numerous contracts in Europe for railway signaling, main line and urban line solutions, simultaneously integrating associated communication networks. The objective is two-fold: improve both traffic security and speed. The Group can therefore put

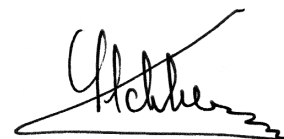
its know-how at the service of new customers, whose complex needs can be met thanks to its extensive experience serving telecom operators. These new opportunities point to the presence of a currently little-known market, which some estimate to have a potential equivalent to that of the operator market.

With one of the most complete and targeted technology portfolios, a global presence, a diverse clientele, controlled costs, and successful internal restructuring, our Group has all the elements essential for consolidating its leadership position on the communication technology market. Our intention is to further improve Alcatel's performance in 2005, by nurturing business growth, increasing operational profitability, and attaining double-digit growth of income per share.

Dear Shareholders, I am convinced that the strategy implemented over the past several years will bear fruit. It is founded on the dedication of all Alcatel employees, whose expertise and involvement have first helped turn around, and now contribute to the growth of your company.

You can be assured of my total commitment to pursue the current course of action.

Serge Tchuruk

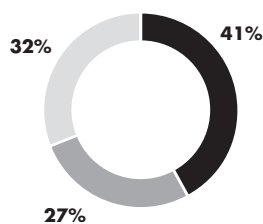


## > KEY FIGURES

Year 2004 has confirmed Alcatel's return to growth and profitability. Alcatel has continued to simultaneously reduce costs, optimize operations, and maintain significant research activities. The Group's healthy position means that it will be able to take advantage of any future rebound in business, while continuing profitable growth.

### SALES REVENUES BY SEGMENT

(as a %)

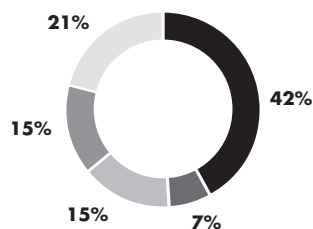


- Fixed communications
- Mobile communications
- Private communications

Fixed communications, which strengthened its leadership positions in 2004, particularly in broadband access, represented 41% of sales revenues. Alcatel has widened its client base to include enterprises, public administrations, and government agencies, thereby increasing private communications revenue. Sales in mobile communications, which represent 27% of the turnover, showed significant growth driven by network deployments in emerging countries.

### SALES REVENUES BY GEOGRAPHIC REGION

(as a %)

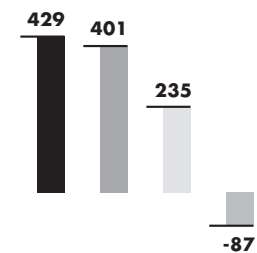


- Western Europe
- Rest of Europe
- North America
- Asia
- Rest of the World

Europe accounted for half of the sales. Sales revenue for Asia and North America decreased. The share represented by emerging countries (Africa, Middle East, and Latin America) has grown significantly.

### OPERATING INCOME PER SEGMENT

(in millions of euros)



- Fixed communications
- Mobile communications
- Private communications
- Other

As a result of continued cost optimization efforts, in a context of higher sales revenues, the Group's operating income almost doubled in 2004, nearing one billion euros, benefiting from the strong growth of the fixed communications operating margin.

**SUMMARY THREE-YEAR  
INCOME STATEMENTS**

(in millions of euros)

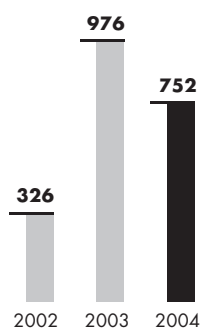
	<b>2004</b>	<b>2003 restated <sup>(1)</sup></b>	<b>2003 published</b>	<b>2002 published</b>
Net sales	12,265	11,606	12,513	16,547
Income (loss) from operations	978	449	332	(727)
Net income (loss)	281	(1,944)	(1,944)	(4,745)
Earnings per share in euros	0.21	(1.46)	(1.46)	(3.99)
Earnings per ADS in USD <sup>(2)</sup>	0.28	(1.84)	(1.84)	(5.03)

(1) All historical results are restated for optical fiber, mobile handsets and power systems.

(2) Earnings per ADS has been calculated using the US Federal Reserve Bank of New York noon euro/dollar buying rate of USD 1.35 as of December 31, 2004.

**CHANGE IN NET CASH**

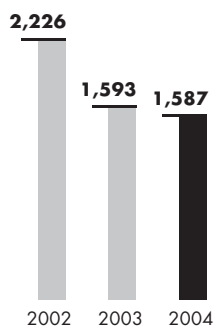
(in millions of euros)



Net cash remained positive in 2004, close to the 2003 level, even following the financing of the last restructuring plans.

**CHANGE IN R&D EXPENDITURE  
(PUBLISHED)**

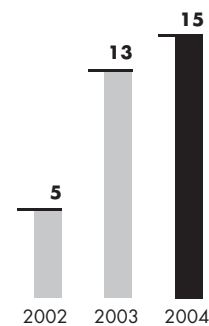
(in millions of euros)



In 2004, R&D expenditure represented around 13% of sales, as in 2003.

**CHANGE IN MARKET  
CAPITALIZATION**

(in billions of euros)



The growth in Alcatel's market capitalization reflects Alcatel's efforts in 2004 to maintain a healthy financial position, develop its product portfolio, gain market share, as well as renewed market confidence in technology stocks.



## > COMPANY MANAGEMENT

### Members of the Board of Directors

**Serge Tchuruk**  
Chairman and Chief Executive Officer

**Philippe Germond**  
Director  
President and Chief Operating Officer

**Daniel Bernard**  
Independent Director

**Philippe Bissara**  
Independent Director  
General representative of ANSA (National Association of Joint Stock Companies)

**Frank W. Blount**  
Independent Director  
Chief Executive Officer of TTS Management Corp.

**Jozef Cornu**  
Director

**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 Directors "IFA"

**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

**Bruno Vaillant**  
Director  
Engineer, Alcatel Space

**Marc Viénot**  
Independent Director  
Honorary Chairman and Director of Société Générale

**Pascal Durand-Barthez**  
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

Marc Viénot

### Auditors

**Deloitte & Associates**  
Represented by Alain Pons

**Barbier Frinault & Autres**  
Represented by Christian Chiarasini

**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

**Christian Reinaldo**  
Executive Vice President of Alcatel and President of Alcatel Asia-Pacific

**Ronald Spithill**  
Executive Vice President of Alcatel and Chief Marketing Officer

Mr. Niel Ransom was a member of the Executive Committee until January 2005.

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## FIXED COMMUNICATIONS

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### Activities

- Design, supply, and install access and long-haul fixed communications infrastructures (telephony, data transfer, video distribution) for telecommunications operators
- Supply multimedia focused applications software
- Integrate complex solutions, including fixed/mobile network convergence

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## MOBILE COMMUNICATIONS

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### Activities

- Design, supply, and installation of mobile communications infrastructures (telephony, data transfer, video distribution) for telecommunications operators
- Supply multimedia focused applications software
- Integrate complex solutions, including fixed/mobile network convergence

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## PRIVATE COMMUNICATIONS

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### Activities

- Design, supply, and installation of fixed and mobile communications infrastructures (telephony, data transfer) for enterprises and public institutions
- Design and supply of satellite-based solutions (telephony, data transfer, television programming distribution) for enterprises and satellite operators
- Design, supply, and installation of signaling and communication networks for operators of urban and rail transportation systems
- Telecommunication solutions integration
- Outsourcing for telecommunications networks

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## Solutions

- Wireline telephone networks
- Broadband access networks over copper (DSL) and Optical fiber (FTTH)
- Optical transmission networks (terrestrial and submarine)
- IP and ATM data networks
- Multimedia services (Video on Demand, interactive television)

## Key Figures

€5.1 billion in sales in 2004

- No. 1 worldwide for ADSL: 19.6 million lines shipped in 2004<sup>(1)</sup>
- No. 1 worldwide for optical networks with 16% market share<sup>(2)</sup>
- No. 2 worldwide for ATM data networks with 24% market share<sup>(3)</sup>
- Over 360 million circuit-switched lines installed<sup>(4)</sup>

(1) (3) Source Dell'Oro (2) Source RHK (4) Source Alcatel

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## Solutions

- Wireless telephone networks (GSM/GPRS, EDGE, 3G/UMTS and CDMA)
- Radio transmission networks
- Multimedia user services (messaging, video, content)
- Applications for mobile operators: value-based billing, user positioning system
- Wireless solutions (WiFi, WiMAX)

## Key Figures

€3.3 billion in sales in 2004

- Over 300 clients in more than 130 countries
- 14% share for GSM infrastructure<sup>(5)</sup>
- No. 2 worldwide with 17% market share for wireless transmission networks<sup>(6)</sup>

(5) (6) Source Alcatel

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## Solutions

- Voice over IP (VoIP) and voice-data convergence solutions for enterprises
- Multimedia call centers
- Satellite-based systems for telecoms, navigation, meteorology, Earth observation, and science
- Integrated signaling, communication, and management solutions for railway networks
- Network operation, maintenance, and management for operators and enterprises
- Sector-specific applications (banking, distribution, energy, administration, etc.)

## Key Figures

€3.9 billion in sales in 2004

- No. 1 in Europe for enterprise IP communications systems with 23% market share<sup>(7)</sup>
- No. 1 worldwide in multimedia contact centers (Genesys)<sup>(8)</sup>
- No. 1 in Europe in telecommunications satellites<sup>(9)</sup>
- A major player in railway management (ETCS, European Train Control System)<sup>(10)</sup>

(7) Source Gartner  
(8) (9) (10) Source Alcatel

## > FIXED COMMUNICATIONS

In 2004, Alcatel was able to capitalize on its investments, finding itself well placed to take full advantage of new market opportunities offered by fixed telecommunications: broadband access deployment, IP networks, video over IP, among others. Alcatel's integration and service capabilities make it an increasingly sought-after partner in complex solution deployment projects.

The fixed communications networks market is changing. In most countries, traditional services, such as PSTN-based telecommunications, have reached full market penetration. At the same time, emerging needs, such as very high-speed access, have been driving telecom operators to adapt their service offerings. In 2004, new investments have nearly compensated recurrent losses from traditional services, and the fixed networks market shrunk by only a few points, in comparison with 2003.

Deployment of high-speed access, increased demand for video services, and IP convergence are the three main market catalysts. Operators around the globe are becoming interested in multimedia services, such as video. This market is driven by a strong demand for new applications, such as video conferencing and interactive television over DSL, among others. Similarly, IP convergence, made possible by the Protocol's widespread use, and the introduction of next generation networks, will allow operators to deploy new services for the general public, as well as for the enterprise market.

Alcatel is well positioned to meet this new demand, having made the investments that allowed the company to be competitive on today's markets. Alcatel is the undisputed leader in broadband access, with 38% of the global ADSL market. The company's IP-based services are perfectly adapted to support the most demanding dynamic applications: video and integrated enterprise communications services. In 2003, Alcatel's purchase of iMagicTV and Thirdspace's key assets strengthened its video services integration capabilities. Lastly, Alcatel has also sharpened its technological edge on optical platforms.

### Access: reaching very high speeds

Access to the user is becoming of increasingly strategic importance for the operators. In 2004, operators have continued investing in access in order to win over clients and introduce new services to boost the market, namely telephony over IP and video.

Alcatel, a world leader in both DSL access and FTTH (Fiber to the User), continues to develop and improve its service offerings in an effort to meet new demand. In 2004, the company launched new IP-based DSL equipment using aggregated Ethernet networks, specially designed for video services requiring 20 Mbps per client. This device can also be used together with optical fiber solutions, making it possible to provide high-speed connections to increasingly remote users, while keeping the same level of efficiency.

Alcatel also offers a new solution, in response to a growing need for higher connection speeds, facilitating the transition from ADSL to ADSL2, ADSL2+, multi ADSL and VDSL, with speeds of up to 16 to 24 Mbps per user. At the same time, Alcatel's new FTTH solution enables IP network integration and the deployment of a full range of new multimedia services at speeds of up to 100 Mbps.

### Network Solutions: towards video and multimedia services

In the voice market, Alcatel boasts the world's largest installed base, with 340 million lines in over 140 countries. Alcatel provides 90% of the maintenance for this base. Recurrent revenue from this activity partially compensates for slacking investment in this area.

In 2004, Alcatel assisted operators in deploying the next generation of softswitches, which streamline new IP-based service routing. Alcatel's OPEN (Open Path to Enhanced Networking) forward-looking strategy provides operators with solutions to deploy next generation networks using gateways to integrate them with traditional networks. The OPEN pro-

gram, which was expanded in 2004, consists of a comprehensive set of switches and gateways that support voice communication network migration and the introduction of new services using SIP (Session Initiation Protocol). IMS (IP Multimedia Subsystem) is a new SIP-based standard, for fixed and mobile applications and networks convergence. Alcatel is presently working with about sixty operators, British Telecom and China Telecom, among others, to assist them in this process.

For the past several years, Alcatel has been committed to developing key technologies for the deployment of IP services. In 2004, Alcatel became a leading provider of Video over DSL solutions, as evidenced by contracts signed with Sistema in Russia, Chunghwa Telecom in Taiwan, and SBC in the United States.

### **IP Networking: increasingly faster migration**

In 2004, data markets continued incorporating IP/MPLS and Ethernet technologies, which enable operators to launch new revenue-generating services in ideal reliability and security conditions. The challenge for operators is to successfully execute this migration process while protecting their current revenue sources, and offering impeccable quality of service both to the general public and enterprise customers, who are particularly demanding in this regard. Alcatel has taken a two-pronged approach to meet this need.

First, the Group has implemented IP/MPLS technologies in its multi-service data networks, thus offering operators a seamless migration strategy, which has been used successfully by British Telecom in Great Britain, Golden Line in Russia, and KT in South Korea.

Second, following the acquisition of Timetra in the second half of 2003, Alcatel reaffirmed its advances in IP/MPLS networks. At the end of 2004, over 55 clients, including SBC in the United States, China Telecom and China Netcom in China, Hutchison in Hong Kong, TeliaSonera in Scandinavia and the Baltic States, and Telenet in Belgium, deployed Alcatel's IP service router and/or Ethernet service switch. These systems are successful due to their density, performance, and flexibility, which offer unequalled protection for operators' investments. In addition, Alcatel's corresponding network management solutions for these systems allow operators to cut operating costs, while improving customer satisfaction.

Hence, the Group has positioned itself as a new force on the IP market through technological innovation and unique carrier-class qualities.

### **Optical Networks: towards market recovery**

In 2004, Alcatel reaffirmed its position as a global leader in the optical transport network market, with a 16% market share. An upturn could be noted in long distance, submarine optic fiber transmissions, due to the signing of the Sea Me We 4 network contract between France and Singapore. Although this market has been experiencing an unprecedented crisis for several years, Alcatel continued to invest in it with the goal of bringing equipment to the market that would integrate an increasing number of features, particularly data services. These new technologies also enable operators to have better control over costs. The new cross-connect platform for metropolitan networks, launched in 2004, integrates four layers of functionality within the same piece of equipment, simplifying both its installation and operation.

Growing user demand for bandwidth-hungry applications, such as Video on Demand, HDTV, and new 3G mobile applications, should lead to increasing demand for higher transmission speed. Similarly, transport and energy sectors, among others, have growing needs for optical network solutions that improve operational security and productivity. Today, Alcatel is ideally poised to benefit from these new growth opportunities and has further strengthened its position on the market by signing new contracts with Belgacom, Cegetel, China Telecom, SingTel, Telemar and Telenet, among others.

In 2004, Alcatel invested in Tropic Networks, an American company specializing in reconfigurable multiplexing technology, which allows operators to remotely reconfigure capacity at individual optical nodes, delivering the functionality operators require to cost-effectively upgrade their network, without affecting in-service traffic.

Alcatel has also signed a partnership agreement with Draka, a Dutch company, to form a joint venture in the optical fiber and cable business.

## > MOBILE COMMUNICATIONS

In 2004, Alcatel strengthened its position on the growing mobile telecommunications market and generated solid profits, thanks to its ability to deploy comprehensive solutions, which use upgradeable multi-standard technologies in its multimedia services and next generation network development.

Within a few years, mobile telecommunications have become pervasive, rapidly outstripping the most optimistic forecasts. Today, mobile solutions provide fast and simple answers to a variety of economic and geographical contexts: high speed Internet access in Russia, numerous on-line services in Japan, GSM networks in developing countries.

In 2004, Alcatel used the deployment of new UMTS services to strengthen its position in this area and conquer new markets in France, the Netherlands, and in the United Kingdom. The boom in high speed connectivity has created increasingly favorable conditions for the development of video services. Already a global leader, Alcatel further expanded its customer portfolio with the acquisition of PacketVideo. GSM has continued to drive the rapidly growing mobile communications market in developing countries, with Alcatel increasing its market share in Africa, the Middle East, Latin America, and Russia.

With the acquisition of Spatial Wireless in 2004, Alcatel gained a significant competitive advantage in NGN solutions. At the end of the year, Alcatel purchased MNC, adding the capability to provide external mobile applications management to its service offer.

In 2004, in anticipation of market changes, and to preserve the diversity of its service offerings, Alcatel entered into three strategic partnerships. The company joined forces with Datang to develop TD-SCDMA based technology in China. At the same time, Alcatel has partnered with Intel to spearhead a broad research program to develop WiMAX, a high speed wireless access technology. Lastly, an agreement with TCL, a leading Chinese firm, will enable Alcatel to boost its mobile terminal business. Through these actions, Alcatel has secured its presence in all market segments.

### Networking: the success of an open multi-standard service

Alcatel's mobile network equipment stands out for its modularity: solutions that were installed over the past years are both multi-access and multi-standard, meaning that their users can gradually adapt to market needs and demands by adding the needed functionalities, without heavily investing in new equipment. Alcatel customers that chose to use the Edge technology in their networks, for example, have all benefited from this key advantage. Modularity is a decisive factor when making new investments.

Thus, Alcatel has continued to grow in the rapidly developing GSM market. Alcatel is one of the world's leading companies on the mobile communications market in developing countries, which currently offers the greatest growth potential. Alcatel has deployed its solutions in Africa, the Middle East, Latin America, notably in Brazil for the first time, and in Eastern Europe, enabling local operators to offer the full range of available mobile services: voice, MMS and SMS applications, Internet access, etc.

Alcatel has kept its positions in Western Europe, and expanded its presence in the UMTS network market. Alcatel now provides network equipment for Orange, the mobile service operator, covering 50% of its network in France, 20% in the United Kingdom, and 100% in the Netherlands. These solutions were also selected by Austria's tele.ring and Telecom Portugal. Alcatel's UMTS solutions are also deployed in the United Arab Emirates, Libya, Tunisia, Saudi Arabia, and are undergoing pilot testing in China—where the agreement with Datang should allow Alcatel to gain footing on the local TD-SCDMA market.

### Core networks and solutions: a technological edge

In 2004, Alcatel gained a decisive position with respect to core NGN technology, further strengthened by the acquisition of Spatial Wireless. Alcatel and Spatial Wireless were chosen to deploy the first mobile NGN for an American operators T-Mobile and Cingular, breaking with the technology used on this market. The new softswitches are both less costly to install and operate, and offer greater simplicity and unequalled functionalities. The equipment can manage both voice and data streams and is integrated into IP networks, thus enabling fixed and mobile network convergence. Alcatel possesses a real advantage in this new technology, which should attract new operators in the coming months.

## **Mobile applications: a gateway to multimedia services**

With respect to mobile applications, Alcatel has focused its investments in three key areas. Its billing chain, the world's leading mobile billing solution has been further enhanced and improved, now providing operators with a customized billing solution that itemizes voice, data, and other services. This market offers Alcatel two dynamic advantages: increasing variety of operator services, requiring new solutions, and new equipment. In 2004, for example, Vodafone and Tele2 both adopted this solution.

Alcatel has positioned itself early on the video applications market, and in 2004 was still ahead thanks to its foresight. In 2004, Hutchison, SFR, Telefonica Movilès, and KPN Mobile all adopted Alcatel's PacketVideo solutions.

The mobile office solution is Alcatel's third key application. This solution offers access to the same telecommunications functionalities whether the user is in or out of the office. Orange France has chosen this solution, which enables its enterprise customers to have better control over communication costs and to distinguish professional and private communications.

## **Wireless: improved competitiveness**

Alcatel, a world leader in wireless communications, significantly improved the competitiveness of its service offer in 2004. The new wireless solutions have reduced the need for investments by one-third, in comparison with the legacy system. Alcatel will continue making its services more competitive in an effort to lower the cost of future generations of this equipment, which is essential for connecting rural or isolated areas. Alcatel is well positioned to take advantage of the upswing in this market, due to UMTS and EDGE deployment.



## > PRIVATE COMMUNICATIONS

In 2004, Alcatel recorded strong growth of its private communications segment, thanks to two lines of development, which guided its strategy over the past several years. With the deployment of integrated solutions and services, Alcatel can offer its enterprise customers global solutions, founded on its complete telecommunications technology portfolio. Alcatel also developed innovative solutions targeting four specific vertical markets: transportation, defense and security, energy, and the public sector.

In 2004, the enterprise market experienced renewed growth, fueled by the development of vertical markets. Alcatel has had a longtime commitment to this area, building up a range of innovative solutions and services that target four sectors of activity, where communications needs are of strategic importance. In the transportation sector (railway, road, and air transport), Alcatel's solutions assist in traffic management and security, and provide new information, CCTV, and leisure services. In the energy sector (in particular the petroleum industry), telecommunication networks closely follow distribution networks, linking petroleum sites throughout the world. New defense and security systems bring together satellite, fixed, and mobile communications within dynamic networks that ensure permanent connectivity between headquarters and action on the ground. In the public sector (administrations, institutions, research, education, and health), networks constitute an essential part of the new applications: telemedicine, e-administration, e-learning. In 2004, Alcatel widened its solutions offerings and made the necessary organizational changes to better meet these market needs: marketing staff, with sector-specific specialization, represent the company throughout the world, enabling the Group to better anticipate its customers' needs and challenges.

Thanks to this dynamic approach and the development of other markets such as network management outsourcing for telecom operators, Alcatel reported 10% growth of its private communications in 2004.

### Integration services: continuously growing demand

In 2004, orders for integrated solutions doubled, in comparison with 2003. Exceptional growth was noted in the transportation sector. Alcatel has a strong position on this market. Having a presence in both railway signaling system and communication solutions allows Alcatel to take advantage of all points of convergence and synergy between the two areas, and offer increasingly innovative and competitive solutions to its customers.

At the same time, Alcatel has significantly developed its position on the network management outsourcing market. In 2004, Telecom New Zealand, One (Austria), and Base (Belgium) all entrusted Alcatel with the operation, maintenance,

and development of their networks. These new contracts reaffirmed Alcatel's leadership position in this promising market, especially in Europe. By doing so, the operators bypass network management limitations and can focus on customer relations and commercial development.

### Signaling systems: European dynamics

In 2004, the railway signaling systems market grew worldwide. Growth in main line and urban line railway transport services is driven by the need to move an increasing number of people and goods over the existing railway networks. Signaling solutions help ensure traffic security. Alcatel gained market shares in this area, thanks to its service offer, which is considered to be one of the most advanced in the world. In Europe, where new traffic regulation standards (European Train Control System) are being implemented, Alcatel's solution won most of the calls for tenders issued in 2004. Alcatel also won numerous calls for tenders in Asia and in America.

### Satellite communication: new applications

Alcatel's satellite solutions experienced strong growth in 2004, thanks to the orders received over these past two years. Alcatel occupies a strong position on this market, which has been affected by the emergence of new telecommunications applications. Alcatel's "DSL in the Sky" solution, offering broadband Internet access over satellite, gave the company a decisive technological advantage. The solution enables operators to provide isolated or rural users, who do not have either cable or ADSL access, with broadband solutions. This service can be provided alongside HDTV broadcasting services. These new developments should continue fostering growth in this sector in the coming years.

In addition, Alcatel decided to strengthen its global position by partnering with Finmeccanica. The first company formed by this alliance, two-thirds of which are held by Alcatel, will be the leader in Europe, and rank third worldwide. This company will be able to take advantage of the complementary technologies that exist between the two partner companies. Alcatel will diversify its customer base thanks to Finmeccanica's strong institutional market. The agreement also includes the creation of a satellite services company, in which Alcatel holds 1/3 of capital. Alcatel and its partners, Finmeccanica, Hispasat, and AENA, have formed the Eurely consortium, which submitted a proposal to the European Economic Commission for the Galileo Concession, which has been retained for the third round of selection.

## Enterprise solutions: IP technology growth

In 2004, IP network deployment picked up speed. Numerous companies chose to implement Alcatel's data management solutions. However, demand for straightforward telecommunications management has given way to the growing need for services such as unified messaging. In 2004, over 30% of the telephone lines Alcatel delivered and installed were IP-based. Whatever the size of the company, and its area of activity, integration between operator networks and internal applications is an essential element of marketing development and customer services. In an effort to meet these new needs, Alcatel has focused on developing the Unified Communications services suite, centered around four applications: My teamwork, My assistant, My phone, My messaging. The growth of Alcatel's subsidiary Genesys, the world leader in contact center software, once again outstripped that of the market, concluding sales with major North American accounts (Wells Fargo, Barclays Bank).

Alcatel bolstered its leading positions working along a three-pronged strategy, and taking advantage of the expansion of new IP technologies. First, by offering convergent voice and data communication equipment and further extending this convergence to the IT world, through the acquisition of Right Vision in November 2004. Second, by promoting comprehensive software products, ranging from contact center solutions (through its fully owned subsidiary Genesys) to the integrated Unified Communications suite, with new collaborative features (instant video and voice conferencing, multi-user management). This product is now developed by eDial, a company acquired in September 2004. Lastly, by joining forces with telecom operators, managed service companies and major distributors, to market a scalable range of solutions and services tailored to the customers' needs and size – a token of Alcatel's unique position on the MCS market.

## > RESEARCH AND DEVELOPMENT

In response to continuously evolving customer needs, research, development, and the anticipation of new telecommunications trends represent a key driver of growth for Alcatel, which has invested around 13% of its sales revenue in R&D.

In order to increase the efficiency of these investments, Alcatel has chosen to place its research centers near the principal global markets: in Europe (Anvers, Marcoussis, Stuttgart), in North America (Dallas, Ottawa), and in Asia (Shanghai).

Alcatel thus leverages the innovation potential and the creativity of the regions in which it is operates.

### Inventing and building new telecommunications technologies

Alcatel's success in broadband access, "Triple Play" multimedia services, and next generation fixed and mobile communications networks demonstrated one of its key advantages over competitors: the ability to bring to the market, at the right time, new technologies which deliver value to customers, operators, enterprises, and their users.

Furthermore, technological innovations often make it possible to unlock latent demand. For example, it is the appearance of affordable technology and broadband access that lead to the birth of online video services. This is why Alcatel wants to continue being a driving force in the development of new technologies that help its clients to identify new sources of revenue, while making new services more accessible for end users.

Consequently, Alcatel has dedicated a significant part of its research activity on inventing the technologies of the future, anticipating network evolution, and developing the new services that consumers will need in the mid-term.

Alcatel then invests in developing, testing, and ensuring the reliability of these new technologies. In 2004, for example, research teams improved the quality of service and interactive television over IP. Research in optics has been concentrated on convergence with data networks and cost optimization. Alcatel has also made significant investments

in fixed and wireless access solutions. In 2004, a research and development program on WiMAX, the wireless DSL alternative, was launched jointly with Intel.

Research has been increasingly focusing on softwares: 60% of investments were dedicated to billing, messaging and video.

In 2004, in an effort to put its research at the service of company strategy, Alcatel created the "R&D Council" committee, bringing together research and strategy managers from Alcatel's three market segments. This committee meets three to four times per year to identify priorities and allocate resources to different research and innovation programs, according to their potential and their contribution to the Group's global strategy. The committee decisions are based on the conclusions of the research division's Network Strategy Group, whose mission is to anticipate mid-term market needs.

### A continued effort to improve product performance

One of the chief missions of Alcatel's research and development teams is to extend product life, continuously improve their cost, performance, and thereby their competitiveness. This effort consists of regularly reviewing product design; it also involves a parallel process by Alcatel's suppliers.

The evolution of DSL equipment is a perfect example of this ongoing effort. Copper, already deployed to cover numerous users, remains irreplaceable for operators and Alcatel has invested in improving speed and reaching the quality levels necessary for video. Five years ago, available solutions offered speeds of 0.5 Mbps per client; in 2004 Alcatel can provide up to 20 Mbps per client, for a lower cost. Innovation has made it possible to reduce the cost per line, all the while increasing capacity and the number of services on the market. This perpetual re-design effort has improved many of Alcatel's technologies.

# CORPORATE GOVERNANCE

## > BOARD OF DIRECTORS

In view of 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 continued to be careful to abide by the best corporate governance practices in terms of the proper operation of its Board of Directors and improved financial reporting.

### Structure of the Board of Directors

The structure of the Board of Directors remained unchanged in 2004 and early 2005, and the Board has the same 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.

The average age of the directors is 62.

### Renewal of directors' mandates

At the Shareholders' Meeting on June 4, 2004, Mr. Jozef Cornu's mandate as Director was renewed for a term of four years, i.e., until the end of the Shareholders' Meeting approving the fiscal year 2007 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.

The terms of office of Messrs. Philippe Bissara, Frank N. Blount, Jean-Pierre Halbron, David Johnston, Pierre-Louis Lions, Thierry de Loppinot, Peter Mihatsch and Bruno Vaillant will expire at the end of the Shareholders' Meeting approving the fiscal year 2004 financial statements.

On recommendation from the Nominating and Compensation Committee, the Board of Directors that met on March 10, 2005, decided to propose to the annual Shareholders' Meeting to be held in May 2005 that it renew the terms of office of the eight directors.

In conformance with the company's bylaws, the above-mentioned terms of office indicated below shall be renewed on a staggered basis to ensure regular renewal of Board members. Consequently, it has been proposed to the Shareholders' Meeting to be held on May 20, 2005 to renew Messrs. Johnston, Lions terms of office for a period of four years, until the end of the Shareholders' Meeting approving the fiscal year 2008 financial statements, to renew Messrs. Bissara, Blount, Halbron and Mihatsch terms for a period of three years, until the end of the Shareholders' Meeting approving the fiscal year 2007 financial statements, and the terms of Messrs. de Loppinot and Vaillant for a period of one year, until the end of the Shareholders' Meeting approving the fiscal year 2005 financial statements.

### Director selection criteria

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 unques-

tionable 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 March 10, 2005 meeting, confirmed the independence of eight of its members, that is, over half the Board as of January 1, 2005 - 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 include a number of 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 six times in 2004, with about 90% of its members present at every meeting. It met twice during the first quarter of 2005.

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 prepared agenda.

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 documentation relating to the agenda items. In general, every point is accompanied by internal and/or external documentation, depending on the subject in question, and may also be accompanied, as appropriate, by a draft resolution of the Board. The file also contains a draft press release of the Board that is generally published the day after the Board meeting and before the opening of the Paris Stock Exchange, in accordance with the recommendations of the French Financial Markets Regulator (Autorité des marchés financiers).

The file also contains a list of the principal contracts and agreements signed since the last meeting as well as data on changes in the Alcatel share price.

Occasionally, 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 Board meetings is three hours, usually preceded by an informal meeting with the company's Senior Executives.

The members of the Board of Directors are invited to meet regularly with the company's main operating executives to familiarize themselves with the Company's strategy and business developments. They may 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 all relevant information concerning the company, particularly press articles and financial analysis reports.

## Deliberations of the Board of Directors

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, 2003, 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 year 2003. At each of these meetings, the financial statements were reviewed in the presence of the Auditors, and the Audit Committee presented a report.

It also examined the timetable for the company's changeover to IFRS (International Financial Reporting Standards).

### The Group's business

The Board regularly examined Alcatel's position on the market, discussed the Group's strategy several times, and issued statements on diverse operations undertaken as part of Group's policy to focus on core business.

The Board approved the creation of a joint mobile phone company, 55% owned by the Chinese holding company TCL Communication Technology Limited, and 45% owned by Alcatel, as well as the regrouping of Alcatel's optical fiber and communication cable business with that of the Dutch company Draka Holding N.V. in a new company, 50.1% owned by Draka and 49.9% owned by Alcatel.

It authorized the acquisition of Spatial Communications Technologies Inc. (USA) and authorized its subsidiary Coralec to issue bonds redeemable for Alcatel shares to finance the acquisition.

The Board also approved the acquisition of eDial Inc., an American conferencing and collaboration solutions provider, and Right Vision, a French IT and communications company.

The Board also authorized the sale, in early 2005, of Alcatel's electrical power system activities to Ripplewood Holdings L.L.C., a global private equity firm, and the combining of Alcatel's and Italian Finmeccanica's space divisions by creating two jointly held companies, in which each partner contributes its industrial and services activities.

It also reviewed various divestitures and acquisitions, still in the planning stages.

### Financial position and transactions

The Board has monitored developments in the Group's income, financial structure, as well as continued restructuring and cost-reduction efforts.

In particular, the Board authorized the exchange through a public offering in Luxembourg, of bonds previously issued by Alcatel as part of a 7% bond issue (initial rate) totaling €1,200 million, maturing in 2006, against newly issued bonds totaling €412 million, maturing in 2014.

### Powers of the Chairman

Pursuant to the bylaws, the Board decided not to separate the duties of Chairman of the Board of Directors from those of Chief Executive Officer and approved the appointment of Mr. Serge Tchuruk as Chairman of the Board Director and Alcatel's Chief Executive Officer for a term due to expire at the end of the Shareholders' Meeting called 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 issues and guarantees and pledges that can be made by the company.

### Corporate governance

The Board examined in particular the functioning of the Ethics Committee created in 2002. This Committee is specifically charged with ensuring that ethics rules have been put in place within the Group and verifying compliance therewith. To this end, the Board issued a Statement on Business Practices, which has been distributed to all Group personnel. This guide was reinforced by the ethics code, more specific to senior executives responsible for preparing and divulging financial information.

Following charges of corruption in Costa Rica and Taiwan against Alcatel, the Board has monitored these cases as well as the implementation, by the Management, of stricter procedures for the signature of commercial contracts and the hiring of agents and intermediaries in the countries where Alcatel operates.

In addition, the Board reviewed proposals by the Nominating and Compensation Committee regarding the proposed grant of stock options for fiscal year 2004, and on the compensation of the Chairman and Chief Executive Officer.

### Shareholders' Meetings

The Board convened the Annual and Special Shareholders' Meeting 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 certain resolutions presented at the Shareholders' Meeting.

All resolutions proposed to the above meetings were approved.

### Evaluation of the Board of Directors

A report evaluating the functioning of the Board was 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 disposes of 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 functioning of the Board of Directors. 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.

The Board also discussed the independence of its members.

During the first quarter of 2005, the Board met on two occasions, essentially to approve the parent company and consolidated financial statements for the year ended December 31, 2004, 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 whose terms are renewed by the Board of Directors on 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.

### Nominating and Compensation Committee

The Committee is made up of three members appointed or whose terms are renewed by the Board of Directors. As of January 1, 2005, 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 once in 2004 and twice in the first quarter of 2005, with all its members in attendance.

At the beginning of 2004, it proposed the renewal of the term of office of Mr. Jozef Cornu as Director.

It reviewed the company's stock option plans from March 2004 and March 2005, as well as the method used to implement the Board's decision from February 2004 to modify existing stock option plans.

It also reviewed the method used to calculate the compensation of the Chairman and Chief Executive Officer and of the Chief Operating Officer and the amount of the variable portion of their remuneration for 2004, and then for 2005.

It reviewed the position of each Director based on the criteria defined by the Board in light of 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.

Lastly, it discussed the Chairman succession plan and the policy for fostering employee loyalty.

In addition, it proposed at the start of 2005, to renew the terms of office of Messrs. Philippe Bissara, Frank W. Blount, Jean-Pierre Halbron, David Johnston, Pierre-Louis Lions, Thierry de Loppinot, Peter Mihatsch and Bruno Vaillant as Directors for staggered terms lengths to ensure regular renewal of Board Members.

The Chairman of the Committee reported on its work to the Board of Directors, which then discussed it.

## **Audit Committee**

The Audit Committee consists of three members, who are nominated or renewed by the Board of Directors on recommendation by the Nominating and Compensation Committee. As of January 1, 2004, the members were Messrs. Daniel Lebègue, Chairman of the Committee, Marc Viénot and Daniel Bernard.

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 plans and procedures are defined. It reviews the Group's significant off-balance sheet commitments and risks, as well as all financial and accounting issues.

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 seven times in 2004. Over 90% of the committee members attended the meetings.

In the first quarter of 2005, the committee met twice to review the financial statements for the fiscal year ending on December 31, 2004 (under French and American standards, then restated using IFRS).

The Committee reports on its work to the Board of Directors on a regular basis, in particular on the following points for 2004:

### **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.

The committee reviewed the changeover to IFRS and approved the Group's deliberations on the impact of their implementations at Alcatel. At the end of March 2005, the committee reviewed the 2004 financial statements prepared under these new accounting standards, the financial statements for the first quarter of 2005 being the first to be established and stated under IFRS.

### **Internal control**

The Committee received the annual internal audit report for 2004 and the internal audit plan for 2005. During the review of internal audits carried out, it consulted with the internal Audit Department and reviewed its resources. In particular, the committee reviewed the procedures put into place to prepare the certification, as required under Section 404 of the "Sarbanes-Oxley Act", to ensure the reliability of contracts with consultants and commercial agents and to prevent fraud inside the Group.

A Disclosure Committee, required under the Sarbanes-Oxley Act, was also created in 2003, responsible for ensuring that procedures for preparing and auditing the financial statements are properly followed in order to publish reliable information on the Group. This committee reports to the Audit Committee.

### **Financial statements and financial position**

During fiscal year 2004, the committee performed a preliminary review of the financial statements for the past fiscal year and the mid-year financial statements, stated under French and American standards, and of the quarterly financial statements. At each of these meetings, the Committee interviewed the Chief Financial Officer 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.

Early in the year, the budget and financial forecasts for 2004 were presented to the Committee.

It noted significant improvements in the presentation of certain information in the notes to the financial statements and in particular reviewed the use of deferred tax assets and the recording of retirement commitments.

### **Auditors**

For the purpose of preserving Auditor independence, in compliance with the new SEC regulations, in 2003 the committee introduced a procedure that requires prior approval of audit engagements. It also set the thresholds that are calcu-

lated based on total fees paid to the Auditors for the statutory audit, above which any engagement must be authorized by the Audit Committee. In conformance with this procedure, missions, for which auditors were engaged outside of statutory audits, have been subject to prior approval by the Audit Committee.

After hearing the Chief Financial Officer's and the Auditors' reports, the committee also set the latter's fee amount for fiscal year 2005, in particular with regard to additional missions related to internal audit and the changeover to IFRS.

## > 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 just ended.

The overall gross annual compensation paid in 2004 amounted to €2,303,610 (as compared with €1,524,490 in 2003).

The variable portion paid in 2004, in respect of 2003, amounts to the gross amount of €770,000. This amount, as stated in the 2003 annual report was fixed 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.

With regard to the variable portion that will be paid in 2005, in respect of 2004, the Board has fixed the gross amount at €1,314,873. This amount was fixed in consideration of the net income before amortization of goodwill and after the deduction of minority interests. The Chairman announced at this Board Meeting that he intended to reinvest the entire amount in Alcatel shares.

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 €9,120 for fiscal 2004.

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 2004, Senior Management, represented by all eleven members of the Executive Committee at December 31, 2004, received total compensation from Alcatel, or from companies controlled by Alcatel, including benefits in-kind and expatriation bonuses, amounting to €11.6 million (compared with a total of €7.5 million paid in 2003). 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 2004, the fixed portion, including benefits in-kind and expatriation bonuses, amounted to €7.2 million, and the variable portion, which is tied to the earnings forecast and the improvement of working capital for fiscal year 2003, amounted to €4.4 million, or 38% 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. The fees, as approved by the Board of Directors and set forth in the internal rules, 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 among the 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 year 2004.



The gross compensation and benefits in-kind paid to the members of the Board of Directors in 2004 are summarized below:

(in euros)	Compensation	Directors' fees	Benefits in-kind
Serge Tchuruk <sup>(1)</sup>	2,294,490	–	9,120
Philippe Germond <sup>(2)</sup>	1,500,000	–	5,496
Daniel Bernard	–	61,807	–
Philippe Bissara	–	48,060	–
Frank W. Blount	–	43,625	–
Jozef Cornu	354,305	45,621	–
Jean-Pierre Halbron	–	41,186	–
David Johnston	–	43,182	–
Daniel Lebègue	–	70,676	–
Pierre-Louis Lions	–	45,621	–
Thierry de Loppinot	99,022	45,621	–
Peter Mihatsch	–	43,182	–
Bruno Vaillant	77,965	45,621	–
Marc Viénot	–	65,798	–

(1) The variable portion paid in 2004, in respect of fiscal year 2003, amounts to €770,000.

(2) The variable portion paid in 2004, in respect of fiscal year 2003, amount to €750,000.

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 31.12.04, the members of the Board of Directors together held 380,959 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 reported to the company every six months all transactions carried out on securities issued by Alcatel. In this respect, an overall report was filed for all members of the Board of Directors with the "Autorité des marchés financiers" (French Financial Markets Regulator).

In accordance with the recommendations of the French Financial Markets regulator (Autorité des marchés financiers), declarations are made individually as transactions are carried out and reported by the company's Directors.

### 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 31.12.04, the members of the Executive Committee owned a total of 117,236 Alcatel shares (including units held in the FCP 3A and American Depository Shares), representing 0.01% of Alcatel's equity capital and voting rights.

### Options

A total of 601,000 stock options were granted to the members of the Board of Directors in 2004. The Chairman and Chief Executive Officer and the Chief Operating Officer received 400,000 and 200,000 stock options respectively. The employee Directors, representing the FCP 3A, were granted 1,000 options.

These options were granted by the Board of Directors on March 10, 2004, under a single plan, involving a total of

18.1 million stock options, entitling the holder to subscribe for Alcatel shares at the price of €13.20, corresponding to the average market price of the Alcatel share during the twenty stock market trading sessions preceding the Board's decision.

The options can be exercised by the beneficiaries between March 10, 2008, and March 9, 2012, after a vesting period of four years from the date granted.

No stock options were exercised by the members of the Board of Directors in 2004.

The eleven members of the Executive Committee as of December 31, 2004 received in 2004 stock options exchangeable for 1,355,000 new shares, following the decision of Board of Directors on March 10, 2004, representing 7.5% of the total number of options granted in 2004. These stock options meet the general conditions of the March 10, 2004 annual plan and can be exercised at an average weighted price of €13.20. No options were exercised by the members of the Executive Committee in 2004.

Stock options granted to senior executives in 2005 are described on page 191.

## > REGULATED AGREEMENTS

Agreements that were authorized in prior years were continued in 2004. They involve agreements concluded between Alcatel and Thales, Alcatel and the Group companies.

### Agreements entered into with Thales

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, 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 2004, income recorded by Alcatel amounted to €689,875. The expense owed by Alcatel to the subsidiaries amounted to €731,527.

## > 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-year 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 15,000 in 2004). 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 fortyeighth of that same number after each subsequent month.

Moreover, to ensure at all times stability of the activities and staff that are most crucial to the Group's development, the Board of Directors is empowered, in the event of a takeover by another company, of a public offer for or de-listing of Alcatel shares, to decide that options beneficiaries, with the exception of corporate officers holding office on the date the options were granted or the decision was taken, should be able to exercise their options without delay, notwithstanding the unavailability period, if any.

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 2004, 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 1,271,000 and these options can be exercised at an average weighted price of €13.20. 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 128,192, and those Alcatel stock options were exercised at a weighted average price of €6.35.

Alcatel's stock subscription and stock purchase option plans are presented on pages 192/193.

## > INFORMATION ON DIRECTORS

	<b>Appointed/ Expiration</b>	<b>Appointments and duties in fiscal year 2004</b>
<b>SERGE TCHURUK</b> Chairman and Chief Executive officer Nationality: French, age 67  Owns 105,450 shares and 209 units in FCP 3A	1995/2007	In France: Director - Thales, Total, and the Pasteur Institute*, Member of the Board of Directors of the Ecole 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.
<b>DANIEL BERNARD</b> Independent Director, Nationality: French, age 59  Owns 141,125 shares	1997/2007	In France: Chairman and CEO of Carrefour*, Director - Saint-Gobain, Erteco*, Manager of SISP*. Abroad: Vice-President of DIA SA., Vice- President of Vicour, Director of Presicarre*, Grandes Superficies de Colombia*, Centros Comerciales Carrefour*, Finiper*, GS*, and Carrefour Argentina*.
<b>PHILIPPE BISSARA</b> Independent Director, Nationality: French, age 63  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 EAIC (European Association for Listed Companies).
<b>FRANK W. BLOUNT</b> Independent Director, Nationality: U.S., age 66 Owns 1,000 American Depository Shares	1999/2005	Abroad: Chairman of JI Ventures Inc., TTS Management Corp., Director - Entergy Corporation USA, Caterpillar Inc., Adran Inc., and Hanson Plc.
<b>JOZEF CORNU</b> Director, Nationality: Belgium, age 60  Owns 20,500 shares and 1,734 units of FCP 3A	2000/2008	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 - Taiwan International Standard Electronics Ltd, Barco, KBC, and Agfa Gevaert. Standard Electronics Ltd, de Barco, de KBC, de Agfa Gevaert.
<b>PHILIPPE GERMOND</b> Director, Nationality: French, age 48  Owns 3,500 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.
<b>JEAN-PIERRE HALBRON</b> Director, Nationality: French, age 68 Owns 21,020 shares and 1,969 units of FCP 3A	1999/2005	In France: Director - Electro Banque, Chairman of Alcatel's Ethics Committee

\* Term of office expired in 2004 or 2005.

	<b>Appointed/ Expiration</b>	<b>Appointments and duties in fiscal year 2004</b>
<b>DAVID JOHNSTON</b> Independent Director, Nationality: Canadian, age 63 Owns 2,080 shares	2001/2005	Abroad: President of the University of Waterloo (Canada), Director - Open Text*, CGI, Masco, Sustainable Development Technology Foundation.
<b>DANIEL LEBEGUE</b> Independent Director, Nationality: French, age 61  Owns 500 shares	2003/2007	In France: Director - Thales*, Scor, Technip, Crédit Agricole SA, 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), President of Transparency International (France) (an Association).
<b>PIERRE-LOUIS LIONS</b> Independent Director, Nationality: French, age 48  Owns 520 shares	1996/2005	In France: Professor at the Collège de France and the Ecole 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, the Academy of Sciences, the Defence 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, Instituto Lombardo, and Academia Europea.
<b>THIERRY DE LOPPINOT</b> Employee Director, Nationality: French, age 61  Owns 6,053 shares and 4,424 units of FCP 3A	1997/2005	In France: Legal counsel at Alcatel's corporate offices, Chairman of the Advisory Board of the Alcatel Employee Share Savings fund (FCP 3A), Chairman of Formalec, Director - Société Immobilière Kléber-Lauriston "SIKL"*.
<b>PETER MIHATSCH</b> Independent Director, Nationality: German, age 64  Owns 1,200 shares	2002/2005	Abroad: Chairman of the Supervisory Board of Giesecke and Devrient Munich, Member of the Supervisory Board of Vodafone GmbH, Vodafone-Mobilfunk, ARCOR- Vodafone and Member of the Board of 3i p.l.c.
<b>BRUNO VAILLANT</b> Employee Director, Nationality: French, age 61 Owns 1,850 shares and 4,761 units of 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.
<b>MARC VIÉNOT</b> Independent Director, Nationality: French, age 76  Owns 4,950 shares	1987/2007	In France: Honorary Chairman and Director - Société Générale, Director - Ciments Français, Member of the Supervisory Board of Aventis and Groupe Barrière, Member of the Board of the French Private Enterprise Association, and of Groupe Banick Abroad: Director - Société Générale Marocaine de Banque.

\* Term of office expired in 2004 or 2005.

## > 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.

This report, compiled by the departments concerned, was submitted to the Audit Committee on March 25, 2005.

The conditions for the preparation and organization of the work of the Board of Directors are described in Chapter "Corporate Governance".

### 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 significant 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 an 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 constituent unit and on the sense of responsibility of each employee, backed by a system of delegated responsibility, through which the Group's policies can be implemented in a consistent fashion. Managers are responsible for efficiently overseeing operations 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 carrying out operations and those responsible for checking and validating 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 their implementation. Within each company, this responsibility is delegated to the senior executives.

##### • Audit Committee

The Audit Committee, which is made up of three members of the Board of Directors, all of whom are independent, checks in presence of Chief Financial Officer and auditors that internal procedures have been defined for collecting and controlling financial data to ensure 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.

##### • Ethics Committee

An Ethics Committee has been formed to ensure compliance with the Statement of Business Practices, in particular using a "Whistle blowing" system made available to the employees, to ensure that it is kept up to date and to propose the necessary steps in the event a clear violation is brought to its attention. 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 and may request the participation of the Internal Audit Department.

##### • 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. The Department has a staff of fifty auditors, and is centralized at the Group level and reports directly 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 obtained in 2001, and renewed in 2004, 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 play an active 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 forecasting 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, for ensuring that these laws and standards are fully complied with, 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 as well as 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.

- *The Information Systems and Information Technology Department*

Reporting to Senior Management, this department consists of a Group Information Governance Department, which is in charge of ensuring procedural compliance with the law and defining security policies, as well as an Organization Department, an Information Systems Department, responsible for application development and maintenance, a Operations Department, in charge of systems and networks operation, and three regional departments, responsible for defining needs and ensuring that the Group's IT standards are being met.

The development of computer applications follows development methods standards. In addition, data integrity and the efficiency of control measures are strengthened by the use of standard access and user profile control 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.

- *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 good business practices**

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 2004. 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.

In 2004, the rules established to prevent internal fraud were strengthened, at the instigation of the Executive Committee, following the disclosure of irregularities in Costa Rica.

The Executive Committee launched a series of actions to strengthen internal control procedures applicable to the selection of and relations with commercial representatives and agents and to further develop anti-corruption legislation training.

The Statement of Business Practices, which applies to all Alcatel employees, has been sent to all Alcatel units to raise their awareness of it in their relationships with customers, suppliers, subcontractors and shareholders.

In addition, under the SEC rules resulting from the Sarbanes-Oxley Act, a code of good conduct specifically designed for Alcatel Group executives 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 persons responsible for 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.

- *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 internal control procedures underlying the preparation of financial statements and the processing of accounting and financial data.

#### **Accounting guidelines**

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 application of the new IFRS is mandatory for listed companies listed of the European Union with effect from January 1, 2005. Alcatel, which publishes its financial statements on a quarterly basis, will present its financial statements for the 1st quarter of 2005 under IFRS accounting and valuation principles. The application of International Accounting Standard (IAS) 34 (Interim Financial Reporting) will not be anticipated.

A Steering Committee has been created to monitor the changeover to IFRS. This 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. The Auditors are closely associated in this process.

In 2004, the Group took a number of actions to better prepare readers and preparers of the Group's financial statements to the impacts resulting from the changeover to IFRS. Internally, the Group implemented a large-scale training plan during 2004 for all persons affected by this change in accounting standards: The financial reporting system used by the Group has also been modified to adapt it to the specific IFRS requirements, and to ensure that the available information meets the disclosure needs, particularly in the area of notes to the consolidated financial statements. The main expected effects of the changeover on the Group have been addressed and are available in the reference document and on the Group's Internet website.

In addition to updating the descriptive summary of the main impacts expected from the changeover to the new account-

ing standards, a special report was issued on March 29, 2005, communicating the first IFRS-based figures. The quantified effect of the changeover to IFRS on the 2004 financial statements is presented in the reference document in a separate section (Changeover to IFRS).

#### 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 listed companies.

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 analysis carried out jointly by the Financial Controls and Consolidation and Accounting Procedures departments enables 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 significant part of the internal audit plan. The purpose of these engagements is to ensure that relevant controls exist and that they are functioning. Internal auditors systematically follow up on the corrective actions they recommend.

#### Strengthening the system of internal control

Starting in 2006, as a company listed in the United States, Alcatel will be subject to the requirements of the Sarbanes-Oxley Act, Section 404, which requires that the Chairman and Chief Executive Officer, and the Chief Financial Officer make an annual assessment of the effectiveness of the internal controls and procedures pertaining to the preparation of financial and accounting data. These executives are required to attest their responsibility for setting up and implementing an appropriate internal control organization for the presentation of financial information.

The selected system consists of five major stages:

- Selection and identification of entities and processes that make a significant contribution to the preparation of the Group's accounting and financial data;
- Documentation of the processes (flow diagram) identified as being important for preparing financial statements;
- Identification of major risks and documentation of controls in place addressing these risks;
- Evaluation of the efficiency of the controls through internal audit checks;
- Identification of weaknesses and implementation of corrective actions.

In 2004 and 2005, Alcatel is dedicating the necessary resources for coming into compliance with section 404 of the Sarbanes-Oxley Act. The approach was developed based on the 34 units considered to contribute the most to the preparation of financial and accounting information.

As a response to the new requirements of the Financial Security Law, a procedure for describing controls related to the preparation of financial and accounting data has been put in place since 2003. This procedure is based on a self-evaluation process that covers 93 units.

The self-evaluation questionnaire includes 87 control points, based on the five COSO guidelines:

- 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,
- management : process designed to make certain that internal controls are adequately designed, effectively applied and relevant to the organization.

This self-evaluation process is supervised by the Chief Financial Officer of each individual unit, who is responsible for designing and implementing action plans targeting any identified weakness.

During every audit engagement in the companies concerned, the internal auditors evaluate the quality of the self-evaluation process, as well as the results and action plans introduced by Senior Management.

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.

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.



## > STATUTORY AUDITORS' REPORT

*This is a free translation into English of a report issued in the French language and is provided solely for the convenience of English speaking readers. This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.*

**Statutory auditors' report, prepared in accordance with article L.225-235 of the French Company Law (Code de Commerce), on the report prepared by the President of the Board of Alcatel Company, 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 French Company Law (Code de Commerce), we report to you on the report prepared by the President of your company in accordance with article L.225-37 (or L.225-68) of the French Company Law (Code de Commerce) for the year ended December 31, 2004.

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, notably of the conditions in which the duties of the board of directors are prepared and organized and the internal control procedures in place within the company.

It is our responsibility to report to you our observations on the information set out in the President's report on the internal control procedures relating to the preparation and processing of financial and accounting information.

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 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 performed to support the information given in the report.

On the basis of these procedures, we have no matters to report in connection with the information 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 (or article L.225-68) of the French Company Law (Code de Commerce).

Neuilly-sur-Seine, March 30, 2005

The Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES  
ERNST & YOUNG

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.

This commitment is articulated in the following Policies, which are signed by the Group's chairman and applicable to all of its companies:

- the Policy on Risk Control, published on November 30, 1999 and updated on December 1, 2004.
- the Environmental Charter, last updated on November 30, 1999.

Two further documents - a Policy on Insurance and a Risk Engineering Policy, updated on December 1, 2004 - define and give detail on the applicable processes.

These processes are as follows:

- mapping: an on-going process to identify and quantify risks, 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;
- impact evaluation programs, designed to assess the potential impact of the particular risks associated with the Group's industrial processes and resources, and implemented at every level;
- an operational continuity process, which draws on the impact evaluation programs to determine the measures which could be taken in a given scenario to ensure a swift return to normal operational activity after an accident;
- a coordinated approach for cost-effective risk transfer or alternative risk coverage for risks that are not self-insured;

Risks associated with physical and operating assets are managed by a dedicated team operating at Group level called DAGRI (Direction des Assurances et Gestion des Risques Industriels) which is part of General Management and has the role of defining, communicating and implementing the Policy on risk management. They submit an annual report of activity to Alcatel's management.

### Mapping

Regular risk mapping is the basis of the Group's Policy on risk management. It involves analysis of the incidence rate and scale of losses suffered by the Group and assessment of catastrophe risk for the industry as a whole, as well as interviews with business division staff to help identify the risks to which the Group is exposed at an operational level. Risk models are used to establish average and maximum exposure levels and desirable levels of cover.

This enables the Group to foresee any material risks which could impact its tangible or intangible assets and to strike the right balance between internal risk reduction and retention and external risk transfer and financing.

### 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 is directly affected by the Law of July 30, 2003

on the prevention of technological and natural risks and on the payment of damages.

An HPR (Highly Protected Risk) material risk program, designed in compliance with internationally recognized standards, has been implemented in the Group's major production sites across the world. This involves a series of regular surveys of any industrial site whose value exceeds €5 million, conducted by an external insurance consultant. The program was launched in 1987 and has been improved on a regular basis since then.

Under this program, 100 surveys were conducted in 2004, 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).

Risk prevention programs have also been launched for other high-risk areas such as transportation, construction sites and general liability.

### Environmental Risks

Using an internal engineering process introduced in our 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 the end of 2004, 19 production sites in eight different countries had been awarded third party certification under this standard.

In cases of disposals or acquisitions, environmental assessments are always made of the different plants by outside consultants. The evaluation exercises carried out in 2004 for the integration of Alcatel's fiber optic activities by Draka Comteq B.V. and the disposal of the SAFT Power Systems business did not bring to light any abnormal risks.

Alcatel has also established an environmental oversight body consisting of a network of around 20 experts across 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

Insurance is an integral part of Alcatel's policy on risk management. The simultaneous application of mapping techniques and the loss prevention policy allows the Group to:

- determine the appropriate level of risk retention practiced by the Group through its Luxembourg-based consolidated reinsurance subsidiary, Electro Ré. Through various reinsurance programs, covering specific activity risks and general catastrophe risk, the Group limits its risk retention to €1.5 million per incident (Total coverage in 2004 was €32 million).
- insure against unretained risks on the external insurance and reinsurance market, methodically and at a reasonable cost. The associated insurance levels are set using exposure data gained through mapping, by comparison with standard industry practice, and by an assessment of the available financing capacity of the global insurance market.

All insurance cover, with the exception of policies such as automobile and general liability insurance taken out in compliance with local regulations, is applied Group-wide and controlled by the DAGRI. Cover is provided for any company in which Alcatel's interest is equal to or exceeds 50%. Disposals and acquisitions come under particularly close scrutiny, since the Group's Policy stipulates the implementation of its insurance programs for recently acquired companies which fulfill the Group's criteria as described above, and the withdrawal of disposed of companies as of their date of sale.

Despite a depressed global insurance market, the Group has operated a blanket insurance program since January 2001 covering the following risk categories: 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.

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.

All insurers and reinsurers used for the cover of unretained risk are subject to regular assessment by "A.M. Best Financial Strength Ratings". The Group requires a minimum rating of A- (Excellent) and tolerates B2+ (Very Good) ratings; contractual provision is made for the replacement of downgraded insurers or reinsurers.

Insurance levels are set at least as high as the recommended levels for catastrophe scenarios determined through mapping, and stand at €1.6 billion for direct damages and loss of profits, and €500 million for general and product liability. In view of the geographic distribution of Alcatel's businesses, terrorism insurance cover is only taken out where local laws require it to do so.

However extensive insurance cover is, the possibility that actual losses might exceed catastrophe scenario predictions or fall foul of policy exclusion clauses cannot be discounted.

### 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 having off balance sheet risk characteristics to manage and reduce its exposure to fluctuations in interest rates and foreign exchange rates.

Market-related exposures are described in note 27 of Consolidated Statements.

### Contingencies

Contingencies are described in note 34 of Consolidated Statements.

## > HUMAN RESOURCES

Alcatel's workforce stabilized in 2004, in comparison with the significant cuts made over the preceding years as a consequence of the collapse of the telecommunications market.

The Group's workforce, which totaled 60,000 employees at the end of 2003, fell to 56,000 by the end of 2004. This change is due to:

- Assignment or termination of partnerships for businesses that did not have the critical size or whose activities were too far removed from Alcatel's core business.
- Acquisition of technology companies to complete the Group's technology portfolio for target market niches.
- Network management services for operators and integration of associated employees.
- Continuation of restructuring measures announced and initiated in 2003 combined with skills renewal programs.

### "HR Vision for One Company"

In the company's Social Charter, Alcatel states its commitment to invest in the "lifelong learning and professional development" of its employees. The HR strategy to achieve this goal led to the ambitious transformation program called "HR Vision for One Company".

Alcatel recognizes that the success of any HR program depends on the effectiveness of its communication. In 2004 a Steering Team made up of HR and internal communication specialists has been established to represent the HR teams of the major countries and all three business regions (Europe and South, Asia Pacific and North America).

The stock option plan implemented by Alcatel to attract and retain the best talents is one of Europe's most advanced programs and compares with those of American competitors.

With a presence in 130 countries, Alcatel encourages cross-cultural and cross-national exchanges. Fostering employee mobility helps to drive personal and professional development as well as better meet the demands of a global customer base.

### "Global Performance Management"

In 2004, Alcatel deployed a Global Performance program worldwide to align all Alcatel entities to one Performance Management process and one supporting tool.

Global Performance was launched as a pilot program in 2003 and continued throughout 2004, with nearly 9,000 professionals participating. The coverage of the pilot program was extended in 2004 to cover more locations in Europe such as Spain and Italy, in addition to those already participating in North America, Latin America, Asia Pacific, Europe and the UK.

### Adapting training to employee and business needs

Alcatel University is a global network of higher learning training centers that provides educational opportunities for employees and customers. The mission of Alcatel University is to capitalize on the company's global resources to provide high-quality, state-of-the-art training, whether virtual or face-to-face.

Alcatel University continued its global integration efforts in 2004, and now manages about 2/3 of Alcatel's training investments for its own employees through the University's presence in 15 of the 20 main units of Alcatel.

Through the Learning Management System (LMS), employees now have access to 2100 individualized learning titles.

As part of the dedicated focus on the development of Alcatel employees and in order to better respond to clients' needs, Alcatel University has put in place a major certification and accreditation program for Project Managers and Project Directors.

In 2004, Alcatel University's position as one of the leading corporate universities was formalized by the reception of the CLIP (Corporate Learning Improvement Process) award.

### Employees and the Social Charter

Throughout 2004, communications regarding Alcatel's Social Charter were cascaded down the organization from management committees and HR executives to employees across the Alcatel's worldwide businesses. Communications methods included presentations at staff meetings, posting the Social Charter on internal Alcatel web sites and incorporating information on the Charter within induction materials for new recruits.

### Diversity at Alcatel

Gender diversity is one of the areas which Alcatel is looking at improving within its workforce. In 2004, women made up 24% of the Alcatel workforce, 19% of High Potentials and 7% of the top management positions at Alcatel.

The topic of careers for women was studied in 2004 and will be examined further in 2005 in order to come up with initiatives which will improve gender diversity throughout different levels of management. To this end, Alcatel already launched a program entitled "Women in Leadership" to support the career progression of women within the company.

## > SUSTAINABLE DEVELOPMENT

### A long-term commitment

For over ten years, Alcatel has been committed to reconciling economic development and social and environmental responsibility. To assist this process, the Group has codified its values and ethical principles in a set of codes and charters, created organs, and set up controls in order to ensure conformance, and an organizational structure designed to coordinate actions being taken. A sustainable development steering committee, composed of representatives of all departments concerned, meets on a monthly basis to guide the sustainable development strategy and conduct a project progress review. The Board of Directors reviews the global objectives once a year.

In addition, following Alcatel's adherence to the United Nations Global Compact initiative in 2003, all of Alcatel's management is involved in implementing the Compact principles. These 10 principles concern human rights, labor standards, environmental protection, and the fight against corruption.

### A commitment in action

Alcatel's commitment translates into concrete actions with respect to key areas of sustainable development.

With respect to social matters, the Group has focused on developing a dynamic and responsible human resources policy, founded on skill management and dialogue.

Alcatel contributes to efforts to reduce the digital divide, by making its technologies and its expertise available for improving access to information in developing countries and isolated regions in developed countries.

The Group is also persisting in its efforts to continually reduce the environmental impact of its activities and products, and to adhere to new environmental regulations.

Lastly, the company has invested in the communities where it is based, through community development projects in education, health and culture.

### Environment: long-term vision and awareness of economic and regulatory challenges

Alcatel's global approach takes into account the environmental impact of its products starting from their design, which includes the choice of materials and components, manufacturing processes, raw material and energy consumption, up through end-of-life reuse and recycling. Furthermore, all of the Group's products on the market are accompanied by the ecodeclaration.

This year, the Group has directed its efforts at two large pan-European projects: the coming into force in August 2005 of the Directive on Waste Electrical and Electronic Equipment, and the adherence to the RoHS (Restrictions of the use of certain Hazardous Substances), Directive, which limits the use of certain dangerous substances, lead in particular, starting in July 2006. Thanks to actions taken by the project teams assembled for this purpose, Alcatel will be ready by the 2005 and 2006 deadlines.

Simultaneously, Alcatel is continuing its program, started in 2003 and scheduled to last until 2005, to reduce the energy consumption of its products by an average of 20% per year.

### A responsible approach vis-à-vis Group suppliers

In 2004, Alcatel reaffirmed its socially responsible procurement policy in its Sustainable Development Purchasing Charter.

In addition, a detailed questionnaire was sent to Alcatel suppliers in 2004. The survey responses were analyzed to evaluate the suppliers' commitment to sustainable development, strengthen dialogue, and define plans of action for 2005, as considered necessary. This evaluation process takes into account the suppliers' ethical, social, and environmental practices, as well as the risks identified for their particular area of activity.

### Improved reporting reflecting international standards

For the third consecutive year, Alcatel has been publishing a Sustainable Development report, which describes actions taken and objectives defined.

The report includes social and environmental indicators, required by the French NRE (New Economic Regulations) law, as well as indicators that reflect the Group's activities. This year, Alcatel used a dedicated reporting tool in order to increase data collection and processing efficiency for this purpose. The Group also publishes a table correlating these indicators with those required under the Global Reporting Initiative.

The sustainable development report can be reviewed online at [www.alcatel.com](http://www.alcatel.com) 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 98% of the Group's workforce at year-end 2003 and 99% of the workforce at year-end 2004 in France. The 2003 data include the following companies: Alcatel Câbles France, Saft Power Systems and the Mobile Phones division of Alcatel Business Systems. These companies were sold in 2004 and hence are not included in the 2004 social data. They represented 11% of the workforce in France at year-end 2003, which may explain the occasionally significant changes in certain data between 2003 and 2004.

#### 1. Employment

##### 1. a) Workforce

	December 31, 2004	December 31, 2003	December 31, 2002	December 31, 2001
<b>Total workforce</b>	<b>15,971</b>	<b>18,519</b>	<b>24,229</b>	<b>27,050</b>
<b>Permanent workforce</b>	<b>13,669</b>	<b>17,222</b>	<b>22,703</b>	<b>23,215</b>
Number of employees on fixed-term employment contracts at December 31	51	279	124	88
Number of employees hired on open-ended contracts	409	205	1,186	3,263
of which intra-Group transfers	260	175	1,065	1,071
Number of employees hired on fixed-term contracts	216	224	96	66

Most of the new hires in 2003 and 2004 consisted of transfers between the Group's entities.

##### 1. b) Departures

	2004	2003	2002	2001
Resignations and end of trial periods	106	122	272	632
End of fixed-term contracts	137	64	2,321	276
Of which fixed-term contracts converted to open-ended contracts	12	3	29	61
Other departures, comprising disposal of businesses, transfers, and dismissals	3,067	5,521	2,288	744
<b>TOTAL</b>	<b>3,322</b>	<b>5,710</b>	<b>2,821</b>	<b>1,713</b>

The reduction in workforce in France resulted mainly from the sale of the following businesses:

- the energy business, Saft Power Systems, to Ripplewood in December 2004.
- the fiber optic business of Alcatel Câbles France to Draka Holding NV, in June 2004.
- the Mobile Phones division of ABS in August 2004 to Tamp Holdings Limited.

Workforce reductions also resulted from restructuring plans, which were implemented in concert with employee representatives of the units concerned.

Restructuring actions affected with following units: Alcatel CIT, Alcatel Submarine Networks, Alcatel Space and Alcatel Business Systems. For the latter, collective relocations were implemented for 272 employees of the Industrial Department at Alcatel's Business Systems site, in collaboration with Asteel and HPF Services.

#### 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.

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Number of employees working part-time	1,275	1,207	1,129	1,209

- *Absenteeism*

<b>In days</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Absences due to illness	62,595	100,579	130,255	131,385
Absences due to work-related accidents	2,270	4,593	6,889	5,942
Absences due to travel accidents	875	1,487	1,399	1,666
Maternity leave	21,030	31,366	25,050	29,741
Absences due to strikes	365	1,287	446	546
Other	22,071	17,314	22,104	23,138
<b>TOTAL DAYS</b>	<b>109,206</b>	<b>156,626</b>	<b>186,143</b>	<b>192,418</b>

The reduction in the number of days of absenteeism is largely due to overall reduction of absenteeism itself on a like from like basis (-25%) and to changes in the Group structure (-5%)

- *Partial unemployment*

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Number of employees placed on partial leave	0	565	1,786	629
Number of days of partial leave compensated	0	10,499	67,952	5,002

### 3. Compensation

The increase in average monthly compensation between 2003 and 2004 results primarily from a change in the weighting of the various employee categories following the change in Group structure, as well as the redefinition of the permanent workforce based on which the average monthly compensation is calculated: excluding part-time employment, long-term absences, end of career leave and taking into account all the variable compensations.

Alcatel maintains an equitable hiring and compensation policy based on employee merit without regard to sex, culture or origin. 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)	<b>December 31, 2004</b>	<b>December 31, 2003</b>	<b>December 31, 2002</b>	<b>December 31, 2001</b>
Average monthly compensation	4,449	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. The ECID includes 30 employee representatives from 15 countries, who meet in plenary sessions twice a year; in 2004, the meetings were held on June 9-10 and December 2-3.

In addition, the Senior Management convened labor bureaus on February 6, March 26, and September 24, 2004.

- *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 Training Works Council elections according to the three electoral colleges. In 2004, it met on June 23-24 and December 14-15.

### 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 elec-

tromagnetic (EM) fields. This collaboration has led to a professional recommendation guide approved by the Technical Union of Electricity and Communications (UTE).

#### 6. Training

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Number of employees trained	10,142	11,172	16,254	18,967
Number of paid training hours	405,987	429,243	564,678	773,294

#### 7. Disabled employees

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Number of disabled employees	231	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

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Average number of temporary workers per month	902	183	545	1,583
Number of trainees (training agreements)	517	1,193	1,601	1,959

The number of temporary workers increased in 2004 as a result of strong growth of industrial activity, in particular at CIT, Space, ASN and AVT.



## Environmental indicators

	Units	2002 <sup>(3)</sup>	2003	2004	2004 Perimeter
<b>Purchased energy and CO<sub>2</sub> emission</b>					
Purchased electricity	GWh	1,118	747	740	100%
Purchased electricity per employee	MWh	18.1	12.3	13.3	100%
Purchased fossil energy	GWh	577	310	251	100%
Purchased fossil energy per employee	MWh	9.4	5.1	4.5	100%
Total purchased energy	GWh	1,695	1,057	990	100%
Total purchased energy per employee	MWh	27.5	17.5	17.8	100%
Indirect emissions of CO <sub>2</sub> , linked to purchased electricity	tCO <sub>2</sub> <sup>(1)</sup>	329,710	264,000	236,397	100%
Indirect emissions of CO <sub>2</sub> per employee	tCO <sub>2</sub> <sup>(1)</sup>	5.3	4.4	4.2	100%
Direct emissions of CO <sub>2</sub> , linked to purchase fossil energy	tCO <sub>2</sub> <sup>(1)</sup>	123,617	83,000	56,149	100%
Direct emissions of CO <sub>2</sub> per employee	tCO <sub>2</sub> <sup>(1)</sup>	2	1.4	1	100%
Total emissions of CO <sub>2</sub>	tCO <sub>2</sub> <sup>(1)</sup>	453,327	347,000	292,546	100%
Total emissions of CO <sub>2</sub> per employee	tCO <sub>2</sub> <sup>(1)</sup>	7.3	5.8	5.2	100%
<b>Water and wastes</b>					
Purchased water	m <sup>3</sup>	3,644,000	2,356,000	2,320,382	100%
Purchased water per employee	m <sup>3</sup>	59.1	39	42	100%
Production of hazardous waste	t	7,264	3,090	2,313	100%
Production of hazardous waste per employee	kg	118	51	42	100%
Percentage of hazardous waste recycled <sup>(2)</sup>	%	51	86	64	100%
Production of non-hazardous waste	t	35,894	24,620	24,289	100%
Production of non-hazardous waste per employee	kg	582	407	436	100%
Percentage of non-hazardous waste recycled <sup>(2)</sup>	%	53	65	67	100%
<b>Other emissions</b>					
Solvents		No significant quantities, indicator not relevant and not consolidated.			100%
Halogenated hydrocarbon		No significant quantities, indicator not relevant and not consolidated.			100%
Discharge into water (heavy metals)		No significant quantities, indicator not relevant and not consolidated.			100%
<b>Miscellaneous</b>					
Production sites, ISO 14001 certified	%	70	50	65	100%
New products covered by ecodeclarations	%	20 <sup>(4)</sup>	83	91	100%
Purchasing volume covered by ecodeclarations	%	30 <sup>(5)</sup>	65 <sup>(5)</sup>	85	100%

(1) tCO<sub>2</sub>: CO<sub>2</sub> equivalent tons.

(2) Recycled: not released and not burned without energy recovery.

(3) Perimeter: Europe and USA.

(4) Perimeter: 100%.

(5) Perimeter: Europe.

## Environmental indicators: definition and methodology

The 2004 environmental reporting perimeter includes all locations worldwide, owned or leased, housing Alcatel employees.

Figures are consolidated at HQ level, from data reported by 49 locations, each one housing more than 300 employees, representing together 79% of Alcatel employees.

Conservative extrapolation hypotheses are used, based on ratios per employee (instead of a ratio based on Total Insured Value in 2003), to cover 100% of Alcatel.

Figures are cross checked with historical data existing since 1992.

Reported energy purchase does not include hot and chilled water, thus corresponding emissions are not included in reported indirect CO<sub>2</sub> emissions.

Reported waste quantity does not include WEEE (Waste Electrical & Electronic Equipment), which represent in 2004 a significant part of total waste production of the Company. These will be covered by specific indicators in 2005.

## Evolution 2004/2003

The decrease in absolute figures reflects both the decrease in Alcatel scope of activities and significant energy consumption reduction efforts at several key sites, resulting in lower CO<sub>2</sub> indirect emissions.

The normalized indicators, measured per employees, for electricity, raw water and non hazardous waste show slight increase due to conservative extrapolation hypotheses and headcount decrease for the same activity load in 2004 compared to 2003.

# 2004 CONSOLIDATED FINANCIAL STATEMENTS

## > FINANCIAL REPORT

In view of the disposal of our mobile telephone, fiber optics and electricity supply businesses announced respectively in April, May and June of 2004, and in order to ensure that the accounts are readily comparable, the financial statements for 2003 have been restated. The figures provided and discussed in relation to the income statement are stated after accounting for these businesses as "activities sold or being sold".

All informations and comments are established in french GAAP.

### Introduction

Following three years of marked contraction in the communications equipment and solutions market, 2004 was characterized by a renewal of growth. The Group's sales rose from €11,606 million in 2003 to €12,265 million in 2004, a 6 % improvement after discounting the negative impact of the dollar's continued weakness in relation to the euro. Given a scenario of foreign exchange stability and on a like for like basis, Group sales growth would have been close to 10%. The Group succeeded in increasing or maintaining its market share in the majority of its areas of activity.

In 2004 the Group reaped the benefits of the restructuring it undertook in the extraordinary telecom crisis of 2001 to 2003: it raised its operating profit more than twofold from €449 million in 2003 to €978 million in 2004. Alcatel was profitable in all of its areas of activity, i.e. fixed, mobile and private communications. Despite the improvement in market conditions, the Group pursued its strategy of rationalization, which led to the posting of significant restructuring costs during the course of the year. The Group's net profit for 2004 of €281 million was adversely affected by both these costs (€304 million) and goodwill amortization and impairment costs (€408 million).

### Consolidation and principal changes in structure

The principal changes in consolidation in 2004 are the result of the following events:

- On January 14, 2004, Alcatel, following its announcement in October 2003, finalized the sale of its SAFT battery operations subsidiary to Doughty Hanson for €390 million. Battery operations were included under disposed of or discontinued operations for January 1 to December 31, 2003. The disposal yielded a profit of €55 million which was recorded in Q1 2004 accounts under other revenue/expense (see note 7).
- On April 26, 2004 Alcatel and TCL Communication Technology Holdings Limited announced the signing of a financial agreement to form a joint mobile phone company. The joint venture was officially launched on August 31, 2004 and its capital is divided between the two partners as follows: TCL 55%, Alcatel 45%. It is consolidated by the equity method and included in Alcatel's accounts as of September 1, 2004.

Alcatel's mobile phone business has been listed under disposed of activities as of January 1, 2004 in the 2004 accounts (see note 6). The income from this disposal has been recorded under other revenue/expense (see note 7).

- On May 17, 2004 Alcatel announced the signing of a document with Draka Holding N.V. ("Draka") expressing definitive intent to combine their global fiber optics and communications cables activities. The definitive agreement was signed on July 2, 2004. The name of the new company, of which 50.1% is held by Draka and 49.9% by Alcatel, is Draka Comteq B.V. It is consolidated by the equity method and appears in the Alcatel Group's accounts as of July 1, 2004. Alcatel's fiber optics business is recorded under disposed of activities as of January 1, 2004 in the 2004 accounts (see note 6). In view of the non-availability of definitive 2004 financial statements for Draka Comteq B.V. at the Group's year-end, a provisional disposal income and an estimated equity affiliate income share were recorded on December 31, 2004.

- On June 18, 2004 Alcatel and Finmeccanica announced the signing of an initial agreement to combine their space activities. This will involve the creation of two separate companies, which will incorporate the manufacturing and service activities of both partners.

The first, Alcatel Alenia Space, which will be 67% owned by Alcatel and 33% by Finmeccanica, will combine the manufacturing activities of Alcatel Space and Alenia Spazio. This company will deal with the design and manufacturing of space systems, satellites, payloads, instruments, equipments and related ground systems. The company's managerial team will be based in France. It will comprise 5 divisions: Telecommunications, Optical Sciences and Observation, Radar and Observation Systems, Navigation, and Orbital Infrastructure and Space Transport.

The second company, Telespazio, which will be 67% owned by Finmeccanica and 33% by Alcatel, will combine the activities of Telespazio (Finmeccanica Group), with the operations and service activities of Alcatel Space. This company will be concerned with space systems operations and services, with particular respect to control and development aspects and value added services for networks, multimedia and planetary observation. The company's management will be based in Italy.

The definitive agreement on the formation of these two companies was signed on January 28, 2005, subject to obtainment of the required authorizations from the regulatory authorities.

- On September 17, 2004 Alcatel announced the acquisition of a non-listed American company called eDial Inc., leader in the market for conference solutions and collaboration services for enterprises and operators. The cost of this acquisition was €22 million, based on the then value of Alcatel's American Depositary Shares (ADS), and was paid for with a combination of Alcatel shares and cash.
- On September 17, 2004 Alcatel signed a deal with the Ripplewood investment fund for a wholesale transfer of its electricity supply activities (Saft Power Systems). This transfer was finalized, subject to the authorization of the competent regulatory bodies, on January 25, 2005. The income earned through this activity and its balance sheet were recorded under disposed of activities for the 2004 tax year (see note 6). The income from the disposal of these securities will be posted in Q1 2005.
- On December 14, 2004 Alcatel announced the disposal of 7.1 million Avanex shares, which reduces its holding in

the company to less than 20%. In view of this partial reduction in stake and the fact that Alcatel is not represented on the company's board, the Group is no longer deemed to have a significant interest; consequently, with effect from the date of disposal, the shares' residual value is now to be recorded under unconsolidated companies and not equity affiliates.

- On December 16, 2004 Alcatel finalized the acquisition of the unlisted US-based company Spatial Communications (Spatial Wireless) the market leader in software solutions for multistandard distributed mobile switching. Alcatel purchased Spatial Wireless' entire share capital in exchange for 17.4 million ADS, worth €207 million.

## Accounting principles

The consolidated financial statements of Alcatel and its consolidated subsidiaries (the "Group") are prepared 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, relating to liabilities, approved by the "Comité de la Réglementation Comptable".

In view of the transition to IFRS standards in 2005 the company has decided to revise the presentation of certain components of the income statement and to anticipate the application of certain accounting rules, in as far as they are compatible with French principles. The major changes made to this end in 2004 are:

- application of Conseil National de la Comptabilité recommendation 2003-R.01 relating to regulations on accounting for and valuation of retirement obligations and similar benefits, with a view to implementing principles compliant with IAS 19 (employee benefits).
- separation of recurring goodwill amortizations, which will no longer be accounted for under IFRS 3, from exceptional amortizations observed as a result of impairment tests.
- revised presentation of research and development expenses (see note 4),
- discontinuation of the article 215 pooling of interests method of accounting for business combinations made as from January 1, 2004 (see note 10).

## Sales

The Group posted net sales of €12,265 million in 2004, up 6% from €11,606 million in 2003.

By business segment, net sales were down 4 % in fixed communications (€5,131 million in 2004 compared with €5,364 million in 2003), up 13% in mobile communications (€3,301 million in 2003 compared with €2,929 million in 2003), and 9% in private communications (€3,965 million in 2004 compared with €3,627 million in 2003). Other activities and inter-segment eliminations totaled €132 million (€330 million in 2003).

In 2004, Western Europe accounted for 42% of sales (43% in 2003), the rest of Europe 7% (8% in 2003), North America 15% (15% in 2003), Asia-Pacific 15% (18% in 2003) and the rest of the world 21% (16% in 2003).

## Operating income

The Group's gross profit for 2004 was up on 2003, rising from 35.4% in 2003 to 37.3% in 2004 based on the use of comparable accounting methods for research and development expenses. R&D expenses rose to €1,587 million in 2004 (€1,654 million in 2003), or 13% of sales for 2004 (14% in 2003) which is a financial reflection of the Group's strong commitment to laying foundations for the future. Administrative and selling expenses were kept level at €2,010 million in 2004 (€2,033 million in 2003). This, in conjunction with the increase in gross profit, enabled the Group to achieve an operating profit of €978 million in 2004, compared to €449 million in 2003.

Each of the Group's segments also posted positive operating results: €429 million in fixed communications (€155 million in 2003), €401 million in mobile communications (€315 million in 2003) and €235 million in private communications (€23 million in 2003). Losses from non-operational activities amounted to €87 million (against €144 million in 2003).

## Financial income

The net financial loss amounted to €132 million compared with a loss of €242 million in 2003. The improvement was partly due to the fact that the group did not have to write down financial receivables as sharply as in 2003 (€39 million in 2004, down from €39 million in 2003). The difference is also due to a reduction in interest costs (€90 million in 2004 compared to €102 million in 2003) accounted for firstly by the drop in the Group's gross debt from €5,293 million on December 31, 2003 to €4,359 million on December 31, 2004 and also by a bond exchange offering which enabled Alcatel to extend its overall debt life through the exchange of €366 million of 2006 securities for €412 million of new 2014 securities and also to benefit from a lower interest rate than the Group's average rate at the time of the issue.

## Consolidated net income (loss) before amortization of goodwill

The consolidated net income before amortization of goodwill amounted to €756 million (compared to a loss of €1,357 million in 2003), and included, in addition to the net financial loss described above, restructuring expenses of €304 million (€1,260 million in 2003), other revenue of €364 million (compared to €248 million in 2003), and a loss of €97 million in 2004 (€418 million in 2003) related to the Group's share in net income of equity affiliates and disposed of or discontinued operations.

## Net income (loss)

Net profit amounted to €281 million (against a net loss of €1,944 million in 2003) after goodwill amortization costs of €408 million (€407 million in 2003).

## Earnings per share

Diluted earnings per share amounts to €0.21 (compared with a loss of €1.46 in 2003).

## 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 a positive €338 million in 2003 (negative €673 million in 2003) and includes the cash outflows on the major restructuring operations implemented by the Group. The increase in working capital had a negative impact on the net cash flow for operating activities, which stood at a negative €289 million (versus positive €444 million in 2003). The net cash flow posted for investing activities in 2004 was a positive €314 million (€443 million in 2003). This was impacted by a program of tangible asset sales in 2004, for which €218 million was received (€457 million in 2003) and also by a decrease in the amount of loans made, at €569 million in 2004 (against €207 million in 2003). Finally, the cash flow from financial activities was a negative €1,102 million, due primarily to a repayment of €1,567 million of gross debt and the issue of €462 million of bonds. Thus, cash and cash equivalents for the Group excluding listed securities totaled €5,111 million at December 31, 2004 versus €6,269 million at December 31, 2003.

## Balance sheet

Group shareholders' equity amounted to €3,368 million at December 31, 2004 compared with €3,030 million at December 31, 2003. Shareholders' equity, minority interests and other equity totaled €4,389 million at December 31, 2004 (€4,038 million at December 31, 2003). Net operating working capital increased from €104 million at December 31, 2003 to €612 million at December 31, 2004. Net cash for the Group, the sum of cash, cash equivalents and marketable securities (including listed securities) less financial debt, decreased from €976 million in 2003 to €752 million on December 31, 2004.

## 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%)

The Thalès holding did not change in 2004. 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 a 28% stake in Avanex in consideration for assets contributed. As of December 31, 2004 the Group's holding in the company stood at 19.65% following a partial disposal of its securities on December 13, 2004, which is accounted for under marketable securities.

## 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 795 million, 293 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 1,742 million at December 31, 2004. 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 605 million at December 31, 2004.

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 31 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 telecommunications operators market and the enterprises and large institutions market.

The market for telecommunications systems and solutions for operators, in which Alcatel holds a leadership 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, 2004 was a year characterized by stabilized investments from major global telecommunications operators after a significant three-year drop. Even if demand was very strong for certain solutions such as ADSL or mobile wireless solutions, price pressure, aggravated by the competitive market conditions, negated most of the volume gains.

Thanks in part to a prudent investment policy implemented since 2001 the Group's major telecom operator customers have now greatly improved their financial position, as demonstrated by their considerable cash flows. In this context, the ability to maintain and speed up growth of the Group's 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 2004 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 strengthened its service offer for businesses and private operators, which deploy telecommunications networks for internal use, without subscribers. This very dynamic market consists of customers operating in the transport industry, the energy and defense sectors, and of local authorities, etc.

In addition to risks specific to the telecommunications sector, the markets in which the Group operates are exposed to risks which are associated with increasingly globalized economies, in particular: exchange rate risks and international competition (between operators and between telecommunications solutions suppliers). 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 its interest rate and currency risks (see note 27 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 Group's risk prevention policy and defines its policy on 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.

This policy enables the group to spread risks as widely as possible across its various subsidiaries, thus limiting the impact of increases in insurance premium levels while retaining the advantages of outsourcing cover for major risks, a factor considered in the renewal of the principal "integrated" program on January 1, 2004.

## Customer concentration

No Alcatel customer accounted for more than 10% of sales in 2004. First client accounted 6% of sales; Alcatel's top five customers accounted 16% and top ten customers represented 26% of sales. They were 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. Consequently it faces an enormous amount of competition, particularly from such major players as: Avaya, Cisco, Ericsson, Huawei, Lucent, Motorola, Nokia, Nortel, Siemens. A very large number of smaller companies also compete with Alcatel in one area or another.

With a slight increase in investment by operators and businesses, 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

Alcatel predicts an increase in first quarter sales 2005 of 3 to 5% on Q1 2004, which should continue at the same rate for the rest of the year. Earnings per share before goodwill amortization should reach double figures and remain at that level throughout the year, and net income before goodwill amortization should remain positive, a healthy situation given that the first quarter is traditionally weakened by seasonal fluctuations in demand.

## Subsequent events

On January 28, 2005, Alcatel announced the signature of final agreement to merge its space activities with those of Finmeccanica and the creation of two joint venture compa-

nies, to which both partners will contribute their respective satellite industrial and service activities.

On March 15, 2005, Alcatel announced that it has successfully completed the amendment of its existing undrawn EURO 1.3 billion syndicated 3-year revolving credit facility to benefit from the attractive conditions prevailing in the loan market.

The amendment consisted in lengthening the maturity of the facility from June 2007 to June 2009 with a possible extension until 2011, cancelling one of the two financial covenants and reducing the cost of the facility. Alcatel decided to reduce its overall amount to EURO 1 billion.

On March 16, 2005, Alcatel announced that it has initiated the disposal of 3 476 388 Nexans shares (i.e. 15 % of the share capital), corresponding to its entire shareholding, currently accounted for as marketable securities. The transaction takes the form of a private placement executed via an accelerated bookbuilding process.

### **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 US 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 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 2004, some may be accounted for under SFAS 146 only in 2005 because the criteria for recognizing liabilities are more restrictive under American principles than under French ones. Moreover, certain costs classified as restructuring costs under French accounting principles are reclassified as cost of sales under U.S. standards (particularly post-restructuring inventory write-downs).

### **Evaluation of 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 which took place during 2003, have been recorded 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 established under market conditions.

As from the 2004 tax year the Group will apply recommendation 2003-R01 of the Conseil National de la Comptabilité relating to regulations on accounting for and valuation of retirement obligations and similar benefits, with a view to implementing principles compliant with IAS 19 (employee benefits).

In response to the contents of the communiqué issued by the Conseil National de la Comptabilité on July 22, 2004 the Group has decided to move actuarial gains and losses arising from adjustments linked to length of employment and from changes in actuarial hypotheses into shareholders' equity during the course of the 2004 tax year, at their value as of January 1, 2004. Under American accounting principles such actuarial gains and losses are amortized over the expected average remaining working life of the employees belonging to the scheme in question.



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](http://www.freeedgar.com)), and on the Group's website for the "Form-20F" statements (address: [www.alcatel.com](http://www.alcatel.com) or [www.alcatel.fr](http://www.alcatel.fr) – shareholders/investors). The "Form-20F" document for the year ended 31.12.04 should be available in April 2005.

## Changeover to IFRS

Opening remark:

All references in this document to the Group's consolidated financial statements concern the financial statements of December 31, 2004, prepared in accordance with French accounting principles.

Fully aware of the challenges involved in the changeover to International Financial Reporting Standards (IFRS) in 2005 for its shareholders, investors, customers, suppliers, and all stakeholders, as well as for its own internal company operations, Alcatel set up, as early as 2003, a Steering Committee to:

- Define the timetable for the changeover to IFRS;
- Evaluate the impacts on both valuation and presentation;
- 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 schemes, reserves 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 listed companies of the European Union with effect from 2005. Alcatel, which publishes financial statements on a quarterly basis, intends to provide consolidated financial statements prepared under IFRS accounting and valuation principles 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. The information provided in the notes to consolidated financial statements at the time of the quarterly statements will have a similar level of detail as the previous information published in accordance with French accounting standards. The application of International Accounting Standard (IAS) 34 (Interim Financial Reporting) will not be anticipated. Each quarter, Alcatel will provide tables in accordance with IFRS 1 (First-time Adoption of IFRS) that reconcile the 2004 financial statements, published in accor-

dance with French accounting standards, with the financial statements restated under IFRS.

### Action undertaken by the Group in 2004 as part of the changeover to IFRS

In 2004, the Group took a number of actions to better prepare readers and preparers of the Group's financial statements to the impacts resulting from the changeover to IFRS. The main actions were:

#### • Internal actions

The Group implemented a **large-scale training plan** during 2004 for all persons affected by this change in accounting standards: Executive Committee members, finance teams (accounting, consolidation, management control, etc.) in the Group's headquarters and in all of its reporting units and business divisions.

In addition to the specific, targeted training conducted at headquarters as from January 2004, the main focus was a three-day training course for financial statement preparers. This course was later adapted and presented in the various geographic regions where the Group is present, driven by the regional IFRS project managers and overseen and supervised by specialist teams from headquarters and the Auditors. Training courses were conducted through September 2004 in Germany, Belgium, the United States, Italy, Spain, China, Brazil, and Mexico.

In addition, the training course presented at headquarters was filmed and made available to all Alcatel employees on the Group's Intranet.

The **financial reporting system** used by the Group has also been modified to adapt it to the specific IFRS requirements, and to ensure that the available information meets the disclosure needs, particularly in the area of notes to the consolidated financial statements. Other information systems have been adapted, when required, for the changeover to IFRS.

In its accounts published during 2004 in accordance with French accounting standards, Alcatel also started to **anticipate** the application of **IFRS accounting rules**. As indicated in Note 1 to the 2004 quarterly and annual consolidated financial statements, the Group anticipated as far as possible certain IFRS rules, primarily with respect to business combinations (decision to abandon the use of the "pooling of interests" method for the 2004 acquisitions and the accounting treatment of in-process research and development costs) or the recording of pensions and other employee benefits (application of the "Conseil National de la Comptabilité" (CNC)'s recommendation in compliance with IAS 19 Employee Benefits). To help the reader understand the future impacts of the changeover to IFRS, Alcatel has also made an effort to clarify the financial statement presentation (presentation of exceptional amortization of goodwill separately from recurring amortization, more detailed information on research and development costs, etc.).

#### • External communication actions.

Alcatel organized an **analysts' meeting on April 5, 2004** to present the main expected impacts of applying the new accounting standards for the Group. The information presented at this meeting is available on the Group's website (<http://www.alcatel.com>).

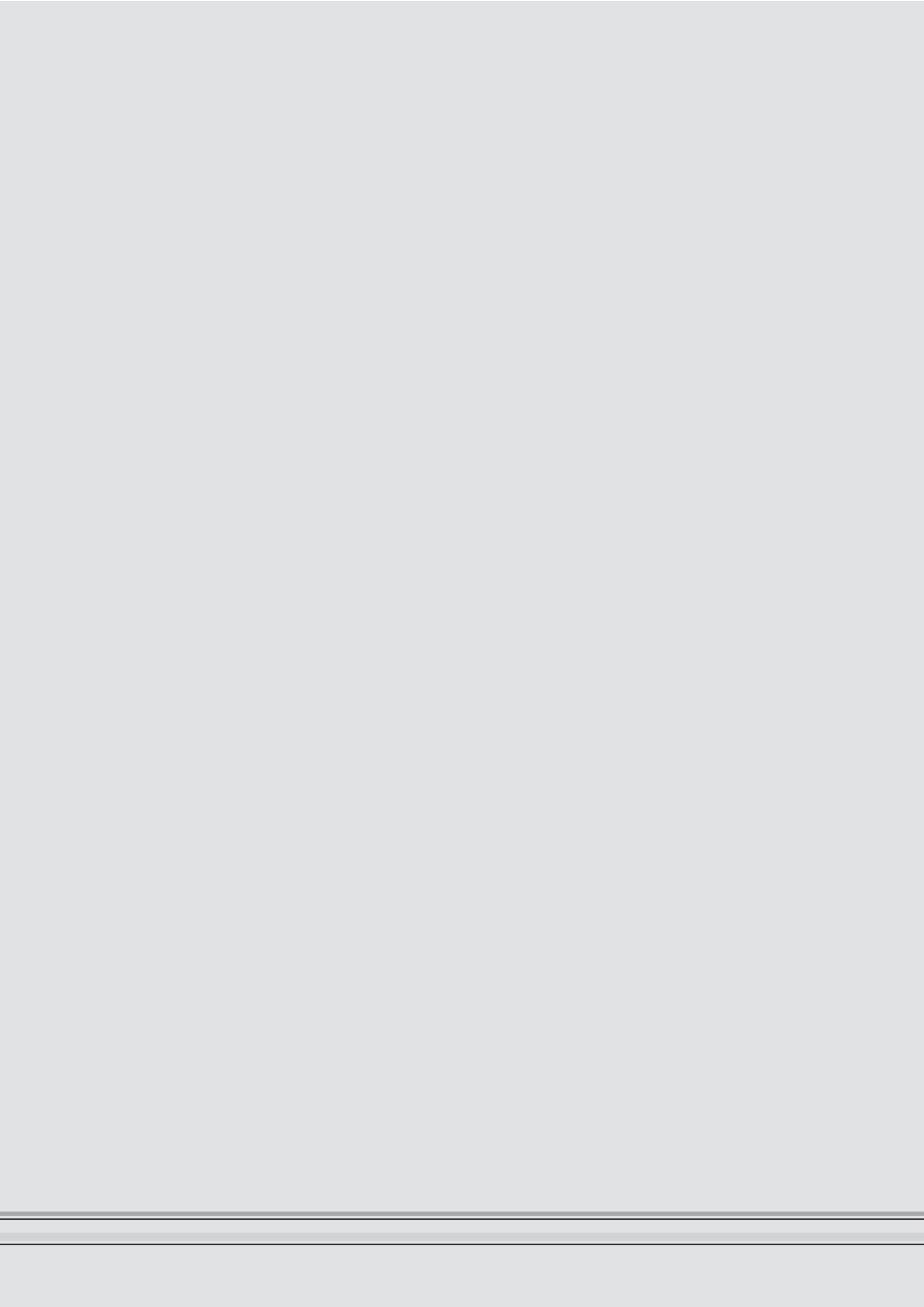
**Articles and analyses addressing** the impact of the changeover to IFRS in Alcatel's field or within the Group were studied to ensure a thorough understanding of the implications and a timely anticipation of the main impacts of the changeover.

#### **Communication on the changeover to IFRS in 2005**

In addition to updating the descriptive summary of the main impacts expected from the changeover to the new accounting standards, the first IFRS-based figures were communicated in late March 2005. This information included the balance sheet at January 1, 2004, the 2004 quarterly and annual income statements, as well as tables reconciling the 2004 financial statements based on French accounting standards to those restated under IFRS.

#### **Impact of IFRS**

The measurable impact of transition to IFRS on the Group's consolidated financial statements for 2004 is detailed in the chapter "Transition to IFRS" of the current reference document.



## > CONSOLIDATED INCOME STATEMENTS

(in millions of euros)	Note	Q4 2004 (not reviewed)	Q4 2003* (not reviewed)	2004	2003*	2002*
Net sales	(3)	3,812	3,765	12,265	12,513	16,547
Cost of sales	(4)	(2,501)	(2,517)	(7,690)	(8,415)	(12,186)
<b>Gross profit</b>	(4)	<b>1,311</b>	<b>1,248</b>	<b>4,575</b>	<b>4,098</b>	<b>4,361</b>
Administrative and selling expenses		(494)	(524)	(2,010)	(2,173)	(2,862)
R&D costs	(4)	(424)	(393)	(1,587)	(1,593)	(2,226)
<b>Income (loss) from operations</b>	(3)	<b>393</b>	<b>331</b>	<b>978</b>	<b>332</b>	<b>(727)</b>
Interest expense on notes mandatorily redeemable for shares	(23)	(11)	(12)	(44)	(47)	(1)
Financial income (loss)	(5)	(45)	(78)	(132)	(242)	(1,018)
Restructuring costs	(25)	(159)	(524)	(304)	(1,314)	(1,474)
Other revenue (expense)	(7)	40	11	364	120	(830)
<b>Income (loss) before amortization of goodwill and tax</b>		<b>218</b>	<b>(272)</b>	<b>862</b>	<b>(1,151)</b>	<b>(4,050)</b>
Income tax	(8)	(40)	(21)	(9)	(82)	19
Share in net income of equity affiliates and disposed of or discontinued operations	(6)	(19)	7	(97)	(113)	(107)
<b>Consolidated net income (loss) before amortization of goodwill and purchased R&amp;D</b>		<b>159</b>	<b>(286)</b>	<b>756</b>	<b>(1,346)</b>	<b>(4,138)</b>
Amortization of goodwill	(10)	(99)	(97)	(408)	(407)	(447)
Exceptional amortization of goodwill	(10)	-	(113)	-	(171)	(142)
Purchased R&D		-	-	(1)	-	-
Minority interests		(20)	(28)	(66)	(20)	(18)
<b>Net income (loss)</b>		<b>40</b>	<b>(524)</b>	<b>281</b>	<b>(1,944)</b>	<b>(4,745)</b>
<b>Ordinary Shares**</b>						
Basic earnings per share (in euros)	(9)	0.03	(0.39)	0.21	(1.46)	(3.99)
Diluted earnings per share (in euros)	(9)	0.03	(0.39)	0.21	(1.46)	(3.99)

\* These are the company's historical results. In order to make comparisons easier, restated income statements for 2003 and 2002 are presented in note 2 to take into account the disposals of the optical components business, the Saft group, the optical fiber, mobile phone and electrical power systems businesses.

\*\* Net (loss) per share for 2002 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

<b>ASSETS</b> (in millions of euros)	Note	<b>2004</b>	<b>2003</b>	<b>2002</b>
Goodwill, net	(10)	3,586	3,839	4,597
Other intangible assets, net	(11)	397	284	312
<b>Intangible assets, net</b>		<b>3,983</b>	<b>4,123</b>	<b>4,909</b>
Property, plant and equipment	(12)	4,849	6,317	8,236
Depreciation	(12)	(3,688)	(4,817)	(5,737)
<b>Property, plant and equipment, net</b>	(12)	<b>1,161</b>	<b>1,500</b>	<b>2,499</b>
Share in net assets of equity affiliates and net assets and liabilities of disposed of or discontinued operations	(13)	454	391	306
Other investments and miscellaneous, net	(14)	506	822	975
<b>Investments and other financial assets, net</b>		<b>960</b>	<b>1,213</b>	<b>1,281</b>
<b>TOTAL FIXED ASSETS</b>		<b>6,104</b>	<b>6,836</b>	<b>8,689</b>
<b>Inventories and work in progress, net</b>	(15) & (16)	<b>1,527</b>	<b>1,432</b>	<b>2,329</b>
Trade receivables and related accounts, net	(15) & (17)	3,520	3,364	4,716
Other accounts receivable, net	(18)	2,775	3,231	4,037
<b>Accounts receivable, net</b>		<b>6,295</b>	<b>6,595</b>	<b>8,753</b>
Marketable securities, net*	(19)	2,326	1,635	716
Cash, net		2,785	4,634	5,393
<b>Cash and cash equivalents*</b>		<b>5,111</b>	<b>6,269</b>	<b>6,109</b>
<b>TOTAL CURRENT ASSETS</b>		<b>12,933</b>	<b>14,296</b>	<b>17,191</b>
<b>TOTAL ASSETS</b>		<b>19,037</b>	<b>21,132</b>	<b>25,880</b>

\* The total cash and cash equivalents at December 31, 2004 included, within marketable securities, listed securities amounting to €44 million (€44 million at December 31, 2003 and 2002). Excluding listed securities, cash and cash equivalents amounted to €5,067 million (€6,225 million at December 31, 2003 and €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.

	Note	2004		2003	2002
		Before appropriation	After	After appropriation	After appropriation
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> (in millions of euros)					
Capital stock (€2 nominal value: 1,305,455,461 ordinary shares issued at December 31, 2004, 1,284,410,224 ordinary shares issued at December 31, 2003, and 1,239,193,498 Class A shares and 25,515,000 Class O shares issued at December 31, 2002)		2,611	2,611	2,569	2,529
Additional paid-in capital		7,758	7,758	7,562	21,602
Retained earnings		(5,041)	(4,760)	(4,855)	(17,107)
Cumulative translation adjustments		(636)	(636)	(518)	(283)
Net income (loss)		281	-	-	-
Less treasury stock at cost		(1,605)	(1,605)	(1,728)	(1,734)
<b>SHAREHOLDERS' EQUITY</b>	(21)	<b>3,368</b>	<b>3,368</b>	<b>3,030</b>	<b>5,007</b>
<b>MINORITY INTERESTS</b>	(22)	<b>376</b>	<b>376</b>	<b>363</b>	<b>343</b>
<b>OTHER EQUITY</b>					
Notes mandatorily redeemable for shares	(23)	645	645	645	645
Accrued pension and retirement obligations	(24)	1,144	1,144	1,010	1,016
Other reserves	(25)	2,278	2,278	3,049	3,301
<b>TOTAL RESERVES FOR LIABILITIES AND CHARGES</b>		<b>3,422</b>	<b>3,422</b>	<b>4,059</b>	<b>4,317</b>
Convertible bonds issued	(26)	1,022	1,022	1,022	-
Bonds and notes issued	(26)	2,742	2,742	3,782	5,325
Other borrowings	(26)	595	595	489	458
<b>TOTAL FINANCIAL DEBT</b> (of which medium and long-term portion)	(26)	<b>4,359</b> 3,323	<b>4,359</b> 3,323	<b>5,293</b> 4,410	<b>5,783</b> 4,687
Customers' deposits and advances	(15) (28)	1,164	1,164	1,181	1,482
Trade payables and related accounts	(15)	3,360	3,360	3,617	4,162
Debt linked to bank activity	(29)	105	105	224	246
Other payables	(30)	2,238	2,238	2,720	3,895
<b>TOTAL OTHER LIABILITIES</b>		<b>6,867</b>	<b>6,867</b>	<b>7,742</b>	<b>9,785</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>19,037</b>	<b>19,037</b>	<b>21,132</b>	<b>25,880</b>

## > CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions of euros)	Q4 2004 (not reviewed)	2004	2003	2002
<b>Cash flows from operating activities</b>				
Net income (loss)	40	281	(1,944)	(4,745)
Minority interests	20	66	20	18
Adjustments to reconcile income before minority interests to net cash provided by operating activities:				
- Depreciation and amortization, net	116	443	605	1,010
- Amortization and depreciation of goodwill and purchased R&D	100	408	577	589
- Net allowances in reserves for pension obligations, net	(29)	(38)	(7)	(3)
- (Utilization) and increase/(reversal) of other reserves, net	(14)	(588)	54	1,358
- Net (gain) loss on disposal of non-current assets	(39)	(351)	(104)	(287)
- Share in net income of equity affiliates and disposed of or discontinued operations (net of dividends received)	18	117	126	188
<b>Net cash provided (used) by operating activities before changes in working capital</b>	<b>212</b>	<b>338</b>	<b>(673)</b>	<b>(1,872)</b>
Net change in current assets and liabilities:				
Decrease (increase) in inventories	345	(154)	478	2,000
Decrease (increase) in accounts receivable	(392)	(231)	1,264	3,436
Decrease (increase) in advances and progress payments	28	8	33	110
Increase (decrease) in accounts payable and accrued expenses	85	90	(404)	(1,084)
Increase (decrease) in customers' deposits and advances	(47)	(127)	(206)	(173)
Increase (decrease) in other receivables and debts	(34)	(213)	(48)	306
<b>Net cash provided (used) by operating activities (a)</b>	<b>197</b>	<b>(289)</b>	<b>444</b>	<b>2,723</b>
<b>Cash flows from investing activities</b>				
Proceeds from disposal of fixed assets	68	218	457	280
Capital expenditures	(126)	(380)	(253)	(490)
Decrease (increase) in loans (b)	122	569	207	(839)
Cash expenditures for acquisition of consolidated companies, net of cash acquired, and for acquisition of unconsolidated companies	(7)	(205)	(107)	(193)
Cash proceeds from sale of previously consolidated companies, net of cash sold, and from sale of unconsolidated companies	33	359	195	813
Disposed of or discontinued operations*	(7)	(247)	(56)	-
<b>Net cash provided (used) by investing activities</b>	<b>83</b>	<b>314</b>	<b>443</b>	<b>(429)</b>
<b>Net cash flows after investing activities</b>	<b>280</b>	<b>25</b>	<b>887</b>	<b>2,294</b>
<b>Cash flows from financing activities</b>				
Increase (decrease) in short-term debt	(282)	(1,567)	(1,580)	(1,469)
Proceeds from issuance of long-term debt	-	462	-	-
Proceeds from issuance of notes mandatorily redeemable for shares (ORANE) or convertible bonds (OCEANE)	-	-	1,022	645
Proceeds from issuance of shares	7	12	1	8
Dividends paid	-	(9)	(7)	(276)
<b>Net cash provided (used) by financing activities</b>	<b>(275)</b>	<b>(1,102)</b>	<b>(564)</b>	<b>(1,092)</b>
Net effect of exchange rate changes	(66)	(51)	(136)	(150)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(61)</b>	<b>(1,128)</b>	<b>187</b>	<b>1,052</b>
<b>Cash and cash equivalents at beginning of year including disposed of activities</b>	<b>5,137</b>	<b>6,225</b>	<b>6,065</b>	<b>5,013</b>
<b>Cash and cash equivalents at beginning of year excluding disposed of activities</b>	<b>5,128</b>	<b>6,195</b>	<b>6,038</b>	<b>-</b>
<b>Cash and cash equivalents at end of year excluding listed securities</b>	<b>5,067</b>	<b>5,067</b>	<b>6,225</b>	<b>6,065</b>
<b>Operational cash flows (a) + (b) = Net cash provided (used) by operating activities + Decrease (increase) in loans (b)</b>	<b>319</b>	<b>280</b>	<b>651</b>	<b>1,884</b>

\* The consolidated statements of cash flows are presented so as to isolate cash flows relating to disposed of or discontinued operations (see note 6).

The corporate tax paid for 2004 amounted to €40 million (€14 million for 2003 and €30 million for 2002) and the gross financial charges amounted to €606 million (€981 million for 2003 and €1,921 million for 2002).

## > CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Note	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
(in millions of euros)										
<b>BALANCE AT DECEMBER 31, 2001</b>										
<b>AFTER APPROPRIATION</b>	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 increases	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 adjustments*					110					110
Translation adjustments						(98)			(98)	
Net income (loss)								(4,745)		(4,745)
Appropriation of net income					(4,745)			4,745		-
<b>BALANCE AT DECEMBER 31, 2002</b>										
<b>AFTER APPROPRIATION</b>	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	26,000,000	(26,000,000)								
Acquisition of Imagic TV	3,531,332		7	19						26
Repayment of notes mandatorily redeemable for shares (ORANE)	1,828		0	0						0
Acquisition of TiMetra	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	144,005	11,655			(1)				6	5
Adjustment relating to the acquisition of Kymata				68					68	Other
adjustments**					113					113
Translation adjustments						(235)			(235)	
Net income (loss)								(1,944)		(1,944)
Appropriation of net income (loss)				(14,157)	12,213			1,944		-
<b>BALANCE AT DECEMBER 31, 2003</b>										
<b>AFTER APPROPRIATION</b>	1,221,838,005	-	2,569	7,562	(5,061)	206	(518)	-	(1,728)	3,030
Other capital increases (21b)	3,258,728		6	20						26
Exchangeable shares Alcatel Networks Corporation					3	(3)				-
Repayment of notes mandatorily redeemable for shares (ORANE) (23)	3,212		0	0						0
Net change in treasury stock of shares owned by consolidated subsidiaries (21e)	2,310,066				(88)				123	35
First-time application of the CNC's 2003-R.01 recommendation (24b)					(209)					(209)
Acquisition of Spatial Wireless (21b)	17,783,297		36	176						212
Other adjustments***					111					111
Translation adjustments							(118)			(118)
Net income (loss)								281		281
<b>BALANCE AT DECEMBER 31, 2004</b>										
<b>BEFORE APPROPRIATION</b>	1,245,193,308	-	2,611	7,758	(5,244)	203	(636)	281	(1,605)	3,368
Allocation of net income (loss) (20)	-	-	-	-	281	-	-	(281)	-	0
<b>AFTER APPROPRIATION</b>	1,245,193,308	-	2,611	7,758	(4,963)	203	(636)	-	(1,605)	3,368

\* 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 n°00-06 (regulation on liabilities) approved by the "Comité de Réglementation Comptable" and from the consolidation of Alcatel Shanghai Bell, which had been previously accounted for under the equity method.

\*\* 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) and from the consolidation of Alcatel Shanghai Bell, which had been previously accounted for under the equity method.

\*\*\* 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).



## > NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

The consolidated financial statements of Alcatel and its consolidated subsidiaries ("Alcatel" or the "Group") are prepared in accordance with French accounting principles in compliance 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.

From January 1, 2002, Alcatel has applied regulation No. 00-06, Regulation on liabilities, approved by the "Comité de la Réglementation Comptable".

As part of the changeover to International Financial Reporting Standards ("IFRS") in 2005, Alcatel decided to revise the method of presenting certain income statement captions and to anticipate the application of certain accounting rules, to the extent that these are compatible with French accounting principles. The main changes made in this respect in 2004 were:

- application of the "Conseil National de la Comptabilité" (CNC) 's recommendation 2003-RO1 relating to standards of accounting for, and measurement of, employee retirement and other similar benefits, in order to apply the accounting principles set forth in IAS 19 (Employee Benefits);
- presentation of recurring goodwill amortization charges (charges that will no longer be incurred in accordance with IFRS 3) separately from exceptional amortization charges (resulting from goodwill impairment tests);
- presentation of research and development costs (see note 4);
- abandonment of the "pooling of interests" method of accounting for business combinations occurring as from January 1, 2004 (see note 10).

#### 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. Any difference between the fair value and the carrying value is accounted for, including minority interests and not only the Group interest (entity theory). Any residual difference is recorded as goodwill (see note 1f, intangible and tangible assets).

As an exception to the above-described rule (the purchase method) 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 10 on goodwill. Alcatel abandoned this "pooling of interests" method as from January 1, 2004 in anticipation of the changeover to IFRS.

In accordance with the position taken in Bulletin n° 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 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 for:

- Software development costs, which 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, which are included in work in progress on long-term contracts.

In connection with the treatment of business combinations accounted for using the purchase method (see Note 1b), 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, so as to stay at the forefront of 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 consideration of 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.

Commencing on January 1, 2004 and in anticipation of applying the principles laid down in IFRS, Alcatel has capitalized the in-process research and development projects that are acquired in a business combination and correspond to applied research projects and development in progress, and which are identifiable and can be reliably evaluated and which have a real chance of being commercially profitable. In previous years, Alcatel did not systematically capitalize in-process research and development projects when the above

criteria were met, as amounts that were attributed to projects that had not reached technical feasibility and that did not have any other possible future use were immediately expensed at the time of acquisition.

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 to exceed 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 2004 was the Group's weighted average cost of capital of 10.8% (10.2% for 2003 and 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 as well as to the approach described in IAS 36 (Impairment of Assets). 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, June 30, 2003 and June 30, 2004. 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 not booking any exceptional goodwill amortization charge for 2004 (€171 million in 2003 and €142 million in 2002) (see note 10).

### 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

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<b>Buildings for administrative and commercial use</b>	<b>20-40 years</b>
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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

Since January 1, 2004, the Group has applied the CNC's recommendation 2003-R.01 relating to standards of accounting for, and measurement of, employee retirement and other similar benefits, in order to apply the accounting principles laid down in IAS 19 (Employee Benefits). The impact of applying this recommendation for the first time is described in note 24b.

In accordance with the laws and practices of each country, the Group participates in employee benefit plans and pro-

vides 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 therefor is made. 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 more than 10% of the present value of the defined benefit obligation or 10% of the fair value of any plan assets.

Since January 1, 2004, the Group has also accrued certain other post-employment benefits, such as life insurance and medical cover, as a result of applying the CNC's recommendation n° 2003-R.01.

In accordance with clarifications made by the CNC in its press release dated July 22, 2004, Alcatel recognized in shareholders' equity the actuarial gains and losses as of January 1, 2004 related to experience adjustments and adjustments linked to changes in actuarial assumptions.

As described above, actuarial gains and losses that have occurred since January 1, 2004 are accounted for using the 'corridor' method, which consists of accounting for them as an adjustment of the reserve and of recognizing them in income if they exceed the threshold of 10%.

The expense resulting from the change in net pension and other post-retirement obligations is recorded in income from operations or in financial income (loss) depending upon the nature of the underlying obligation.

As the CNC's recommendation 2003-R.01 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.

### 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 balance sheet 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-offs 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 and are calculated based on the most recently voted tax rate applicable to the following fiscal year.

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 construction and 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, in application of the principles described in the second preceding paragraph. For arrangements to sell software licenses with services, software license revenue is recognized separately from the related service revenue, providing 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 specified criteria, the Group applies the percentage of completion method of accounting. 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 (loss), 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.

## n) Financial income (loss)

Financial income (loss) 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 pension costs and other financial expenses and income (capital gain/loss on disposal of marketable securities, for example).

Alcatel's banking subsidiary (Electro Banque) is fully consolidated. The operational banking revenues and costs are presented in financial income (loss), as 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

Most of the Group's activities in the various business segments involve long-term operating cycles. As a result, the consolidated balance sheet combines trading assets (inventories and work in progress and accounts receivable) and trading liabilities (reserves for liabilities and charges, customers' deposits and advances, trade payables and other payables) without distinction between the amounts due in less than one year and due after more than one year.

## q) Financial instruments

The Group uses financial instruments to manage and reduce its exposure to fluctuations in interest rates, foreign currency exchange rates and metal prices. 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

Cash and cash equivalents 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 sheets 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 of 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 (loss) or in other expenses (see note 1o). Changes in net loans receivable are included in cash flows from investing activities (decrease / increase in loans) of 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 31).

## NOTE 2 - CHANGES IN THE CONSOLIDATED COMPANIES

The main changes in consolidated companies for 2004 were as follows:

■ On January 14, 2004, Alcatel, pursuant to its announcement in October 2003, finalized the sale of SAFT, a subsidiary of the Group that specialized in battery operations, to Doughty Hanson for €390 million. The battery operations were recorded as a discontinued operation for the year ended December 31, 2003. The gain on disposal amounted to €255 million and was recorded in 2004 under the caption "other revenue (expense)" (see note 7).

■ On April 26, 2004, Alcatel and TCL Communication Technology Holdings Limited announced the execution of a memorandum of understanding to form a joint venture mobile handset company. The joint venture company officially started operations on August 31, 2004, and is 55% owned by TCL and 45% owned by Alcatel. It is consolidated under the equity method in Alcatel's accounts from September 1, 2004. The mobile phone business has been accounted for as a disposed of activity as from January 1, 2004 (see note 6). The gain on disposal was recorded in 2004 under the caption "other revenue (expense)" (see note 7).

■ On May 17, 2004, Alcatel announced that it had signed definitive binding documentation with Draka Holding N.V. ("Draka") in relation to the proposed combination of their respective global optical fiber and communication cable businesses. The final agreement was signed on July 2, 2004. Draka owns 50.1% and Alcatel owns 49.9% of the new company, Draka Comteq B.V.. This company was consolidated under the equity method as of July 1, 2004. Alcatel's optical fiber activity has been accounted for as a disposed operation as of and after January 1, 2004 (see note 6). As the 2004 financial statements for Draka Comteq BV were not available at the closing date of Alcatel's financial statements, an estimated gain/loss on disposal and an estimated share in the net result of Draka Comteq BV were taken into account in the income statement at December 31, 2004.

■ On June 18, 2004, Alcatel and Finmeccanica announced the execution of a memorandum of understanding to merge their space activities through the creation of two sister companies, to which both partners will contribute their respective satellite industrial and service activities.

The first company, Alcatel Alenia Space, of which Alcatel will hold 67% and Finmeccanica 33%, will combine Alcatel Space and Alenia Spazio's industrial activities. This company will concentrate on the design, development, and manufacture of space systems, satellites, equipment, instruments, payloads and associated ground systems. The management team of Alcatel Alenia Space will be located in France. The company will operate through five business divisions (Telecommunications, Optical Observation and Science, Observation Systems and Radar, Navigation, Infrastructure and Transportation).

The second company, of which Finmeccanica will hold 67% and Alcatel 33%, will combine Telespazio (Finmeccanica group) with Alcatel Space's operations and services activities. This company will concentrate on operations and services for satellite solutions, which includes control and exploitation of space systems as well as value-added services for networking, multimedia and earth observation. Its management team will be located in Italy.

The definitive agreement relating to the creation of these two new companies was signed on January 28, 2005, subject to the necessary approvals of the regulatory authorities.

■ On September 17, 2004, Alcatel announced that it had acquired privately held, U.S.-based eDial Inc., a leading provider of conferencing and collaboration services for businesses and telephone companies. The acquisition price was €22 million (based on the market value at that date of Alcatel's American Depositary Shares and was paid for in Alcatel ADSs and cash.

■ On September 17, 2004, Alcatel signed an agreement with a private equity firm, Ripplewood, to divest all of its electrical power system activities (Saft Power Systems). The closing of this sale, subject to regulatory approvals, took place on January 25, 2005. The results of this business were recorded as a discontinued operation in 2004 (see note 6). The gain/loss on disposal will be recorded in the first quarter of 2005.

■ On December 14, 2004, Alcatel announced that it had sold 7.1 million Avanex shares, bringing the Group's stake in this company to below 20%. With this partial disengagement and in the absence of a seat on Avanex's board of directors, the Group considers that it no longer exercises significant influence on Avanex and, as a result, as from this date, the remaining net book value of the shares has been accounted for as a non-consolidated investment and no longer as an equity affiliate.

■ On December 16, 2004, Alcatel completed the acquisition of the privately held, U.S.-based Spatial Communications (known as Spatial Wireless), a leading provider of software-based and multi-standard distributed mobile switching solutions. All Spatial Wireless shares were acquired for 17.4 million of Alcatel's ADSs, representing a value of €207 million.

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, 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 operation (see note 5).

■ In June 2003, Alcatel entered into a settlement that brought 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.

In order to make comparisons easier, restated income statements, which have not been audited by the auditors, are presented to take into account changes in the consolidated companies and discontinuation of the following businesses:

- sale of the optical components business announced in May 2003 and finalized in July 2003;
- disposal of Saft announced in October 2003 and finalized in January 2004;
- disposal of the optical fiber activity announced in May 2004 and completed in July 2004;
- disposal of the mobile phones activity announced in April 2004 and completed in August 2004; and
- disposal of the electrical power systems activity (Saft Power Systems), announced in September 2004 and completed in January 2005.

Data for the fourth quarters of 2004, 2003 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)	<b>Q4 2004 (not reviewed)</b>	<b>Q4 2003 restated (not reviewed)</b>	<b>2004</b>	<b>2003 restated (unaudited)</b>	<b>2002 restated (unaudited)</b>
Net sales	3,812	3,443	12,265	11,606	14,337
Cost of sales	(2,501)	(2,242)	(7,690)	(7,614)	(10,192)
<b>Gross profit</b>	<b>1,311</b>	<b>1,201</b>	<b>4,575</b>	<b>3,992</b>	<b>4,145</b>
Administrative and selling expenses	(494)	(490)	(2,010)	(2,033)	(2,652)
R&D costs	(424)	(377)	(1,587)	(1,510)	(1,958)
<b>Income from operations</b>	<b>393</b>	<b>334</b>	<b>978</b>	<b>449</b>	<b>(465)</b>
Interest expense on notes mandatorily redeemable for shares	(11)	(12)	(44)	(47)	(1)
Financial income (loss)	(45)	(77)	(132)	(248)	(1,004)
Restructuring costs	(159)	(522)	(304)	(1,260)	(1,168)
Other revenue (expense)	40	7	364	248	(445)
<b>Income (loss) before amortization of goodwill and tax</b>	<b>218</b>	<b>(270)</b>	<b>862</b>	<b>(858)</b>	<b>(3,082)</b>
Income tax	(40)	(19)	(9)	(81)	34
Share in net income of equity affiliates and disposed of or discontinued operations	(19)	3	(97)	(418)	(1,149)
<b>Consolidated net income (loss) before amortization of goodwill and purchased R&amp;D</b>	<b>159</b>	<b>(286)</b>	<b>756</b>	<b>(1,357)</b>	<b>(4,197)</b>
Amortization of goodwill	(99)	(97)	(408)	(407)	(388)
Exceptional amortization of goodwill	-	(113)	-	(160)	(142)
Purchased R&D	-	-	(1)	-	-
Minority interests	(20)	(28)	(66)	(20)	(18)
<b>Net income (loss)</b>	<b>40</b>	<b>(524)</b>	<b>281</b>	<b>(1,944)</b>	<b>(4,745)</b>
<b>Ordinary shares</b>					
Basic earnings per share (in euros)	0.03	(0.39)	0.21	(1.46)	(3.99)
Diluted earnings per share (in euros)	0.03	(0.39)	0.21	(1.46)	(3.99)

### 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 organization put into place at the beginning of 2003, comprising three business segments, addressing three principal markets. Previously, Alcatel was organized along technology lines.

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; and
- 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 communication markets other than telecom operator markets and is organized along vertical market segment lines covering equipment, network solutions and applied solutions; and

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

The segment Other includes miscellaneous businesses outside Alcatel's core businesses, 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 2003 and 2002 have been restated to take into account the organization put in place at the beginning of 2003 and the disposal and discontinuation of significant businesses described in note 2 and accounted for in the presentation of the restated income statements.

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

(in millions of euros)	<b>Fixed Communications</b>	<b>Mobile Communications</b>	<b>Private Communications</b>	<b>Other</b>	<b>Eliminations</b>	<b>Total Group</b>
<b>2004</b>						
Sales						
■ segments	5,131	3,301	3,965	-	-	12,397
■ between segments	(34)	(3)	(95)	-	-	(132)
Net sales	5,097	3,298	3,870	-	-	12,265
Income (loss) from operations	429	401	235	(87)	-	978
Depreciation of property, plant and equipment	(160)	(73)	(100)	-	-	(333)
Changes in operational reserves (current assets and accrued contract costs)	41	(60)	(29)	-	-	(48)
Capital expenditures	65	82	78	1	-	226
Property, plant and equipment, net	523	285	349	4	-	1,161
Operating assets*	1,846	1,634	1,716	12	(72)	5,136

\* Operating assets includes net inventories and work in progress, net customer receivables and advances and progress payments.



(in millions of euros)	<b>Fixed Communications</b>	<b>Mobile Communications</b>	<b>Private Communications</b>	<b>Other</b>	<b>Eliminations</b>	<b>Total Group</b>
<b>2003 restated (unaudited)</b>						
Sales						
■ segments	5,364	2,929	3,627	16	-	11,936
■ between segments	(106)	(31)	(192)	(1)	-	(330)
Net sales	5,258	2,898	3,435	15	-	11,606
Income (loss) from operations*	155	315	123	(144)	-	449
Depreciation of property, plant and equipment	(245)	(71)	(132)	(1)	-	(449)
Changes in operational reserves (current assets and accrued contract costs)	184	68	(41)	-	-	211
Capital expenditures	52	39	47	-	-	138
Property, plant and equipment, net	655	247	497	(38)	-	1,361
Operating assets**	2,001	1,249	1,481	34	(108)	4,657

\* 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 7).

\*\* Operating assets includes net inventories and work in progress, net customer receivables and advances and progress payments.

(in millions of euros)	<b>Fixed Communications</b>	<b>Mobile Communications</b>	<b>Private Communications</b>	<b>Other</b>	<b>Eliminations</b>	<b>Total Group</b>
<b>2002 restated (unaudited)</b>						
Sales						
■ segments	7,284	3,351	4,109	21	-	14,765
■ between segments	(198)	(60)	(170)	-	-	(428)
Net sales	7,086	3,291	3,939	21	-	14,337
Income (loss) from operations*	(686)	248	115	(142)	-	(465)
Depreciation of property, plant and equipment	(403)	(91)	(152)	4	-	(642)
Changes in operational reserves (current assets and accrued contract costs)	503	159	112	-	-	774
Capital expenditures	112	42	87	18	-	259
Property, plant and equipment, net	1,113	309	573	34	-	2,029
Operating assets**	3,355	1,547	1,829	38	(113)	6,656

\* 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 7).

\*\* Operating assets includes net inventories and work in progress, net customer receivables and advances and progress payments.

## b) Information by geographical segment

Data for 2003 and 2002 have been restated to take into account the organization put in place at the beginning of 2003 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)	France	Germany	Other		Asia Pacific	North America	Rest of world	Consolidated
			Western Europe	Rest of Europe				
<b>2004</b>								
Net sales								
■ by subsidiary location	4,394	1,189	2,302	253	1,423	1,819	885	12,265
■ by geographical market	1,676	794	2,712	892	1,868	1,785	2,538	12,265
Income (loss) from operations	276	86	138	30	132	286	30	978
Property, plant and equipment, net	365	168	293	20	97	174	44	1,161
Total Assets	10,280	827	2,875	202	1,944	2,271	638	19,037
<b>2003 restated (unaudited)</b>								
Net sales								
■ by subsidiary location	3,960	1,028	2,130	266	1,496	1,969	757	11,606
■ by geographical market	1,439	757	2,611	857	2,083	1,833	2,026	11,606
Income (loss) from operations	(7)	28	116	43	154	90	25	449
Property, plant and equipment, net	393	180	388	28	92	226	54	1,361
Total Assets	11,853	1,014	2,714	195	1,944	2,411	534	20,665
<b>2002 restated (unaudited)</b>								
Net sales								
■ by subsidiary location	4,698	1,354	2,609	390	1,648	2,666	972	14,337
■ by geographical market	1,966	1,074	2,840	974	2,408	2,637	2,438	14,337
Income (loss) from operations	(146)	(28)	(260)	45	122	(268)	71	(464)
Property, plant and equipment, net	602	229	579	41	132	369	77	2,029
Total Assets	13,095	1,238	3,997	249	2,252	3,097	683	24,611

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

## NOTE 4 - RESEARCH AND DEVELOPMENT COSTS

(in millions of euros)	2004	2003 published
Research costs	83	218
Development costs	1,442	1,375
Customer-funded research and development	62	-
<b>R&amp;D costs</b>	<b>1,587</b>	<b>1,593</b>
Customer-funded research and development	-	59
Customer design engineering costs	237	278
Capitalized development costs	32	10
<b>R&amp;D effort</b>	<b>1,856</b>	<b>1,940</b>
As a % of sales	15.1%	15.5%

Customer design engineering costs represent amounts disbursed under the terms of contracts with customers and are expensed to cost of sales. Certain software development costs are capitalized. The net effect of this capitalization (being the capitalization of certain costs of the period less the amortization charge of previously capitalized costs) results in a decrease of research and development costs.

As part of the changeover to IFRS in 2005, the method of presenting research and development costs has been revised as from January 1, 2004 to better reflect the requirements of IAS 18 (Revenue) and IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance).

In previous years, research and development grants and license revenues received were deducted from R&D costs,

and costs incurred in respect of customer-funded research and development or research contracts were systematically recorded in cost of sales.

As a result, commencing on January 1, 2004, research and development costs are recorded gross and include research financed by institutions or carried out in the framework of research contracts.

The purpose of changing the manner in which the research and development effort is presented is to improve the quality of the information given, to prepare for the changeover to IFRS and to be more in line with the accounting practice of Alcatel's principal competitors.

The new method of presentation described above would have had the following impacts on Alcatel's results for the year ended December 31, 2003 and for each quarter in 2003:

(in millions of euros)	New presentation				
	Q1 2003	Q2 2003	Q3 2003	Q4 2003	December 31, 2003
	restated	restated	restated	restated	restated
Net sales	2,632	2,848	2,742	3,469	11,691
of which revenue relating to R&D	15	19	25	26	85
Cost of sales	(1,765)	(1,880)	(1,689)	(2,221)	(7,555)
<b>Gross profit</b>	<b>867</b>	<b>968</b>	<b>1,053</b>	<b>1,248</b>	<b>4,136</b>
Administrative and selling expenses	(549)	(512)	(482)	(490)	(2,033)
R&D costs	(421)	(409)	(400)	(424)	(1,654)
<b>Income (loss) from operations</b>	<b>(103)</b>	<b>47</b>	<b>171</b>	<b>334</b>	<b>449</b>

(in millions of euros)	Previous presentation				
	Q1 2003	Q2 2003	Q3 2003	Q4 2003	December 31, 2003
	restated	restated	restated	restated	restated
Net sales	2,616	2,829	2,718	3,443	11,606
of which revenue relating to R&D	-	-	-	-	-
Cost of sales	(1,771)	(1,898)	(1,703)	(2,242)	(7,614)
<b>Gross profit</b>	<b>845</b>	<b>931</b>	<b>1,015</b>	<b>1,201</b>	<b>3,992</b>
Administrative and selling expenses	(549)	(512)	(482)	(490)	(2,033)
R&D costs	(399)	(372)	(362)	(377)	(1,510)
<b>Income (loss) from operations</b>	<b>(103)</b>	<b>47</b>	<b>171</b>	<b>334</b>	<b>449</b>

## NOTE 5 - FINANCIAL INCOME (LOSS)

(in millions of euros)	Q4 2004 (not reviewed)	2004	2003	2002
Net interest (expense) income	(17)	(90)	(102)	(159)
Dividends	2	6	4	9
Provisions*	(4)	39	(39)	(669)
Net exchange gain (loss)	(12)	(14)	(21)	(82)
Financial component of pension costs	(5)	(50)	(70)	(70)
Other financial items (net)	(9)	(23)	(14)	(47)
<b>Financial income (loss)</b>	<b>(45)</b>	<b>(132)</b>	<b>(242)</b>	<b>(1,018)</b>

\* Of which, €(480) million related to reserves to cover guarantees issued by a member of the Group and customer loans in 2002. For 2003 and 2004, they related primarily to the change in provisions on customer loans.

**NOTE 6 - EQUITY AFFILIATES AND DISPOSED  
OF OR DISCONTINUED OPERATIONS**

<b>Income statement</b> (in millions of euros)	<b>Q4 2004 (not reviewed)</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Share in net income of equity affiliates*	(26)	(31)	(12)	(75)
Income (loss) on disposed of or discontinued operations**	7	(66)	(101)	(32)
<b>Total</b>	<b>(19)</b>	<b>(97)</b>	<b>(113)</b>	<b>(107)</b>

\* For 2002, €(79) million related to the actual share of the 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. 2004 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 2004..

\*\* Disposed of or discontinued operations for 2003 and 2004 are described in note 2.

The income statements of disposed of or discontinued operations for 2004, 2003 and 2002 are as follows:

(in millions of euros)	<b>Q4 2004 (not reviewed)</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net sales*	46	571	545	318
Cost of sales*	(27)	(476)	(412)	(257)
<b>Gross margin</b>	<b>19</b>	<b>95</b>	<b>133</b>	<b>61</b>
Administrative and selling expenses	(8)	(93)	(83)	(82)
R&D costs	(4)	(61)	(34)	-
<b>Income (loss) from operations</b>	<b>7</b>	<b>(59)</b>	<b>16</b>	<b>(21)</b>
<b>Net income (loss)</b>	<b>7</b>	<b>(66)</b>	<b>(101)</b>	<b>(32)</b>

\* 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 2004 and 2003 were as follows:

(in millions of euros)	<b>2004</b>	<b>2003</b>
Net income (loss)	(66)	(101)
Net cash provided (used) by operating activities before changes in working capital	(122)	(3)
Net cash provided (used) by operating activities	(246)	(5)
Net cash provided (used) by investing activities	(4)	(51)
Net cash provided (used) by financing activities*	231	60
Net effect of exchange rate changes	2	(5)
Net increase (decrease) in marketable securities and cash	(17)	(1)

\* Alcatel Group's Central Treasury provided financing for disposed of or discontinued activities 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.

Disposed of or discontinued operations as of December 31, 2004 were the optical fiber, mobile phone and electrical power systems businesses (see note 2).

## NOTE 7 - OTHER REVENUE (EXPENSE)

(in millions of euros)	<b>Q4 2004 (not reviewed)</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net capital gains (loss) on disposal of property, plant and equipment	18	93	199	(9)
Net capital gains (loss) on disposal of shares	21	258	(95)	296
<b>Net capital gains (loss) on disposal of assets*</b>	<b>39</b>	<b>351</b>	<b>104</b>	<b>287</b>
Write-off of trade receivables and inventories**	13	36	90	(548)
Write-off of other assets***	(20)	(22)	(151)	(473)
Cost linked to the termination or disposal of activities****	-	-	5	(2)
Other	8	(1)	72	(94)
<b>Other revenue (expense)</b>	<b>1</b>	<b>13</b>	<b>16</b>	<b>(1,117)</b>
<b>Total</b>	<b>40</b>	<b>364</b>	<b>120</b>	<b>(830)</b>
* Of which:				
- disposal of Vivendi, Société Générale, Thales and Thomson Multimedia shares	-	-	-	261
- disposal of Nexans securities	-	-	-	(22)
- disposal of Saft shares	4	255	-	-
- disposal of Alcatel Microelectronics shares	5	7	6	221
- disposal of properties	6	66	215	-
- disposal of optical components business	4	4	(76)	-
- miscellaneous (less than €100 million of net value each)	20	19	(41)	(173)
** Of which:				
- related to the Fixed Communications segment	13	36	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	-	-	(126)	(394)
**** Of which:				
- shut-down of the LMDS activity	-	-	-	-
- disposal of CPE activities	-	-	5	10
- write-off of acquired technologies	-	-	-	(9)
- miscellaneous	-	-	-	(3)

## NOTE 8 - INCOME TAX

### a) Analysis of income tax (charge) benefit

(in millions of euros)	<b>Q4 2004 (not reviewed)</b>	<b>2004</b>	<b>2003</b>	<b>2002*</b>
Current income tax (charge) benefit	38	103	(62)	283
Deferred income tax (charge) benefit, net	(78)	(112)	(20)	(264)
<b>Income tax (charge) benefit</b>	<b>(40)</b>	<b>(9)</b>	<b>(82)</b>	<b>19</b>

\* Due to the decision taken to carry back tax losses, mainly in France, a current income tax profit was recorded during 2002 (see note 31b), of which the counter-part is a charge in deferred income tax.

Given income expectations in 2002 and local tax regulations, the Group extended as from the second quarter of 2002 the scope of countries where deferred tax assets are no longer recorded. This action explains the deferred income tax charges for 2004 of €112 million, for 2003 of €20 million and for 2002 of €264 million.

As income expectations are now more favorable, deferred tax assets were recorded in Belgium in 2004 for €44 million. These were more than offset by the write-off of deferred tax assets in other countries. The current income tax benefit recorded in 2004 related primarily to the favorable outcome of tax litigation.

### b) Effective income tax rate

The effective tax rate can be analyzed as follows:

(in millions of euros except for percentage)	<b>2004</b>	<b>2003</b>	<b>2002</b>
Income (loss) before taxes, share in net income of equity affiliates, amortization of goodwill and purchased R&D	862	(1,151)	(4,050)
Average income tax rate	29.04%	32.85%	35.6%
Expected tax (charge) benefit	(250)	378	1,442
Impact of:			
- reduced taxation of certain revenues*	-	4	5
- utilization of/(unrecognized) tax loss carry forwards and other temporary differences	(12)	(575)	(1,903)
- tax credits	35	(3)	25
- other permanent differences	218	114	450
<b>Actual income tax (charge) benefit</b>	<b>(9)</b>	<b>(82)</b>	<b>19</b>
<b>Effective tax rate</b>	<b>1.04%</b>	<b>7.1%</b>	<b>0.5%</b>

\* 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)	<b>2004</b>	<b>2003</b>	<b>2002</b>
Other accounts receivable			
- deferred tax assets recognizable	6,125	6,317	6,284
- deferred tax assets not recognized	(4,473)	(4,306)	(4,128)
<b>Total*</b>	<b>1,652</b>	<b>2,011</b>	<b>2,156</b>
Other payables			
- deferred tax liabilities	(80)	(70)	(112)
<b>Total*</b>	<b>(80)</b>	<b>(70)</b>	<b>(112)</b>
<b>Net deferred tax assets (liabilities)</b>	<b>1,572</b>	<b>1,941</b>	<b>2,044</b>

\* See notes 18 and 30.

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, 2004. 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 carry-forwards, accrued pension and retirement obligations and other non-tax deductible reserves.

The potential impact of the U.S. American Jobs Creation Act on the deferred tax assets carried in the United States is under investigation.

Deferred taxes that are not recognized because of their uncertain recovery amount to €4,473 million, €4,306 million, €4,128 million respectively at December 31, 2004, 2003 and 2002.

#### d) Tax losses carried forward

Total tax losses carried forward represented a potential tax saving of €4,858 million at December 31, 2004 (€4,483 million at December 31, 2003 and €4,292 million at December 31, 2002).

Tax losses carried forward expire as follows:

(in millions of euros)

<b>Years</b>	<b>Amount</b>
2005	9
2006	14
2007	124
2008	80
2009 and thereafter*	4,631
<b>Total</b>	<b>4,858</b>

\* Of which €2,900 million without delay.

## NOTE 9 - 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 2004, 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 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 convertible bonds and notes mandatorily redeemable for shares are calculated on the assumption that the bonds and 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:

<b>2004</b>	<b>Ordinary shares</b>		
	<b>Net income (loss)</b> (in millions of euros)	<b>Number of shares</b>	<b>Per share amount</b>
Basic earnings per share	281	1,349,528,158	€0.21
Stock option plans	-	14,133,029	-
Convertible bonds and notes mandatorily redeemable for shares	-	-	-
<b>Diluted earnings per share</b>	<b>281</b>	<b>1,363,661,187</b>	<b>€0.21</b>

**Ordinary shares:**

Consolidated subsidiaries of the Group owned 61,839,627 Alcatel ordinary shares and no share equivalents.

**Shares subject to future issuance:**

The number of stock options not exercised as of December 31, 2004 amounted to 150,715,229 shares. Only 14,133,029 share equivalents have been taken into account for the calculation of the diluted earnings per share, as the remaining share equivalents had an anti-dilutive effect.

Furthermore, 63,192,027 new or existing Alcatel ordinary shares, which are issuable in respect of Alcatel's convertible bonds (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.

<b>2003</b>	<b>Ordinary shares</b>		
	<b>Net income (loss)</b> (in millions of euros)	<b>Number of shares</b>	<b>Per share amount</b>
Basic earnings per share	(1,944)	1,332,364,920	€(1.46)
Stock option plans	-	-	-
Convertible bonds and notes mandatorily redeemable for shares	-	-	-
<b>Diluted earnings per share</b>	<b>(1,944)</b>	<b>1,332,364,920</b>	<b>€(1.46)</b>

**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 156,681,418 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 convertible bonds (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.

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

**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.



## NOTE 10 - GOODWILL, NET

Acquisitions (in millions of euros)	Amort. length	2004			2003			2002
		Gross value	Cumulative amortization	Net	Gross value	Cumulative amortization	Net	Net
CFA*	20	3,614	(2,631)	983	3,614	(2,451)	1,163	1,344
Telettra	20	1,703	(1,362)	341	1,703	(1,320)	383	424
"Submarine cables" activities	20	328	(147)	181	328	(131)	197	213
Alcatel Submarine Networks Tel	20	865	(735)	130	866	(722)	144	165
Alcatel Network Systems Inc	20	490	(385)	105	528	(398)	130	177
Alcatel Space	20	1,226	(401)	825	1,236	(357)	879	971
Thales	20	262	(91)	171	261	(76)	185	196
Xylan/Packet Engines	20	894	(634)	260	964	(664)	300	482
Alcatel Shanghai Bell	20	132	(16)	116	142	(7)	135	200
Spatial Wireless	20	182	--	182				
Other	5 to 20	694	(402)	292	755	(432)	323	425
<b>Total</b>		<b>10,390</b>	<b>(6,804)</b>	<b>3,586</b>	<b>10,397</b>	<b>(6,558)</b>	<b>3,839</b>	<b>4,597</b>

\* The goodwill relating to the line CFA corresponds to the buy-back of the activities of IIT Corporation's subsidiaries in the 1990s.

For 2004, the amortization charge amounted to €408 million.

In 2004, changes of gross values and amortization of goodwill were as follows:

Gross value (in millions of euros)	12/31/2003	Acquisitions	Disposals	Other movements	12/31/2004
CFA	3,614	-	-	-	3,614
Telettra	1,703	-	-	-	1,703
"Submarine cables" activities	328	-	-	-	328
Alcatel Submarine Networks Tel	866	-	-	(1)	865
Alcatel Network Systems Inc	528	-	-	(38)	490
Alcatel Space	1,236	-	-	(10)	1,226
Thales	261	-	-	1	262
Xylan/Packet Engines	964	-	-	(70)	894
Alcatel Shanghai Bell	142	-	-	(10)	132
Spatial Wireless	-	200	-	(18)	182
Other	755	45	(27)	(79)	694
<b>Total</b>	<b>10,397</b>	<b>245</b>	<b>(27)</b>	<b>(225)</b>	<b>10,390</b>

Other changes correspond primarily to exchange rate fluctuations and to the removal of Avanex and Saft Power Systems from the consolidated companies (see note 2).

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 (€132 million at December 31, 2004 due to changes in the exchange rate).

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). As a result

of the changeover to International Financial Reporting Standards in 2005, this method of accounting has been abandoned as from January 1, 2004, since it is not in compliance with the IFRS 3 reporting standard. Details of the last acquisitions completed and accounted for by this method are given below.

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.

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 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.

Other than TiMetra, the pooling of interests method of accounting for stock-for-stock business combinations (art. 215) was also applied to the acquisitions of Astral Point, Telera, DSC, Genesys and Newbridge.

The acquisition of Spatial Wireless during the third quarter 2004 was financed by a capital increase of €212 million. This business combination was accounted for using the purchase method. Allocation of the cost of the combination resulted in recording €71 million of intangible assets (acquired technologies, customer contractual relationships...) and goodwill of €200 million.

<b>Amortization</b> (in millions of euros)	<b>12/31/2003</b>	<b>2004</b> <b>Appropriation</b>	<b>Exceptional</b> <b>amortization</b>	<b>Changes in</b> <b>consolidated</b> <b>companies</b>	<b>Other</b> <b>movements</b>	<b>12/31/2004</b>
CFA	2,451	180	-	-		2,631
Telettra	1,320	42	-	-		1,362
"Submarine cables" activities	131	16	-	-		147
Alcatel Submarine Networks Tel	722	15	-	-	(2)	735
Alcatel Network Systems Inc	398	18	-	-	(31)	385
Alcatel Space	357	55	-	-	(11)	401
Thales	76	13	-	-	2	91
Xylan/Packet Engines	664	20	-	-	(50)	634
Alcatel Shanghai Bell	7	11	-	-	(2)	16
Spatial Wireless	-	-	-	-	-	-
Other	432	38	-	(19)	(49)	402
<b>Total</b>	<b>6,558</b>	<b>408</b>	<b>-</b>	<b>(19)</b>	<b>(143)</b>	<b>6,804</b>

Other changes correspond primarily to exchange rate fluctuations and to the removal of Avanex and Saft Power Systems from the consolidated companies (see note 2).

The method applied for the goodwill impairment tests performed in 2004, 2003 and 2002 is described in note 1f.

## NOTE 11 - OTHER INTANGIBLE ASSETS, NET

### a) Changes in other intangible assets

(in millions of euros)	Gross value		
	Software	Other	Total
<b>December 31, 2001</b>	<b>962</b>	<b>296</b>	<b>1,258</b>
Additions	144	6	150
Disposals	(112)	(18)	(130)
Write-offs	(57)	(1)	(58)
Other movements	(308)	(32)	(340)
<b>December 31, 2002</b>	<b>629</b>	<b>251</b>	<b>880</b>
Additions	104	7	111
Disposals	(128)	(25)	(153)
Write-offs	-	-	-
Other movements	(24)	(51)	(75)
<b>December 31, 2003</b>	<b>581</b>	<b>182</b>	<b>763</b>
Additions	148	4	152
Disposals	(21)	(1)	(22)
Write-offs	-	-	-
Other movements	(37)	110*	73
<b>December 31, 2004</b>	<b>671</b>	<b>295</b>	<b>966</b>

\* Other changes relate primarily to other intangible assets acquired with business combinations.

### b) Changes in accumulated amortization of other intangible assets

(in millions of euros)	Accumulated amortization		
	Software	Other	Total
<b>December 31, 2001</b>	<b>564</b>	<b>222</b>	<b>786</b>
Amortization charge	192	31	223
Write-backs	(108)	(18)	(126)
Write-offs and exceptional amortization charges	(12)	8	(4)
Other movements	(281)	(30)	(311)
<b>December 31, 2002</b>	<b>355</b>	<b>213</b>	<b>568</b>
Amortization charge	111	16	127
Write-backs	(127)	(23)	(150)
Write-offs and exceptional amortization charges	-	-	-
Other movements	(16)	(50)	(66)
<b>December 31, 2003</b>	<b>323</b>	<b>156</b>	<b>479</b>
Amortization charge	118	9	127
Write-backs	(21)	(1)	(22)
Write-offs and exceptional amortization charges	-	18	18
Other movements	(33)	-	(33)
<b>December 31, 2004</b>	<b>387</b>	<b>182</b>	<b>569</b>

### c) Changes in other intangible assets, net

(In millions of euros)	Net value		Total
	Software	Other	
<b>December 31, 2001</b>	<b>398</b>	<b>74</b>	<b>472</b>
Additions	144	6	150
Net impact of disposals	(4)	-	(4)
Amortization charge	(192)	(31)	(223)
Write-offs and exceptional amortization charges	(45)	(9)	(54)
Other movements	(27)	(2)	(29)
<b>December 31, 2002</b>	<b>274</b>	<b>38</b>	<b>312</b>
Additions	104	7	111
Net impact of disposals	(1)	(2)	(3)
Amortization charge	(111)	(16)	(127)
Write-offs and exceptional amortization charges	-	-	-
Other movements	(8)	(1)	(9)
<b>December 31, 2003</b>	<b>258</b>	<b>26</b>	<b>284</b>
Additions	148	4	152
Net impact of disposals	-	-	-
Amortization charge	(118)	(9)	(127)
Write-offs and exceptional amortization charges	-	(18)	(18)
Other movements	(4)	110	106
<b>December 31, 2004</b>	<b>284</b>	<b>113</b>	<b>397</b>

## NOTE 12 - PROPERTY, PLANT AND EQUIPMENT, NET

### a) Changes in property, plant and equipment, gross

(in millions of euros)	Gross value				Total
	Land	Buildings	Plant, equipment and tools	Other	
<b>December 31, 2001</b>	<b>189</b>	<b>2,237</b>	<b>5,618</b>	<b>1,654</b>	<b>9,698</b>
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)
<b>December 31, 2002</b>	<b>173</b>	<b>2,113</b>	<b>4,803</b>	<b>1,147</b>	<b>8,236</b>
Additions	-	9	86	47	142
Disposals	(19)	(229)	(743)	(101)	(1,092)
Write-offs	-	(2)	(26)	-	(28)
Other changes	3	(100)	(532)	(312)	(941)
<b>December 31, 2003</b>	<b>157</b>	<b>1,791</b>	<b>3,588</b>	<b>781</b>	<b>6,317</b>
Additions	-	12	134	80	226
Disposals	(14)	(171)	(413)	(69)	(667)
Write-offs	-	(1)	(7)	(5)	(13)
Other changes	(18)	(302)	(555)	(139)	(1,014)
<b>December 31, 2004</b>	<b>125</b>	<b>1,329</b>	<b>2,747</b>	<b>648</b>	<b>4,849</b>

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

	Accumulated depreciation				
	Land	Buildings	Plant, equipment and tools	Other	Total
(in millions of euros)					
<b>December 31, 2001</b>	<b>11</b>	<b>1,010</b>	<b>3,615</b>	<b>860</b>	<b>5,496</b>
Depreciation charge	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)
<b>December 31, 2002</b>	<b>19</b>	<b>1,099</b>	<b>3,865</b>	<b>754</b>	<b>5,737</b>
Depreciation charge	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)
<b>December 31, 2003</b>	<b>21</b>	<b>1,125</b>	<b>3,038</b>	<b>633</b>	<b>4,817</b>
Depreciation charge	1	71	224	37	333
Write-backs	(1)	(69)	(408)	(65)	(543)
Write-offs and exceptional depreciation charges	-	(1)	(4)	(5)	(10)
Other changes	(4)	(309)	(519)	(77)	(909)
<b>December 31, 2004</b>	<b>17</b>	<b>817</b>	<b>2,331</b>	<b>523</b>	<b>3,688</b>

c) Changes in property, plant and equipment, net

	Accumulated depreciation				
	Land	Buildings	Plant, equipment and tools	Other	Total
(in millions of euros)					
<b>December 31, 2001</b>	<b>178</b>	<b>1,227</b>	<b>2,003</b>	<b>794</b>	<b>4,202</b>
Additions	8	33	168	131	340
Net impact of disposals	(10)	(65)	(84)	(97)	(256)
Depreciation charge	(2)	(111)	(572)	(102)	(787)
Write-offs and exceptional depreciation charges	(9)	(130)	(603)	(67)	(809)
Other changes	(11)	60	26	(266)	(191)
<b>December 31, 2002</b>	<b>154</b>	<b>1,014</b>	<b>938</b>	<b>393</b>	<b>2,499</b>
Additions	-	9	86	47	142
Net impact of disposals	(18)	(154)	(77)	(7)	(256)
Depreciation charge	(1)	(124)	(295)	(58)	(478)
Write-offs and exceptional depreciation charges	(3)	(75)	(153)	(6)	(237)
Other changes	4	(4)	51	(221)	(170)
<b>December 31, 2003</b>	<b>136</b>	<b>666</b>	<b>550</b>	<b>148</b>	<b>1,500</b>
Additions	-	12	134	80	226
Net impact of disposals	(13)	(102)	(5)	(4)	(124)
Depreciation charge	(1)	(71)	(224)	(37)	(333)
Write-offs and exceptional depreciation charges	-	-	(3)	-	(3)
Other changes	(14)	7	(36)	(62)	(105)
<b>December 31, 2004</b>	<b>108</b>	<b>512</b>	<b>416</b>	<b>125</b>	<b>1,161</b>

## NOTE 13 - 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		
	2004	2003	2002	2004	2003	2002
Draka Comteq <sup>(1)</sup> BV	49.9	-	-	136	-	-
TAMP <sup>(2)</sup>	45.0	-	-	32	-	-
Avanex <sup>(3)</sup>	-	26.2	-	-	33	-
Thales (formerly Thomson-CSF) <sup>(4)</sup>	9.5	9.5	9.7	134	128	129
Atlinks <sup>(5)</sup>	-	-	50.0	-	-	36
Other (less than €50 million)	-	-	-	134	124	141
<b>Total share of equity affiliates</b>				<b>436</b>	<b>285</b>	<b>306</b>
Assets, net of liabilities, of disposed of or discontinued operations <sup>(6)</sup>				18	106	-
<b>Total</b>				<b>454</b>	<b>391</b>	<b>306</b>

(1) Under the agreement, dated July 2, 2004, between Alcatel and Draka Holding BV concerning the business combination of the optical fiber and communication cable activities of the two groups, a new company Draka Comteq BV was created. Alcatel owns 49.9% of this new company, which is consolidated under the equity method as from July 1, 2004 (see note 2).

(2) Under the agreement, dated August 31, 2004, between Alcatel and TCL Communication Technology Holdings Limited concerning the creation of a new joint venture for mobile handsets, a new company was created. Alcatel owns 45% of this company, which is consolidated under the equity method as from September 1, 2004 (see note 2).

(3) Under the agreement, dated July 31, 2003, between Alcatel and Avanex, providing for the disposal of Alcatel's optical components business, Alcatel received 28% of the capital of Avanex in consideration for the assets contributed (see note 2). As a result of capital increases made by Avanex since July 31, 2003, Alcatel's stake fell to 26.2% at December 31, 2003. With the partial disposal by Alcatel in December 2004 of its investment, and Alcatel's loss of significant influence over this company, the remaining investment of 19.7% is no longer consolidated under the equity method.

(4) Further to prior disposals, 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, 2004, Alcatel's stake was 9.5% (12.8% in voting rights).

(5) Alcatel's interest in Atlinks was sold to Thomson in February 2003 (see note 2).

(6) Relates to disposal in progress of Saft Power Systems at December 31, 2004 and of Saft at December 31, 2003 (see note 2).

### b) Information on equity affiliates

Summarized financial information for Thales at December 31:

(in millions of euros)	2004*	2003	2002
<b>Balance sheet data</b>			
Non-current assets		4,276	4,680
Current assets		14,075	13,529
<b>Total assets</b>		<b>18,351</b>	<b>18,209</b>
Shareholders' equity		2,014	2,139
Minority interests		43	29
Financial debt		2,131	2,376
Reserves and other liabilities		14,163	13,665
<b>Total liabilities and shareholders' equity</b>		<b>18,351</b>	<b>18,209</b>
<b>Income statement data</b>			
Net sales		10,569	11,105
Income from operations		497	447
<b>Net income (loss)</b>		<b>112</b>	<b>111</b>

\* The 2004 figures had not been published when Alcatel's accounts were approved by its Board of Directors.

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

(in millions of euros)	2004	2003	2002
Total assets	1,303	712	607
Shareholders' equity	689	336	151
Net sales	712	396	295
Net income (loss)	(103)	(91)	(70)

## NOTE 14 - OTHER INVESTMENTS AND MISCELLANEOUS, NET

(in millions of euros)	2004			2003	2002
	At cost	Provision	Net value	Net value	Net value
Investments in:					
listed companies*	271	(237)	34	1	22
unlisted companies	326	(184)	142	209	245
<b>Total</b>	<b>597</b>	<b>(421)</b>	<b>176</b>	<b>210</b>	<b>267</b>
Electro Banque/Customer loans and advances**	105	-	105	224	176
Other***	1,133	(908)	225	388	532
<b>Total</b>	<b>1,835</b>	<b>(1,329)</b>	<b>506</b>	<b>822</b>	<b>975</b>

\* Market value 2004 : €71 million  
2003 : €8 million  
2002 : €31 million

\*\* See note 29.

\*\*\* €820 million reserve on 360 Networks bonds at December 31, 2004 (€820 million at December 31, 2003 and 2002).

Investments in listed companies at December 31, 2004:

(in percentage and millions of euros)	% interest	Net value	Market value	Shareholders' equity*	Net income (loss)*
Loral**	1.9%	0	0	(721)	(108)
Avanex**	19.7%	33	69	100	(100)
Other (less than €10 million of net value)		1	2		
<b>Total</b>		<b>34</b>	<b>71</b>		

\* Data set forth are at September 30, 2004 for shareholders' equity and for net income (loss) (nine months from January 1 to September 30, 2004), because financial data at December 31, 2004 were not published at the closing date of Alcatel's financial statements.

\*\* Data set forth are at September 30, 2004 for shareholders' equity and at June 30, 2004 for net income (loss) (12 months from July 1, 2003 to June 30, 2004), because financial data at December 31, 2004 were not available at the date of publication of Alcatel's financial statements.

## NOTE 15 - OPERATING WORKING CAPITAL

(in millions of euros)	12/31/2003	Cash flow	Change in consolidated companies	Translation adjustments and other	12/31/2004
Inventories and work in progress, net	2,410	154	(103)	(439)	2,022
Receivables and related accounts, net*	3,800	231	(180)	(47)	3,804
Advances and progress payments, net	106	(8)	(6)	(3)	89
Advances and customer deposits	(1,181)	127	1	(111)	(1,164)
Accounts payable and accrued expenses	(3,617)	(90)	287	60	(3,360)
<b>Operating working capital requirement - gross</b>	<b>1,518</b>	<b>414</b>	<b>(1)</b>	<b>(540)</b>	<b>1,391</b>
Valuation allowance	(1,414)		51	584	(779)
<b>Operating working capital requirement - net</b>	<b>104</b>	<b>414</b>	<b>50</b>	<b>44</b>	<b>612</b>

\* Customer receivables sold without recourse amounted to €861 million at December 31, 2004 (€898 million at December 31, 2003 and €1,010 million at December 31, 2002).

## NOTE 16 - INVENTORIES AND WORK IN PROGRESS, NET

(in millions of euros)	2004	2003	2002
Raw materials and goods	501	620	1,181
Industrial work in progress	522	589	696
Work in progress on long-term contracts	354	221	397
Finished products	645	980	1,449
<b>Gross value</b>	<b>2,022</b>	<b>2,410</b>	<b>3,723</b>
<b>Valuation allowance</b>	<b>(495)</b>	<b>(978)</b>	<b>(1,394)</b>
<b>Net value</b>	<b>1,527</b>	<b>1,432</b>	<b>2,329</b>

## NOTE 17 - TRADE RECEIVABLES AND RELATED ACCOUNTS, NET

(in millions of euros)	2004	2003	2002
Receivables on long-term contracts	965	744	1,268
Receivables bearing interest	155	198	462
Other trade receivables	2,684	2,858	4,078
<b>Gross value</b>	<b>3,804</b>	<b>3,800</b>	<b>5,808</b>
<b>Valuation allowance</b>	<b>(284)</b>	<b>(436)</b>	<b>(1,092)</b>
<b>Net value</b>	<b>3,520</b>	<b>3,364</b>	<b>4,716</b>

## NOTE 18 - OTHER ACCOUNTS RECEIVABLE, NET

(in millions of euros)	2004	2003	2002
Advances and progress payments	89	107	147
Prepaid taxes	324	257	351
Deferred taxes	1,652	2,011	2,156
Prepaid expenses	158	234	236
Advances made to employees	30	31	21
Other accounts	576	626	1,162
<b>Gross value</b>	<b>2,829</b>	<b>3,266</b>	<b>4,073</b>
<b>Valuation allowance</b>	<b>(54)</b>	<b>(35)</b>	<b>(36)</b>
<b>Net value</b>	<b>2,775</b>	<b>3,231</b>	<b>4,037</b>

## NOTE 19 - 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 €2,287 million at December 31, 2004, €1,590 million at December 31, 2003 and €675 million at December 31, 2002.

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 Nexans.

The market value of the remaining interest in Nexans was €101 million at December 31, 2004 (€92 million at December 31, 2003 and €55 million at December 31, 2002).

## NOTE 20 - ALLOCATION OF 2004 RESULT

The Board of Directors will propose to the Shareholders' Ordinary Annual General Meeting not to distribute any dividend for the year ended December 31, 2004 (distributions for previous years: no dividends were distributed for 2003 and 2002).



## NOTE 21 - SHAREHOLDERS' EQUITY

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

Under a capital increase program 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 the one-year period from July 1, 2004 until July 1, 2005 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, 2004, the capital stock consisted of 1,305,455,461 ordinary shares of nominal value €2 (1,284,410,024 Class A shares of nominal value €2 at December 31, 2003 and 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).

During 2004, increases in capital stock and additional paid-in capital amounted to €238 million. These increases related to the following actions:

- issuance of 1,508,728 shares for €9.9 million, as a result of the exercise of 1,508,728 options (including additional paid-in capital of €6.9 million);
- ORANE redemption of 3,212 notes issued in 2002 and redeemable for new or existing Alcatel shares, generating a capital increase of €0.02 million, including additional paid-in capital of €0.01 million;
- acquisition of Spatial Wireless in December 2004, which resulted in the issuance of 17,390,262 shares for €207.2 million (including additional paid-in capital of €172.4 million); in addition, of the 1,598,072 bonds redeemable for Alcatel shares issued in this transaction by Coralec (a subsidiary of Alcatel) at the price of €11.912 to cover the exercise of options and warrants, 393,035 bonds were redeemed by the issuance of an equal number of Alcatel shares, generating a capital increase of €4.7 million, including additional paid-in capital of €3.9 million; and
- redemption of 300,000, 400,000, 50,000 and 1,000,000 bonds redeemable for Alcatel shares to cover option exercises, warrant exercises and note conversions issued in connection with the acquisitions of Astral Point in 2002, Telera in 2002, iMagic TV in 2003 and TiMetra in 2003, generating capital increases of €4.9 million, €2.1 million, €0.4 million and €8.1 million, including additional paid-in capital of €4.3 million, €1.3 million, €0.3 million and €6.1 million, respectively.

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

- issuance of 108,632 shares for €0.8 million, as a result of 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 to cover the exercise of options and warrants, 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 to cover options and warrant exercises in connection with 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.
- redemption of 1,828 notes issued in 2002 and redeemable for new or existing Alcatel shares, generating a capital increase of €0.009 million, including additional paid-in capital of €0.006 million.

### c) Stock options

At December 31, 2004, 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	07/01/03	12/13/03	12/13/01
To	12/31/03	12/31/03	12/31/04	12/31/04	12/31/05	12/31/05		04/01/05	06/30/04	12/13/05	12/13/04
								12/31/05	06/30/06	12/31/05	12/12/08
								12/31/07	06/30/06	12/31/07	12/12/08
<b>Outstanding at January 1, 1996</b>	-	-	-	-	-	-	-	-	-	-	-
Granted	9,069,500	394,000	-	-	-	-	-	-	-	-	-
Exercised	-	-	-	-	-	-	-	-	-	-	-
Forfeited	(185,000)	-	-	-	-	-	-	-	-	-	-
Expired	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 1996</b>	8,884,500	394,000	-	-	-	-	-	-	-	-	-
Granted	-	-	8,199,500	367,000	-	-	-	-	-	-	-
Exercised	-	-	-	-	-	-	-	-	-	-	-
Forfeited	(396,000)	(7,500)	(115,000)	-	-	-	-	-	-	-	-
Expired	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 1997</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 1998</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 1999</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2000</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2001</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2002</b>	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	-	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>	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
Exercised	-	-	-	-	-	-	-	-	-	-	-
Forfeited	-	-	(56,000)	(15,000)	(110,000)	(10,000)	(2,276,230)	(174,000)	(5,429,868)	(11,000)	(3,838)
Expired	(2,602,130)	(135,250)	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>	-	-	7,436,500	297,000	10,122,250	443,750	11,142,851	13,066,055	3,261,660	1,021,850	207,741

(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	07/01/04	04/02/02	04/02/02	06/15/02	09/03/02	11/15/02	12/19/02	12/19/02	01/01/05
To	03/07/05	07/01/05	04/01/09	04/01/09	06/15/05	09/03/05	11/15/05	12/19/05	12/19/05	01/01/06
	03/06/09	06/30/05			06/14/09	09/02/09	11/14/09	12/18/09	12/18/09	12/31/05
	03/06/09	06/30/06			06/14/09	09/02/09	11/14/09	12/18/09	12/18/09	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	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2001</b>	<b>36,593,428</b>	<b>274,953</b>	<b>41,800</b>	<b>2,500</b>	<b>958,060</b>	<b>138,200</b>	<b>162,000</b>	<b>27,871,925</b>	<b>565,800</b>	<b>935,660</b>
Exercised	-	-	-	-	-	-	-	-	-	-
Forfeited	(1,271,749)	(2,343)	(5,500)	-	(21,175)	(10,300)	(30,000)	(2,283,225)	(37,200)	(16,840)
Expired	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2002</b>	<b>35,321,679</b>	<b>272,610</b>	<b>36,300</b>	<b>2,500</b>	<b>936,885</b>	<b>127,900</b>	<b>132,000</b>	<b>25,588,700</b>	<b>528,600</b>	<b>918,820</b>
Exercised	-	-	-	-	-	-	-	-	(64,444)	-
Forfeited	(6,345,632)	(150)	(24,050)	-	(119,780)	(13,050)	(23,000)	(2,517,719)	(68,750)	(23,950)
Expired	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>	<b>28,976,047</b>	<b>272,460</b>	<b>12,250</b>	<b>2,500</b>	<b>817,105</b>	<b>114,850</b>	<b>109,000</b>	<b>23,070,981</b>	<b>395,406</b>	<b>894,870</b>
Exercised	-	-	-	-	-	-	(3,000)	-	(44,474)	-
Forfeited	(1,047,721)	(240)	-	-	(33,484)	(8,800)	-	(2,539,840)	(11,426)	(240)
Expired	-	-	-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>	<b>27,928,326</b>	<b>272,220</b>	<b>12,250</b>	<b>2,500</b>	<b>783,621</b>	<b>106,050</b>	<b>106,000</b>	<b>20,531,141</b>	<b>339,506</b>	<b>894,630</b>

(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	04/02/03	05/13/03	06/03/03	09/02/03	10/07/03	11/14/03	12/02/03
To			02/15/06	05/13/06	06/03/06	09/02/06	10/07/06	11/14/06	12/02/06	
			02/14/10	04/01/10	05/12/10	06/02/10	06/01/10	10/06/10	11/13/10	12/01/10
			05/14/10		05/12/10	06/02/10	06/01/10	10/06/10	11/13/10	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			-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2002</b>			<b>109,370</b>	<b>54,750</b>	<b>54,300</b>	<b>263,340</b>	<b>1,116,800</b>	<b>30,500</b>	<b>111,750</b>	<b>54,050</b>
Exercised			-	-	-	-	(32,182)	(853)	(3,375)	-
Forfeited			(20,425)	(13,000)	(5,250)	(14,090)	(165,232)	(9,138)	(4,250)	(10,250)
Expired			-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2003</b>			<b>88,945</b>	<b>41,750</b>	<b>49,050</b>	<b>249,250</b>	<b>919,386</b>	<b>20,509</b>	<b>104,125</b>	<b>43,800</b>
Exercised			-	-	-	-	(204,147)	(3,165)	(20,807)	(2,915)
Forfeited			(5,578)	(6,000)	(4,469)	(5,771)	(60,849)	(3,885)	(7,325)	(2,647)
Expired			-	-	-	-	-	-	-	-
<b>Outstanding at December 31, 2004</b>			<b>83,367</b>	<b>35,750</b>	<b>44,581</b>	<b>243,479</b>	<b>654,390</b>	<b>13,459</b>	<b>75,993</b>	<b>38,238</b>

(in number of options)

**2003 Plans**

Exercise price	€6.70	€6.70	€7.60	€8.10	€9.30	€10.90	€11.20	€11.10
Exercise period								
From	03/07/04	07/01/06	06/18/04	07/01/04	09/01/04	10/01/04	11/14/04	12/01/04
To	03/07/07	07/01/07	06/18/07	07/01/07	09/01/07	10/01/07	11/14/07	12/01/07
	03/06/11	06/30/07	06/17/11	06/30/11	08/31/11	09/30/11	11/13/11	11/30/11
	03/06/11	06/30/08	06/17/11	06/30/11	08/31/11	09/30/11	11/13/11	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
Exercised	(1,221,749)	(111)	(6,944)	(473)	(1,603)	-	-	(562)
Forfeited	(1,142,822)	(605)	(31,654)	(23,981)	(6,300)	(29,376)	(2,000)	(37,300)
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	21,671,314	809,411	299,602	29,526	141,497	71,974	61,600	163,988

(in number of options)

**2004 Plans**

Exercise price	€13.20	€13.10	€12.80	€11.70	€9.90	€9.80	€11.20	€11.90
Exercise period								
From	03/10/05	04/01/05	05/17/05	07/01/05	09/01/05	10/01/05	11/12/05	12/01/05
To	05/10/08	04/01/08	05/17/08	07/01/08	09/01/08	10/01/08	11/12/08	12/01/08
	03/09/12	03/31/12	05/16/12	06/30/12	08/31/12	09/30/12	11/11/12	11/30/12
	03/09/12	03/31/12	05/16/12	06/30/12	08/31/12	09/30/12	11/11/12	11/30/12
Granted	18,094,315	48,100	65,100	313,450	38,450	221,300	69,600	42,900
Exercised	-	-	-	-	-	-	-	-
Forfeited	(724,065)	(7,350)	(2,550)	(13,500)	-	-	-	-
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	17,370,250	40,750	62,550	299,950	38,450	221,300	69,600	42,900

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 that 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, 2004, the weighted average exercise price and the weighted average exercise period.

Company	Exercise price	Outstanding options			Exercisable options	
		Number outstanding at 12/31/2004*	Weighted remaining exercise period (years)	Weighted average exercise price	Amount exercisable at 12/31/2004	Weighted average exercise price
Packet Engines	USD 0.29-USD 0.86	14,372	2.89	0.50	14,372	0.50
Xylan	USD 0.05-USD 18.14	1,897,842	3.02	8.60	1,897,842	8.60
Internet Devices Inc	USD 0.26-USD 1.17	26,480	3.83	0.89	26,480	0.89
DSC	USD 16.57-USD 44.02	110,150	1.24	30.76	110,150	30.76
Genesys	USD 0.01-USD 41.16	3,407,778	4.26	20.70	3,407,778	20.70
Newbridge	USD 11.72-USD 52.48	389,110	0.26	42.55	389,110	42.55
Astral Point	EUR 0.29-EUR 58.71	254,395	6.33	16.83	253,363	16.84
Telera	EUR 0.43-EUR 6.36	188,605	5.23	5.23	173,042	5.13
iMagic TV	EUR 2.84-EUR 64.68	130,372	2.55	15.40	95,694	17.59
TiMetra	EUR 0.53-EUR 7.97	2,172,909	5.83	5.31	1,069,286	3.80
Spatial Wireless	EUR 0.24-EUR 9.1	1,563,396	8.97	4.48	408,532	2.92
<b>Total number of options</b>		<b>10,155,409</b>			<b>7,845,649</b>	

\* In number of Alcatel shares.

Except in the case of Astral Point, Telera, iMagic TV, TiMetra and Spatial Wireless, upon exercise, Alcatel will not issue new ADSs (or, consequently, shares); the options set forth in the above table for Packet Engines, Xylan, Internat Devices, DSC, Genesys and Newbridge entitle the holders to purchase existing ADSs held by Group subsidiaries.

The 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 Class

O shares at exercise prices ranging from €0.80 to €35.15. As part of the disposal of Alcatel's optical components business, these stock option plans were transferred to Avanex.

Only stock option plans established after November 7, 2002 and whose stock options had not yet vested as of January 1, 2005 fall within the scope of IFRS 2 (Share-based Payment), which will be applied starting January 1, 2005.

The following schedule details the options falling within the scope of IFRS:

Year	Exercise price	Exercise period		Number of options
		from	to	
2002	€4.60	11/14/03	11/13/10	45,281
		11/14/06	11/13/10	
	€5.40	12/02/03	12/01/10	19,900
		12/02/06	12/01/10	
2003	€6.70	03/07/04	03/06/11	12,079,954
		03/07/07	03/06/11	
	€7.60	06/18/04	06/17/11	184,844
		06/18/07	06/17/11	
	€8.10	07/01/04	06/30/11	19,356
		07/01/07	06/30/11	
	€9.30	09/01/04	08/31/11	98,244
		09/01/07	08/31/11	
	€10.90	10/01/04	09/30/11	56,206
10/01/07		09/30/11		
€11.20	11/14/04	11/13/11	46,375	
	11/14/07	11/13/11		
€11.10	12/01/04	11/30/11	131,288	
	12/01/07	11/30/11		
	€0.53 - €7.97		1,011,892	
2004	€13.20	03/10/05	03/09/12	17,370,250
		05/10/08	03/09/12	
	€13.10	04/01/05	03/31/12	40,750
		04/01/08	03/31/12	
	€12.80	05/17/05	05/16/12	62,550
		05/17/08	05/16/12	
	€11.70	07/01/05	06/30/12	299,950
		07/01/08	06/30/12	
	€9.90	09/01/05	08/31/12	38,450
09/01/08		08/31/12		
€9.80	10/01/05	09/30/12	221,300	
	10/01/08	09/30/12		
€11.20	11/12/05	11/11/12	69,600	
	11/12/08	11/11/12		
€11.90	12/01/05	11/30/12	42,900	
	12/01/08	11/30/12		
	€0.24 - €9.1		1,563,396	
<b>Total</b>				<b>33,402,486</b>

#### 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, 2004, Alcatel, the parent company, had distributable retained earnings of €1,868 million. Distributable retained earnings were €1,873 million at December 31, 2003 and €0 million at December 31, 2002.

#### e) Treasury stock

Alcatel has established a buy-back program for the ordinary shares, authorized at the shareholders' ordinary annual gen-

eral meetings held on April 18, 2002, April 17, 2003 and June 4, 2004, 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, 2004 (no shares had been purchased as of December 31, 2003 and 2002).

Alcatel shares owned by Group consolidated subsidiaries, which amounted to €1,605 million at December 31, 2004 (€1,728 million at December 31, 2003 and €1,734 million at December 31, 2002), are deducted at cost from retained earnings.

### NOTE 22 - MINORITY INTERESTS

(in millions of euros)

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
Other changes**	(53)
Minority interests in 2004 income	66
Balance at December 31, 2004	376

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

\*\* This amount relates to translation adjustments and to the distribution of dividends.

### NOTE 23 - OTHER EQUITY

On December 19, 2002, Alcatel issued 120,786,517 notes, of nominal value €5.34 each, mandatorily redeemable for new or existing shares (ORANE) (one share for one note), 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 note.

Interest due on the ORANEs for 2004 was €44 million.

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 2004, 3,660 notes were repaid by issuance of 3,212 shares. In 2003, 2,338 notes were repaid by issuance of 1,828 shares. The difference in the amount of notes and shares corresponds to the reimbursement of pre-paid interest by the noteholders.

### NOTE 24 - 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 (securities, bonds, insurance contracts or other types of dedicated investments).

#### (1) 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. State plans are considered to be defined contribution plans.

### (2) 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.

### (3) 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, projection of future salary levels and revaluation of future benefits. Future estimated benefits are discounted using discount rates appropriate to each country.

These plans have differing characteristics:

- perpetual annuity: the retirees benefit from the receipt of a pension during 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: These plans are to be found primarily in France, Belgium and Italy.
- post-employment medical care during retirement: in the United States, Alcatel contributes to plans that reimburse medical expenses of certain retired employees.

### a) Post-employment benefits and retirement indemnities

Post-employment benefits are determined in accordance with the accounting principles presented in note 1i).

For retirement plans, actuarial gains and losses are recognized as income or expense in accordance with the 'corridor' method (net cumulative actuarial gains and losses exceeding the greater of 10% of the present value of the defined benefit obligations and 10% of the fair value of the plan assets are amortized as income or expense over the expected average remaining working lives of the employees participating in those plans).

For plans reimbursing medical expenses, the actuarial gains and losses are amortized as income or expense over the average remaining working lives of the employees participating in those plans.

To determine actuarial valuations, 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 2004, 2003 and 2002 are as follows (the rates indicated are weighted average rates):

	2004	2003	2002
Discount rate	4.46%	4.81%	5.75%
Future salary increases	3.52%	3.55%	3.72%
Expected long-term return on assets	4.70%	4.50%	4.47%
Post-retirement cost trend rate	5.00%	NA	NA
Average residual active life	15-27 years	15-27 years	15-27 years
Amortization period of transition obligation	NA	15 years	15 years

The above rates are broken down by geographical segment as follows for 2004, 2003 and 2002:

	<b>Discount rate</b>	<b>Future salary increases</b>	<b>Expected long-term return on assets</b>
<b>2004</b>			
France	4.32%	2.82%	4.73%
Belgium	4.30%	5.98%	4.00%
United Kingdom	5.25%	4.50%	6.50%
Germany	4.31%	2.75%	4.50%
Rest of Europe	3.96%	2.55%	4.68%
North America	5.27%	4.76%	5.37%
Other	5.03%	4.16%	3.37%
<b>2003</b>			
France	4.30%	2.25%	3.42%
Belgium	4.80%	7.00%	1.50%
United Kingdom	5.30%	2.60%	6.50%
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%
<b>2002</b>			
France	5.50%	2.57%	5.00%
Belgium	6.00%	7.00%	1.50%
United Kingdom	5.50%	3.75%	6.00%
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 yields on high quality bonds (government and prime-rated corporations) 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 of post-employment benefit plans are:

(in millions of euros)	<b>2004</b>	<b>2003</b>	<b>2002</b>
Service cost	72	96	138
Interest cost	146	153	180
Expected return on plan assets	(96)	(95)	(110)
Amortization of transition obligation	-	(2)	(2)
Amortization of prior service cost	-	5	5
Amortization of recognized actuarial gain/(loss)	(5)	(19)	(11)
Effect of curtailments	(15)	(55)	(35)
Effect of settlements	-	23	23
Special termination benefits	-	1	(1)
Effect of adjustment on net asset	2	NA	NA
<b>Net periodic benefit cost</b>	<b>104</b>	<b>107</b>	<b>187</b>
Of which operating expense	54	37	117
finance cost	50	70	70



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

(in millions of euros)	<b>Post-employment benefit obligations</b>		
	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>CHANGE IN BENEFIT OBLIGATION</b>			
<b>Benefit obligation at beginning of year</b>	<b>3,282</b>	<b>3,270</b>	<b>3,305</b>
Service cost	72	96	138
Interest cost	146	153	180
Plan participants' contributions	4	5	8
Amendments	(29)	23	101
Business combinations	-	-	1
Disposals	(72)	(36)	(157)
Curtailments	(14)	(73)	(73)
Settlements	(19)	(65)	(44)
Special termination benefits	0	1	(1)
Actuarial loss/(gain)	41	211	139
Benefits paid	(166)	(186)	(250)
Other (foreign currency translation)	(18)	(117)	(77)
<b>Benefit obligation at end of year</b>	<b>3,227</b>	<b>3,282</b>	<b>3,270</b>
Benefit obligation excluding effect of future salary increases	2,886	2,825	2,852
Effect of future salary increases	341	457	418
<b>Benefit obligation</b>	<b>3,227</b>	<b>3,282</b>	<b>3,270</b>
Of which retirement plans	3,210	3,282	3,270
Of which post-employment medical care plans	17	-	-
<b>CHANGE IN PLAN ASSETS</b>			
<b>Fair value of plan assets at beginning of year</b>	<b>2,050</b>	<b>2,137</b>	<b>2,281</b>
Actual return on plan assets	143	91	(36)
Employers' contributions	84	68	103
Plan participants' contributions	4	5	8
Amendments	(56)	4	78
Business combinations	-	-	19
Disposals	(10)	(5)	(71)
Curtailments	-	(3)	-
Settlements	(15)	(61)	(83)
Benefits paid / Special termination benefits	(108)	(108)	(129)
Other (foreign currency translation)	(8)	(78)	(33)
<b>Fair value of plan assets at end of year</b>	<b>2,084</b>	<b>2,050</b>	<b>2,137</b>
Present value of defined benefit obligations that are wholly or partly funded	(3,110)	(3,120)	(3,103)
Fair value of plan assets	2,084	2,050	2,137
<b>Funded status of defined benefit obligations that are wholly or fully funded</b>	<b>(1,026)</b>	<b>(1,070)</b>	<b>(966)</b>
Present value of defined benefit obligations that are wholly unfunded	(117)	(162)	(167)
<b>Funded status</b>	<b>(1,143)</b>	<b>(1,232)</b>	<b>(1,133)</b>
Unrecognized actuarial loss/(gain)	16	162	45
Unrecognized transition obligation	-	(3)	2
Unrecognized prior service cost	-	63	70
Unrecognized surplus (due to application of asset ceiling)	(17)	-	-
<b>NET AMOUNT RECOGNIZED</b>	<b>(1,144)</b>	<b>(1,010)</b>	<b>(1,016)</b>

The unfunded status, which amounted to €1,143 million at December 31, 2004 (€1,232 million at December 31, 2003 and €1,133 million at December 31, 2002), 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	Marketable securities	Property assets	Total
2002	952 45%	597 28%	390 18%	198 9%	2,137 100%
2003	845 41%	546 27%	372 18%	287 14%	2,050 100%
2004	844 40%	555 27%	373 18%	312 15%	2,084 100%

The investment policy relating to plan assets within the Group depends upon local practices. In all cases, the proportion of equity securities cannot exceed 80% of plan assets and no individual equity security may represent more than 5% of total equity securities within the plan. The equity securities 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) Impact of first-time application of the CNC's 2003-R.01 recommendation

Starting January 1, 2004, Alcatel decided to apply the Conseil National de la Comptabilité (CNC)'s recommendation 2003-R.01 relating to standards of accounting for, and measurement of, employee retirement and other similar benefits, in order to anticipate application of the accounting principles set forth in IAS 19 (Employee Benefits).

The impact of the first-time application of the CNC's recommendation 2003-R01 resulted in a decrease in shareholders' equity of €209 million, analyzed as follows:

(in millions of euros)

- Recognition in shareholders' equity of unrecognized amounts at December 31, 2003 (unrecognized actuarial gains and losses, transition obligation and prior service costs already vested)	222
- First-time accounting for post-employment medical care plans	17
- Harmonization of the Group's methods for the calculation of employee benefit obligations	(30)
<b>Total impact on Group shareholders' equity</b>	<b>209</b>

The actuarial gains and losses linked to experience adjustments and to the effects of changes in actuarial assumptions that were recorded at December 31, 2003, have been recorded in shareholders' equity in accordance with the option provided by the CNC in its press release dated July 22, 2004, in order to adopt the same accounting treatment that will be applied in the opening balance sheet in accordance with IFRS (International Financial Reporting Standards).

Actuarial gains and losses arising since January 1, 2004 have been recorded in accordance with the 'corridor' method, which consists of recording the actuarial differences as an adjustment to the defined benefit liability and amortizing them to income insofar as they exceed a certain threshold.

Applying this recommendation has resulted in:

- recording the actuarial differences at December 31, 2003, as described above, in shareholders' equity;
- harmonizing the Group's methods for calculating employee benefit obligations;
- recording provisions for post-employment benefits that had not been previously provided.

The table below presents the principal figures for 2004, 2003 and 2002 in accordance with the 2003 accounting method and, for 2004, in accordance with the new method now adopted.

(in millions of euros)	2004		2003	2002
	Former method (unaudited)	New method		
Present value of funded obligations at December 31	(3,200)	(3,227)	(3,282)	(3,270)
Fair value of plan assets at December 31	2,084	2,084	2,050	2,137
Unfunded status	(1,116)	(1,143)	(1,232)	(1,133)
Actuarial gains and losses, effect of curtailments and/or settlements, transition obligation and, for 2004 only, unrecognized surplus	239	(1)	222	117
<b>Liability recognized in the balance sheet</b>	<b>(877)</b>	<b>(1,144)</b>	<b>(1,010)</b>	<b>(1,016)</b>
<b>Expense recognized in the income statement</b>	<b>72</b>	<b>104</b>	<b>107</b>	<b>187</b>
Of which : operating expense	29	54	37	117
finance cost	43	50	70	70

## NOTE 25 - OTHER RESERVES

### a) Balance at closing

(in millions of euros)	2004	2003	2002*
Reserves for product sales	928	1,199	1,489
Reserves for restructuring	662	1,068	919
Reserves for litigation	97	76	-
Other reserves	591	706	893
<b>Total</b>	<b>2,278</b>	<b>3,049</b>	<b>3,301</b>

\* Provisions for litigation at December 31, 2002 are included in other reserves.

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

In 2003, and following the CNC's recommendation 2003-R.01, for the first time, long-service awards to employees were 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) Changes during 2004

(in millions of euros)	12/31/03	Appropriation	Utilization	Reversals	Change in consolidated companies	Other	12/31/04
Reserves for product sales	1,199	428	(337)	(299)	(68)	5	928
Reserves for restructuring	1,068	368	(606)	(64)	(67)	(37)	662
Reserves for litigation*	76	67	-	(43)	-	(3)	97
Other reserves**	706	72	(44)	(117)	10	(36)	591
<b>Total</b>	<b>3,049</b>	<b>935</b>	<b>(987)</b>	<b>(523)</b>	<b>(125)</b>	<b>(71)</b>	<b>2,278</b>
Effect on the income statement (net of expenses booked):							
- income from operations*		(505)		376			(129)
- financial income (loss)		(3)		7			4
- restructuring costs		(368)		64			(304)
- other revenue (expense)		(46)		28			(18)
- taxes**		(13)		48			35
<b>Total</b>		<b>(935)</b>		<b>523</b>			<b>(412)</b>

\* Of which, €28 million results from the reversal of a reserve made in income (loss) from operations in each of 2000 and 2001 in connection with the resolution of legal proceedings with a distributor pursuant to an arbitration award that occurred during the first half 2004.

\*\* Of which, €48 million results from the reversal of a reserve in income taxes corresponding to the change in the estimate of a provision for tax risks.

### c) Analysis of restructuring reserves

(in millions of euros)

	2004	2003	2002
Opening balance	1,068	919	1,113
Expensed during year	(606)	(980)	(1,105)
New plans and adjustments to previous estimates*	304	1,160	1,081
Effect of acquisition (disposal) of consolidated subsidiaries	(67)	(20)	(41)
Cumulative translation adjustments and other changes	(37)	(11)	(129)
<b>Closing balance</b>	<b>662</b>	<b>1,068</b>	<b>919</b>

\* In 2004, €304 million of restructuring costs related to new plans and adjustments to previous estimates (in 2003, restructuring costs amounted to €1,314 million, of which €1,160 million related to new plans and adjustments to previous estimates and €154 million related to asset write-offs).

For 2004, restructuring reserves concern primarily continuing layoffs in France, Germany and Spain.

For 2003, restructuring reserves related mainly to 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.

## NOTE 26 - FINANCIAL DEBT

On December 31, 2004, outstanding Alcatel bonds amounted to €3,764 million compared to €4,804 million a year before. This is the result of the following transactions in 2004:

(in millions of euros)		Maturing in 2004	Maturing after 2004
Tender offer to exchange bonds and issuance of new bonds	96	-	96
Buy-back of bonds from the market	(617)	(24)	(593)
Repayments	(519)	(519)	-
<b>Total repurchases, repayments and exchange</b>	<b>(1,040)</b>	<b>(543)</b>	<b>(497)</b>

### a) Analysis of debt by type

(in millions of euros)

	2004	2003	2002
Convertible bonds	1,022	1,022	-
Bonds	2,742	3,782	5,325
Bank loans and overdrafts	411	313	244
Capital lease obligations	45	57	80
Accrued interest	139	119	134
<b>Total</b>	<b>4,359</b>	<b>5,293</b>	<b>5,783</b>

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.

#### Changes in 2004:

- Offer to exchange bonds:

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%. Additional bonds having a nominal value of €50 million, which are interchangeable with the new bonds, were also issued. The total nominal value of the new and additional bonds, due 2014, amounts to €462 million. The exchange offer, which closed on April 7, 2004, was recorded in the second quarter 2004. The loss arising on the exchange offer (43 million of euros) will be amortized over the life of the bonds in accordance with the requirements of IAS 39. The amortization charge for 2004 included in financial income (loss) was €3 million.

■ Repurchases and repayments:

During 2004, certain other bonds were subject to buy-back and cancellation, amounting to €643 million and corresponding to a nominal value of €617 million, detailed as follows:

**Nominal value repurchased**

5.75% FRF due February 2004	€762,245
5% EUR due October 2004	€22,819,000
5.875% EUR due September 2005	€217,102,000
Zero-rate coupon due June 2006	€111,191,052
5.625% EUR due March 2007	€38,874,495
7% EUR due December 2006	€226,209,000

The difference between the repurchased amount and the nominal value was included in financial income (loss) in "other financial items (net)" (see note 5).

The other changes for 2004 were the repayment on February 17, 2004 of the residual €183 million on €305 million in bonds issued by Alcatel at a fixed rate of 5.75% in February 1994, and the repayment on October 12, 2004 of the residual €336.4 million in bonds issued at a rate of 5% on October 12, 1999.

**Changes in 2003**

During 2003, €987 million of bonds were repurchased and cancelled, either on the occasion of the tender offer, or as a result of selective buy-back operations.

■ 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 book building 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 (loss).

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

Repurchased bonds	Nominal value repurchased
5.75% FRF due February 2004	€72,722,746
5% EUR due October 2004	€108,912,000
5.875% EUR due 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	Nominal value repurchased
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 (loss).

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).

**b) Analysis by maturity date:**

(in millions of euros)	2004	2003
<b>Short-term financial debt</b>	<b>1,036</b>	<b>883</b>
2005	–	847
2006	598	1,308
2007	194	223
2008	9	–
2009	1,018	1,010
2010 and thereafter	1,504	1,022
<b>Long-term financial debt</b>	<b>3,323</b>	<b>4,410</b>
<b>Total</b>	<b>4,359</b>	<b>5,293</b>

### c) Debt analysis by rate

(in millions of euros)	2004		2003		2002	
	Before hedging	After hedging	Before hedging	After hedging	Before hedging	After hedging
Total fixed rate debt	4,221	905	5,100	1,297	4,927	1,800
Total floating rate debt	138	3,454	193	3,996	856	3,983
<b>Total</b>	<b>4,359</b>	<b>4,359</b>	<b>5,293</b>	<b>5,293</b>	<b>5,783</b>	<b>5,783</b>

At December 31, 2004, the weighted average interest rate of financial debt before accounting for hedging instruments was 5.18% (5.6% as of December 31, 2003).

At December 31, 2004, the weighted average interest rate of financial debt after accounting for hedging instruments was 3.72% (4% as of December 31, 2003).

### d) Debt analysis by currency

(in millions of euros)	2004		2003		2002	
	Before hedging	After hedging	Before hedging	After hedging	Before hedging	After hedging
Euro	4,265	4,265	5,143	5,161	5,597	3,530
U.S. dollar	52	52	86	86	90	2,093
Other	42	42	64	46	96	160
<b>Total</b>	<b>4,359</b>	<b>4,359</b>	<b>5,293</b>	<b>5,293</b>	<b>5,783</b>	<b>5,783</b>

### 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 the end of the year, adjusted by the Group's credit rate risk. The fair value of debt and bank overdrafts at floating interest rates approximates the net carrying amounts.

At December 31, 2004, the fair value of debt before hedging (and credit spread) amounted to €4,733 million (€5,574 million as of December 31, 2003). The fair value of the financial instruments that hedge the debt is calculated in accordance with the same method, based on the net present value of the future cash flows.

At December 31, 2004, the fair value of the debt after hedging was €4,555 million (€5,409 million as of December 31, 2003).

### f) Credit rating and financial covenant

As of January 8, 2005, Alcatel credit ratings were as follows:

Rating Agency	Long-term debt	Short-term debt	Outlook	Last update
Standard & Poor's	BB	B	Stable	November 10, 2004
Moody's	Ba3	Not Prime	Positive	September 8, 2004

In 2004, Standard and Poor's decided to revise Alcatel's long-term debt credit rating from B+ to BB-, outlook stable and Moody's revised its long-term rating from B1 to Ba3, maintaining an outlook positive.

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

Date	Standard & Poor's	Date	Moody's
November 10, 2004	BB- Outlook stable	September 8, 2004	Ba3 Outlook positive
March 10, 2004	BB- Outlook stable	May 10, 2004	B1 Outlook positive
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

#### Rating clauses affecting Alcatel debt at December 31, 2004

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 was first 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 bank credit facility

On June 21, 2004, Alcatel closed a €1,300 million 3-year multi-currency revolving credit facility. This facility replaced the undrawn €1,375 million syndicated facility maturing in April 2005 that was put in place on April 9, 2002 (for an initial amount of €2,075 million, of which €700 million matured within one year).

The availability of this syndicated credit facility of €1,300 million is not dependent upon Alcatel's credit ratings. At December 31, 2004, the credit facility had not been drawn and remained undrawn at the date of approval of the 2004 financial statements by Alcatel's Board of Directors. Alcatel's ability to draw on this facility is conditioned upon its compliance with certain financial covenants. 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 net debt. Alcatel was in compliance with these financial covenants at December 31, 2004, 2003 and 2002. As the Group had cash and cash equivalents in excess of its gross financial debt at December 31, 2004 and December 31, 2003, the above-mentioned ratios were not applicable at these dates.

#### NOTE 27 - 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 having off balance sheet risk characteristics to manage and reduce its exposure to fluctuations in interest rates and foreign exchange rates.

All of Alcatel's debt is issued in euros. Interest rate derivatives are used primarily to convert fixed rate debt into floating rate debt.

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.

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, 2004 are intended to reduce the cost of debt and to hedge interest rate risk. As of December 31, 2004 and 2003, outstanding interest rate derivatives have the following characteristics:

### a) Outstanding interest rate derivatives at December 31, 2004

– Analysis by type and maturity date

(in millions of euros)	2004			2003			
	Contract notional amounts			Total	Market value	Total	Market value
	Maturity date						
	Less than one year	1 to 5 years	After 5 years				
Interest rate swaps							
– Pay fixed rate	727	3,312	49	4,088	27	1,707	(42)
– Pay floating rate	1,190	5,547	548	7,285	149	5,563	204
Caps							
– Buy	1,482	2,247	–	3,729	13	14,606	3
– Sell	981	1,990	–	2,971	(11)	13,824	–
Floors							
– Buy	367	–	–	367	2	9,452	100
– Sell	367	–	–	367	(2)	9,452	(100)
Forward rate agreements							
– Buy	–	–	–	–	–	600	(1)
– Sell	–	–	–	–	–	600	1
Options on interest rate swaps USD Libor							
– Buy	–	–	–	–	–	871	7
– Sell	–	–	–	–	–	871	(7)
<b>Total market value</b>					<b>178</b>		<b>165</b>

### b) Interest rate sensitivity

#### Interest rate sensitivity in terms of financial cost

An immediate increase in interest rates of 1%, applied to financial assets and liabilities and related hedging instruments, would decrease interest expense by €14 million for 2004 (€15 million for 2003).

#### Interest rate sensitivity in terms of mark-to-market

An increase of 1% in the interest rate curve, applied to financial debt and related hedging instruments, would have a positive impact of €50 million on the market value of the financial debt in 2004 (€62 million in 2003).

## B - Currency risk

The financial instruments held or issued at December 31, 2004 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, 2004, off balance sheet financial instruments held to manage currency risk were as follows:

– Outstanding currency derivatives at December 31

(in millions of euros)	2004			2003			
	U.S. dollar	Pound sterling	Other	Total	Market value	Total	Market value
Buy / Lend currency							
Forward exchange contracts	784	232	706	1,722	(37)	2,146	(74)
Short-term exchange swaps	–	80	52	132	(2)	163	(6)
Cross currency swaps	–	–	0	0	0	19	(6)
Currency option contracts:							
– Buy call	634	669	103	1,406	18	2,372	140
– Sell put	460	1,174	1,019	2,653	(72)	1,388	(55)
<b>Total</b>	<b>1,878</b>	<b>2,155</b>	<b>1,880</b>	<b>5,913</b>	<b>(93)</b>	<b>6,088</b>	<b>(1)</b>



(in millions of euros)	2004					2003	
	U.S. dollar	Pound sterling	Other	Total	Market value	Total	Market value
<b>Sell / Borrow currency</b>							
Forward exchange contracts	2,204	338	382	2,924	177	3,165	235
Short-term exchange swaps	264	13	108	385	5	807	27
Cross currency swaps	-	-	-	-	-	73	27
Currency option contracts:							
- Sell call	660	629	166	1,455	(17)	2,304	(146)
- Buy put	776	1,209	1,047	3,032	86	1,917	73
<b>Total</b>	<b>3,904</b>	<b>2,189</b>	<b>1,703</b>	<b>7,796</b>	<b>251</b>	<b>8,266</b>	<b>216</b>
<b>Total market value</b>					<b>158</b>		<b>215</b>

Most of the currency derivatives entered into have a maturity of less than one year.

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

(in millions of euros)	2004		2003	
	Carrying value	Fair value	Carrying value	Fair value
<b>Assets</b>				
Marketable securities, net		2,326		1,635
Cash		2,785		4,634
<b>Liabilities</b>				
Convertible bonds		(1,022)		(1,022)
Bonds and notes issued		(2,742)		(3,782)
Other borrowings		(595)		(489)
Interest rate derivatives		0		165
<b>Cash and cash equivalents, net of financial debt</b>		<b>752</b>		<b>976</b>
Currency derivatives		0		215

The fair value of listed financial instruments is based on the quoted market price on the last trading day of the year.

Fair values of non-listed financial instruments were estimated using one or more valuation models that incorporate observable or quantifiable market information. As a result of the subjective nature and the limitations of such estimates, the values presented for non-listed financial instruments may differ from the values that could have been obtained at December 31, 2004 in the event of a sale. The fair values used were based on market conditions existing at December 31, 2004. Minor changes in assumptions concerning those market conditions could have a material effect on the estimated values.

Methods and assumptions used to estimate the fair value of gross financial debt are described in note 26 e.

For non-listed investments and cash, the carrying amount is considered as a reasonable estimate of fair value.

Fair values of currency and interest-rate derivatives were obtained by calculating the discounted value of firm or expected future cash flows, based on market conditions observed at December 31, 2004.

### 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 14).

At December 31, 2004, no transactions are in progress on Alcatel shares or on other shares held by Alcatel.

### Note 28 - Customers' deposits and advances

(in millions of euros)	2004	2003	2002
Advance payments received on long-term contracts	637	842	1,024
Other deposits and advances received from customers	527	339	458
<b>Total customers' deposits and advances</b>	<b>1,164</b>	<b>1,181</b>	<b>1,482</b>

## NOTE 29 - DEBT LINKED TO THE BANK ACTIVITY

(in millions of euros)	2004	2003	2002
Debt linked to the bank activity	105	224	246

This debt corresponds to the amount of customer loans and advances presented under the captions "Other investments" and "Other accounts receivable":

2004: "Other investments" were €105 million (note 14)

2003: "Other investments" were €224 million (note 14).

2002: "Other investments" were €176 million (note 14) and under "Other accounts receivable" were €70 million.

## NOTE 30 - OTHER PAYABLES

Analysis is as follows:

(in millions of euros)	2004	2003	2002
Accrued payables and other	825	1,330	2,354
Wages, salaries and other social payables	839	913	1,001
Accrued taxes	449	361	380
Deferred taxes	80	71	112
Dividends to be paid	4	-	-
Government grants	41	45	48
<b>Total</b>	<b>2,238</b>	<b>2,720</b>	<b>3,895</b>

## NOTE 31 - 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				Total
	Less than one year	1-3 years	4-5 years	After 5 years	
<b>Contractual cash obligations</b>					
Financial debt (excluding capital leases)	1,031	752	1,027	1,504	4,314
Capital lease obligations	5	40	-	-	45
<b>Sub-total – included in balance sheet</b>	<b>1,036</b>	<b>792</b>	<b>1,027</b>	<b>1,504</b>	<b>4,359</b>
Operating leases	104	160	118	164	546
Commitments to purchase fixed assets	28	-	-	-	28
Unconditional purchase obligations*	161	59	1	-	221
<b>Sub total – Commitments</b>	<b>293</b>	<b>219</b>	<b>119</b>	<b>164</b>	<b>795</b>

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

Rental expense (excluding capital lease rental payments) is as follows:

(in millions of euros)	2004	2003	2002
Minimum rentals	49	47	116
Indexed rentals	61	88	46
Sublease rentals	(5)	-	-
<b>Total</b>	<b>105</b>	<b>135</b>	<b>162</b>

## b) Off balance sheet commitments

Off balance sheet commitments of the Group were primarily as follows:

- certain guarantees given to the Group's customers for contract execution (performance bonds, guarantees on advances received issued by financial institutions...);
- guarantee relating to the maximum intra-day bank overdraft allowed for Group subsidiaries under the Group's cash pooling agreement with certain banks;
- guarantees given under securitization programs or on sale of receivables (see description below).

Alcatel does not rely on special purpose entities to deconsolidate these risks.

(in millions of euros)	2004	2003	2002
Guarantees given on contracts made by entities within the Group or by non-consolidated subsidiaries	1,742	2,106	2,787
Discounted notes receivable and other	5	25	14
Other contingent commitments	793	702	833
<b>Sub-total - Contingent commitments</b>	<b>2,540</b>	<b>2,833</b>	<b>3,634</b>
Debt security interests granted and other debt guarantees	156	157	262
Guarantees on cash pooling	605	652	807
<b>Total</b>	<b>3,301</b>	<b>3,642</b>	<b>4,703</b>

No material commitments are omitted from this note 31 in accordance with current accounting practice.

### Contingent commitments

(in millions of euros)	Maturity date				Total
	Less than one year	1-3 years	4-5 years	After 5 years	
<b>Contingent commitments</b>					
Guarantees on Group contracts*	1,188	197	47	52	1,484
Guarantees on third party contracts	168	70	14	6	258
Discounted notes receivable and other	3	1	-	1	5
Other contingent commitments	342	58	213	180	793
<b>Total</b>	<b>1,701</b>	<b>326</b>	<b>274</b>	<b>239</b>	<b>2,540</b>
<b>Counter guarantees received</b>	<b>301</b>	<b>87</b>	<b>12</b>	<b>4</b>	<b>404</b>
*reflected in balance sheet					478

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 34. Potential commitments linked to the inclusion in French law of the European Directive on Waste Electrical and Electronic Equipment, which will only be applicable as from August 2005, are also not included.

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 25) 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, 2004 (€3 million at December 31, 2003 and €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				Total
	Less than one year	1-3 years	4-5 years	After 5 years	
Security interests granted	6	-	-	4	10
Other guarantees given	103	4	9	30	146
<b>Total</b>	<b>109</b>	<b>4</b>	<b>9</b>	<b>34</b>	<b>156</b>
Net book value of assets given in guarantee:					
- financial assets	-	-	-	4	4
- other assets	6	-	-	-	6

#### Guarantee on cash pooling

Not included in the preceding table is a 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's accounts and the Group subsidiaries' accounts. As of December 31, 2004, this guarantee was valued at €0.6 billion (€0.7 billion as of December 31, 2003 and €0.8 billion as of December 31, 2002).

#### Other specific commitments linked to significant operations

##### > SVF trust program

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.

As Alcatel does not own any equity share in the trust, the SVF trust was not consolidated within the Group's accounts in accordance with the "Comité de la Réglementation Comptable" Regulation 99-02. However, in accordance with new financial regulations, which are applicable from the first financial accounting year beginning after August 2, 2003, the SVF trust is consolidated with the Group's accounts starting January 1, 2004.

In April 2004, as part of a reassessment of its financing requirements and credit facilities and with a view to optimizing its financial costs, Alcatel decided to cancel this securitization program. As a result, the banks no longer have any financing commitments in this respect and Alcatel bought back from the SVF trust all outstanding receivables at nominal value during the second quarter 2004. The cancellation of the program did not have a significant impact on the results and financial position of the Group.

##### > 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 2004 amounted to €10 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 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. This special purpose vehicle is fully consolidated in accordance with paragraph 10052 of the "Comité de la Réglementation Comptable" Regulation 99-02. The receivables sold at December 31, 2004, which amounted to €82 million (€54 million at December 31, 2003), are therefore maintained in the consolidated balance sheet. At December 31, 2004, 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 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 32 - 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 5.22% of the parent company's share capital.

Transactions with related parties during 2004 and 2003 were as follows:

(in millions of euros)	2004	2003
<b>Net sales of goods and services</b>		
– Non-consolidated affiliates	42	47
– Equity affiliates	11	10
<b>Cost of sales</b>		
– Non-consolidated affiliates	(67)	(29)
– Equity affiliates	(4)	(6)

Outstanding balances arising from related party transactions at December 31, 2004 and 2003 were as follows:

(in millions of euros)	2004	2003
<b>Assets:</b>		
– Non-consolidated affiliates	41	23
– Equity affiliates	14	4
– Valuation allowances	(6)	(5)
<b>Other liabilities :</b>		
– Non-consolidated affiliates	(20)	(56)
– Equity affiliates	(15)	(7)
<b>Financial debt:</b>		
– Non-consolidated affiliates	(11)	(5)
– Equity affiliates	(31)	(17)

Key management personnel being members of the Group's executive committee are listed in the Corporate Governance section of the Annual Report. In 2004, the total compensation paid to members of the executive committee was as follows:

(in millions of euros)	2004	2003
<b>Salary and benefits in kind paid</b>	11.6	7.5

(in number of options)	2004	2003
<b>Stock options granted</b>	1,355,000	1,396,256

## NOTE 33 - PAYROLL, STAFF AND STAFF TRAINING RIGHTS

### a) Payroll and staff training rights

(in millions of euros and number of hours)	2004	2003	2002
Wages and salaries (including social security/pension costs)	3,740	4,004	5,488
of which remuneration of executive officers*	11.6	7.5	7.7
Staff training rights in hours**	312,400	–	–

\* Compensation paid for the full year to the 11 members of the Senior Management as of December 31, 2004 because of their functions in Alcatel or in consolidated companies.

\*\* Cumulated number of training hours acquired by staff (French companies only) at December 31, 2004. No staff requests for training had been received at December 31, 2004.

## b) Staff

(in number of staff)

	2004	2003	2002
Fixed communications	18,446	26,502	36,104
Mobile communications	15,350	14,110	14,816
Private communications	21,367	19,282	24,314
Other	555	592	706
<b>Total</b>	<b>55,718</b>	<b>60,486</b>	<b>75,940</b>
(in number of staff)	2004	2003	2002
France	16,161	18,989	25,282
Germany	5,951	7,381	8,561
Other Western Europe	10,401	11,285	15,915
Rest of Europe	1,517	1,694	2,298
Asia Pacific	8,338	8,716	8,960
North America	8,783	9,075	10,788
Rest of world	4,567	3,346	4,136
<b>Total</b>	<b>55,718</b>	<b>60,486</b>	<b>75,940</b>
of which Executives and senior technical staff*	61%	55%	53%

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

## NOTE 34 - CONTINGENCIES

In addition to legal proceedings incidental to the conduct of its business (including employment-related collective actions in France and the US) which management believes are adequately reserved against in the financial statements or will not result in any significant costs to the Group, Alcatel is involved in the following legal proceedings:

### 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 client, France Telecom, based on an audit of production costs conducted in 1989 in the transmission division, and in 1992 in the switching division. Two settlement agreements were entered into with France Telecom, one in 1993 in relation to the transmission division, and the other in May 2004 in relation to the switching activity: in the latter it was recognized that the parties' dispute on pricing did not involve fraud by Alcatel CIT.

In April 1999, Alcatel 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. Since then, the file has been the subject of several procedural developments, including appeals relating to the closing of the investigation phase with respect to a former employee of Alcatel CIT, who has been indicted. At the end of November 2004, the investigating magistrate again declared his investigation closed, following which three other indicted defendants took new procedural steps. It is therefore unlikely that the investigating magistrate will be able to close his investigation before June 2005 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 the former Optronics division's 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. Amount of damages sought by these lawsuits has not yet been specified.

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. Alcatel filed a motion to dismiss this action on January 31, 2003 and a decision on the motion was rendered on March 4, 2005. The judge rejected a certain number of the plaintiffs' demands with prejudice. He also rejected all the remaining claims under the federal securities laws for lack of specificity in the pleadings, but with leave to file a further amended complaint.

### Costa Rica

Beginning in early October 2004, Alcatel learned that investigations had been launched in Costa Rica by the Costa Rican Attorney General and the National Congress, regarding payments alleged to have been made by a consultant on behalf of an Alcatel subsidiary to various state and local officials in Costa Rica, two political parties in Costa Rica and representatives of ICE, the state owned telephone company, in connection with the procurement by the Alcatel

subsidiary of several contracts for network equipment and services from ICE. Upon learning of these allegations, Alcatel immediately commenced and is continuing an investigation into this matter.

In Costa Rica and other countries, Alcatel retains consultants to assist it with its local operations and contracts. Alcatel's contracts with persons through whom Alcatel deals locally strictly prohibit the provision of any pecuniary or other advantage in contravention of applicable laws. In addition, Alcatel has a strict Statement of Business Practice (a copy of which is available on its web site, [www.alcatel.com](http://www.alcatel.com), under the heading Sustainable Development - Values and Charters) that imposes the highest standards of legal and ethical conduct on its employees. Alcatel rigorously enforces this Statement of Business Practice across the entire company and, when violations occur, Alcatel takes prompt and appropriate action against the persons involved.

Alcatel has terminated the employment of the president of Alcatel de Costa Rica and a vice president-Latin America of a French subsidiary. Alcatel is also in the process of pursuing criminal actions against the former president of Alcatel de Costa Rica, the local consultants and the employee of the French subsidiary based on its suspicion of their complicity in an improper payment scheme and misappropriation of funds. The contracts with the local consultants were limited to the specific projects involved and are no longer in effect or are terminated, and any payments due under those contracts have been suspended. Alcatel's internal investigation is continuing.

The United States Securities and Exchange Commission and the United States Department of Justice, who have been informed by Alcatel of this affair, are conducting an inquiry into the allegations, the results of which are unknown at present.

Several investigations have been launched in Costa Rica concerning this matter by both the Costa Rican Attorney General and the Costa Rican National Congress. On November 25, 2004, the Costa Rican Attorney General's Office commenced a civil lawsuit against Alcatel CIT to seek compensation for the pecuniary damage caused by the alleged payments described above to the people and the Treasury of Costa Rica, and for the loss of prestige suffered by the Nation of Costa Rica. On February 1, 2005, ICE commenced a lawsuit against Alcatel CIT to seek compensation for the pecuniary damage caused by the alleged payments described above to ICE and its customers, and for the tarnishment to the reputation of ICE resulting from these events. The amount of damages sought by these lawsuits has not yet been specified. Alcatel intends to defend these actions vigorously and deny any liability or wrongdoing with respect to these litigations.

Alcatel is unable to predict the outcome of these investigations and civil lawsuit and their effect on our business. If the Costa Rican authorities conclude criminal violations have occurred, Alcatel may be banned from participating on public contracts within Costa Rica for a certain period and fines or penalties may be imposed on Alcatel, in an amount which Alcatel is not able to determine at this time. Alcatel expects to generate approximately €9 million in revenue from Costa Rican contracts in 2005. Based on the amount of revenue received from these contracts, Alcatel does not believe a loss of business in Costa Rica would have a material adverse effect on Alcatel as whole. However, these events may have a negative impact on the image of its company in Latin America.

## Taiwan

Certain employees of Alcatel Taisel, a Taiwanese subsidiary of Alcatel, and Siemens Taiwan, along with a few suppliers and a legislative aide, have been the subject of an investigation by the Taipei Investigator's Office of the Ministry of Justice relating to an axle counter supply contract awarded to Alcatel Taisel by Taiwan Railways in 2003. It has been alleged that persons in Alcatel Taisel and Siemens Taiwan and subcontractors hired by them were involved in a bid rigging and payment arrangement for the Taiwan Railways contract.

Upon learning of these allegations, Alcatel immediately commenced and is continuing an investigation into this matter. Alcatel terminated the former country senior officer of Alcatel Taisel. A director of international sales and marketing development of a German subsidiary who was involved in the Taiwan Railways contract has resigned and is under ongoing investigation by the Taiwanese authorities.

On February 21, 2005, the former country senior officer of Alcatel Taisel and Alcatel Taisel were indicted for violation of the Taiwanese Government Procurement Act. If the former country senior officer is found guilty of the allegations in the indictment, Alcatel Taisel may be banned from participating in governmental contracts within Taiwan for a certain period and fines or penalties may be imposed on Alcatel, in an amount not to exceed €25,000. As a group, Alcatel expects to generate approximately €80 million in all or part of this revenue from Taiwanese contracts in 2005. Based on the amount of revenue received from these contracts, Alcatel does not believe a loss of business in Taiwan would have a material adverse effect on Alcatel as whole.

## Effect of the investigations

Alcatel reiterates that its policy is to conduct its business with transparency, and in compliance with all laws and regulations, both locally and internationally. Alcatel will fully cooperate with all governmental authorities in connection with the investigation of any violation of those laws and regulations.

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 or its income from operations. 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.

## NOTE 35 - SUBSEQUENT EVENTS

On January 28, 2005, Alcatel announced the signature of final agreement to merge its space activities with those of Finmeccanica and the creation of two joint venture companies, to which both partners will contribute their respective satellite industrial and service activities.

On March 15, 2005, Alcatel announced that it has successfully completed the amendment of its existing undrawn EURO 1.3 billion syndicated 3-year revolving credit facility to benefit from the attractive conditions prevailing in the loan market.

The amendment consisted in lengthening the maturity of the facility from June 2007 to June 2009 with a possible extension until 2011, cancelling one of the two financial covenants and reducing the cost of the facility. Alcatel decided to reduce its overall amount to EURO 1 billion.

On March 16, 2005, Alcatel announced that it has initiated the disposal of 3 476 388 Nexans shares (i.e. 15 % of the

share capital), corresponding to its entire shareholding, currently accounted for as marketable securities. The transaction

takes the form of a private placement executed via an accelerated bookbuilding process.

## NOTE 36 - MAIN CONSOLIDATED COMPANIES

Company	Country	% control	% interest	Consolidation method
<b>Alcatel** and***</b>	France			Parent company
<b>OPERATING COMPANIES*</b>				
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 CIT	France			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 Network Systems SDN BHD	Malaysia	51	51	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****	China	50	50	Full consolidation
Alcatel Space	France			Full consolidation
Alcatel Submarine Networks S.A.	France			Full consolidation
Alcatel Telecom Limited	U.K.			Full consolidation
Alcatel Telecom Nederland BV	The Netherlands			Full consolidation
Alcatel Telecom Norway A/S	Norway			Full consolidation
Alcatel Telecomunicacoes SA	Brazil			Full consolidation
Alcatel Teletas Telekomunikasyon**	Turkey	65	65	Full consolidation
Alcatel USA Inc	U.S.			Full consolidation
Alcatel Vacuum Technology	France			Full consolidation
Genesys Telecommunications Laboratories Inc	U.S.			Full consolidation
Radio Frequency Systems GmbH	Germany			Full consolidation
Radio Frequency Systems Inc	U.S.			Full consolidation
Shanghai Bell Samsung Communications	China	51	25.5	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
Draka Comteq BV	The Netherlands	49.9	49.9	Equity
TAMP (TCL & Alcatel Mobile Phones Ltd)	China	45	45	Equity

\* Percentages of control and interest equal 100% unless otherwise specified.

\*\* Publicly traded.

\*\*\* The activities of Alcatel, as the parent company, are included under the business segment "Others".

\*\*\*\* The Group owns 50% plus one share.

Company	Country	% control	% interest	Consolidation method
<b>HOLDINGS AND OTHER SEGMENT***</b>				
<b>Aerospace, defence and IT&amp;S</b>				
Thales (ex Thomson-CSF)**	France	12.8	9.5	Equity
<b>Financial Holdings</b>				
Alcatel China Investment Co. Ltd	China			Full consolidation
Alcatel Holding Canada Corp.	Canada			Full consolidation
Alcatel NV	The Netherlands			Full consolidation
Alcatel Participations	France			Full consolidation
Alcatel Participations China	France			Full consolidation
Alcatel UK Limited	U.K.			Full consolidation
Compagnie Financière Alcatel	France			Full consolidation
Coralec	France			Full consolidation
Florelec	France			Full consolidation
Lubelec	France			Full consolidation
<b>Financial Services</b>				
Electro Banque	France			Full consolidation
Electro Ré	Luxemburg			Full consolidation

\*\* Publicly traded.

\*\*\* Financial data for Alcatel, as the parent company, are included in this business segment.



## NOTE 37 - QUARTERLY INFORMATION (NOT REVIEWED)

### a) Consolidated income statements

<b>2004</b> (in millions of euros)	<b>Q1</b> <b>Restated</b>	<b>Q2</b> <b>Restated</b>	<b>Q3</b> <b>Restated</b>	<b>Q4</b>	<b>Total</b>
Net sales	2,533	2,911	3,009	3,812	12,265
Cost of sales	(1,562)	(1,755)	(1,872)	(2,501)	(7,690)
<b>Gross profit</b>	<b>971</b>	<b>1,156</b>	<b>1,137</b>	<b>1,311</b>	<b>4,575</b>
Administrative and selling expenses	(498)	(532)	(486)	(494)	(2,010)
R&D costs	(369)	(413)	(381)	(424)	(1,587)
<b>Income from operations</b>	<b>104</b>	<b>211</b>	<b>270</b>	<b>393</b>	<b>978</b>
Interest expense on notes mandatorily redeemable for shares	(11)	(11)	(11)	(11)	(44)
Financial income (loss)	(40)	(3)	(44)	(45)	(132)
Restructuring costs	(64)	(67)	(14)	(159)	(304)
Other revenue (expense)	245	32	47	40	364
<b>Income before amortization of goodwill, tax and purchased R&amp;D</b>	<b>234</b>	<b>162</b>	<b>248</b>	<b>218</b>	<b>862</b>
Income tax	16	28	(13)	(40)	(9)
Share in net income of equity affiliates and disposed of or discontinued operations	(16)	(43)	(19)	(19)	(97)
<b>Consolidated net income before amortization of goodwill and purchased R&amp;D</b>	<b>234</b>	<b>147</b>	<b>216</b>	<b>159</b>	<b>756</b>
Amortization of goodwill	(104)	(102)	(103)	(99)	(408)
Exceptional amortization of goodwill	-	-	-	-	-
Purchased R&D	(1)	-	-	-	(1)
Minority interests	5	(22)	(29)	(20)	(66)
<b>Net income</b>	<b>134</b>	<b>23</b>	<b>84</b>	<b>40</b>	<b>281</b>
<b>Ordinary shares</b>					
Basic earnings per share (in euros)	0.10	0.02	0.06	0.03	0.21
Diluted earnings per share (in euros)	0.10	0.02	0.06	0.03	0.21

Data for Q1, Q2 and Q3 have been restated to take into account the principal changes in the consolidated companies during 2004, as described in note 2. The following businesses have been restated as discontinued operations:

- disposal of the optical fiber business;
- disposal of the mobile phones business;
- disposal of Saft Power Systems business.

<b>2003 restated</b> (in millions of euros)	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>	<b>Total</b>
Net sales	2,616	2,829	2,718	3,443	11,606
Cost of sales	(1,771)	(1,898)	(1,703)	(2,242)	(7,614)
<b>Gross profit</b>	<b>845</b>	<b>931</b>	<b>1,015</b>	<b>1,201</b>	<b>3,992</b>
Administrative and selling expenses	(549)	(512)	(482)	(490)	(2,033)
R&D costs	(399)	(372)	(362)	(377)	(1,510)
<b>Income (loss) from operations</b>	<b>(103)</b>	<b>47</b>	<b>171</b>	<b>334</b>	<b>449</b>
Interest expense on notes mandatorily redeemable for shares	(12)	(12)	(11)	(12)	(47)
Financial income (loss)	(32)	(67)	(72)	(77)	(248)
Restructuring costs	(266)	(284)	(188)	(522)	(1,260)
Other revenue (expense)	214	38	(11)	7	248
<b>Income (loss) before amortization of goodwill, tax and purchased R&amp;D</b>	<b>(199)</b>	<b>(278)</b>	<b>(111)</b>	<b>(270)</b>	<b>(858)</b>
Income tax	(28)	(14)	(20)	(19)	(81)
Share in net income of equity affiliates and disposed of or discontinued operations	(87)	(286)	(48)	3	(418)
<b>Consolidated net income (loss) before amortization of goodwill and purchased R&amp;D</b>	<b>(314)</b>	<b>(578)</b>	<b>(179)</b>	<b>(286)</b>	<b>(1,357)</b>
Amortization of goodwill	(105)	(105)	(100)	(97)	(407)
Exceptional amortization of goodwill	(47)	-	-	(113)	(160)
Purchased R&D	-	-	-	-	-
Minority interests	5	8	(5)	(28)	(20)
<b>Net income (loss)</b>	<b>(461)</b>	<b>(675)</b>	<b>(284)</b>	<b>(524)</b>	<b>(1,944)</b>
<b>Ordinary shares</b>					
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)

## b) Information by segment

### 2004 restated (non reviewed)

(in millions of euros)	Q1	Q2	Q3	Q4	Total
<b>Net sales</b>					
Fixed Communications	1,086	1,303	1,209	1,533	5,131
Mobile Communications	617	714	894	1,076	3,301
Private Communications	865	929	935	1,236	3,965
Other	-	-	-	-	-
Eliminations	(35)	(35)	(29)	(33)	(132)
<b>Total</b>	<b>2,533</b>	<b>2,911</b>	<b>3,009</b>	<b>3,812</b>	<b>12,265</b>
<b>Income (loss) from operations</b>					
Fixed Communications	28	134	118	149	429
Mobile Communications	88	71	103	139	401
Private Communications	35	35	68	97	235
Others	(47)	(29)	(19)	8	(87)
<b>Total</b>	<b>104</b>	<b>211</b>	<b>270</b>	<b>393</b>	<b>978</b>

### 2003 restated

(in millions of euros)	Q1	Q2	Q3	Q4	Total
<b>Net sales</b>					
Fixed Communications	1,234	1,314	1,258	1,558	5,364
Mobile Communications	658	728	697	846	2,929
Private Communications	817	868	839	1,103	3,627
Other	3	4	4	5	16
Eliminations	(96)	(85)	(80)	(69)	(330)
<b>Total</b>	<b>2,616</b>	<b>2,829</b>	<b>2,718</b>	<b>3,443</b>	<b>11,606</b>
<b>Income (loss) from operations</b>					
Fixed Communications	(59)	8	63	143	155
Mobile Communications	40	44	107	124	315
Private Communications	(34)	21	41	95	123
Others	(50)	(26)	(40)	(28)	(144)
<b>Total</b>	<b>(103)</b>	<b>47</b>	<b>171</b>	<b>334</b>	<b>449</b>

### c) Earnings per share

Earnings per share is determined according to the method described in note 9. The following tables present a reconciliation of basic earnings per share and diluted earnings per share for Q4 2004 and Q4 2003.

Q4 2004	Ordinary shares		
	Net income (loss) (in millions of euros)	Number of shares	Per share amount
Basic earnings per share	40	1,350,765,467	€0.03
Stock option plans	-	13,579,097	-
Notes mandatorily redeemable for shares	-	-	-
<b>Diluted earnings per share</b>	<b>40</b>	<b>1,364,344,564</b>	<b>€0.03</b>

#### Ordinary shares:

Consolidated subsidiaries of the Group owned 60,624,711 Alcatel ordinary shares and no share equivalents.

#### Shares subject to future issuance:

The number of stock options not exercised as of December 31, 2004 amounted to 150,715,229 shares. Only 13,579,097 share equivalents were taken into account for the calculation of the diluted earnings per share, as the balance of share equivalents had an anti-dilutive effect.

Furthermore, 63,192,027 new or existing Alcatel ordinary shares, which are issuable in respect of Alcatel's convertible bonds (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.

Q4 2003	Ordinary shares		
	Net income (loss) (in millions of euros)	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	-	-	-
<b>Diluted earnings per share</b>	<b>(524)</b>	<b>1,342,366,503</b>	<b>€(0.39)</b>

#### 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, new or existing Alcatel shares, which are issuable in respect of Alcatel's convertible bonds (OCEANE), 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 (YEAR ENDED DECEMBER 31, 2004)

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. This report includes information specifically required by French law in all audit reports, whether qualified or not, and this is presented below the opinion on the financial statements. This information includes explanatory paragraphs discussing the auditors' assessments of certain significant accounting matters. These assessments were made for the purpose of issuing an opinion on the financial statements taken as a whole and not to provide separate assurance on individual account captions or on information taken outside of the consolidated financial statements. The report also includes information relating to the specific verification of information in the group management report.

This report [together with the statutory auditors' report addressing financial and accounting information in the Presidents' report on internal control], should be read in conjunction with, and is construed in accordance with French law and professional auditing standards applicable in France.

Dear Alcatel Shareholders,

In compliance with the assignment entrusted to us by your Shareholders' Meeting, we have audited the accompanying consolidated financial statements of the Alcatel Company for the year ended December 31, 2004.

These consolidated financial statements have been approved by the Board of Directors. Our role is to express an opinion on these financial statements based on our audit.

### I - Opinion on the financial statements

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

In our opinion, the financial statements give a true and fair view of the assets, liabilities, financial position and results of the consolidated group of companies in accordance with the accounting rules and principles applicable in France.

Without qualifying our opinion, we draw attention to the matter discussed in Notes 1 and 31 to the financial statements describing the changes, from January 1, 2004:

- in method, relating to the new consolidation rules of the "ad hoc" entities, introduced by the "Loi de Sécurité Financière" dated August 1, 2003, to in process Research and Development capitalisation, and to implementation of 2003 - R-01 CNC recommendation on accounting and evaluation principles on pensions and other long-term benefits,
- in presentation, done in the context of the project of the IFRS transition at January 1, 2005.

### II - Justification of assessments

In accordance with the requirements of article L. 225-235 of the French company Law (Code de commerce) relating to the justification of our assessments, 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 8, 10, 12, 1 f) and 1 k) of the notes to the financial statements, your company reports in the balance sheet deferred tax asset amounting to 1.652 million euros, goodwill amounting to 3.586 million euros, and fixed assets amounting to 1.161 million 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 2,278 millions euros as stated in note 25 to the financial statements. 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.

Notes 1i) and 24b) to the financial statements describe the change in method related to the implementation of 2003 - R-01 CNC recommendation on accounting and evaluation principles on pensions and other long-term benefits.

In the context of our assessment of the accounting rules and principles applied by your company, we have examined the relevance of this change and its disclosure.

The assessments were thus made in the context of the performance of our audit of the consolidated financial statements taken as a whole and therefore contributed to the formation of our unqualified audit opinion expressed in the first part of this report.

### III - Specific verification

In accordance with professional standards applicable in France, we have also verified the information given in the Group management report. We have no matters to report regarding its fair presentation and conformity with the consolidated financial statements.

Neuilly-sur-Seine, March 30, 2005

The Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES  
ERNST & YOUNG

Christian Chiarasini

# TRANSITION TO IFRS

### a. Reasons for publication

Due to Alcatel's listing in a European Union country and in accordance with CE regulation No. 1606/2002 of 19 July 2002, the company and its subsidiaries' ("the Group") 2005 consolidated accounts will be prepared in accordance with the IFRS (International Financial Reporting Standards) framework as endorsed by European Union.

The recommendation made by the CESR (Committee of European Securities Regulators) on December 30, 2003 concerning information to be submitted during the IFRS transition period advises issuers to disclose the quantifiable impact of the transition to the new accounting régime as soon as this impact has been accurately and reliably measured.

In view of the publication of the aforementioned comparative consolidated financial statements for the 2005 financial year, and in accordance with the recommendation of the AMF concerning disclosure of financial information during the transition period, Alcatel has prepared financial information for the 2004 financial year relating to IFRS transition, which begins by outlining the expected quantifiable impact of IFRS adoption on:

- the balance sheet at transition date, January 1, 2004, which is when the confirmed impact of transition will be recorded in shareholders' equity in the publication of the 2005 consolidated financial statements,
- the financial position as of December 31, 2004 and the financial performance for the 2004 financial year.

This information was examined by the Audit Committee at their meeting of March 25, 2005 and by the company auditors, whose positive opinion of the information given in this publication is stated in a special audit report which appears on Page 36 of the current document.

### b. Basis for preparation of the Group's IFRS financial information

Alcatel has based the preparation of the above-mentioned 2004 financial information quantifying the impact of IFRS transition on those IFRS standards and interpretations which it considers should be applied in the preparation of its comparative consolidated financial statements as of December 31, 2005. The bases used in the preparation of the above-mentioned 2004 financial information, as detailed in the notes to this document, are as follows:

- the versions of those IFRS standards and interpretations whose application is mandatory for the financial year ended December 31, 2005, as they are known at this date;
- those IFRS standards and interpretations whose application is mandatory after the 2005 financial year end, which the Group has elected to apply early, as authorized under IFRS first application ;
- the principles resulting from Alcatel's anticipated resolution of certain technical questions and work-in-progress currently under discussion by the IASB (International Accounting Standards Board) and the IFRIC (International Financial Reporting Interpretation Committee), which could be applicable in the publication of its consolidated financial statements for 2005 financial year;
- those options and exemptions which the group has applied and which in all likelihood it will use in the preparation of its first IFRS consolidated financial statements for the 2005 financial year.

Given the fact that the above list contains principles applied that may be subject to change before the end of the 2005 financial year, it is possible that the opening balance sheet as of January 1, 2004 here presented will differ from the one actually used as the basis for the 2005 consolidated financial statements, and that quarterly 2004 income statements and the consolidated balance sheet as of December 31, 2004 will be modified during 2005.

## > 2004 CONSOLIDATED INCOME STATEMENT – IFRS STANDARDS

(in millions of euros)	<b>2004</b>
Revenues	12,244
Cost of sales	(7,631)
<b>Gross profit</b>	<b>4,613</b>
Administrative and selling expenses	(1,944)
R&D expenses before capitalization of development expenses	(1,620)
Impact of capitalization of development expenses	132
R&D costs	(1,488)
<b>Operating profit (loss)</b>	<b>1,181</b>
Share-based payment (stock options plans)	(60)
Restructuring costs	(319)
Impairment of goodwill and other intangibles	(88)
<b>Income (loss) from operating activities</b>	<b>714</b>
Financial interests relative to the gross financial debt	(226)
Financial revenues(expenses) relative to cash, cash equivalents and marketable securities	113
Finance costs	(113)
Other financial income (expense)	18
Share in net income (losses) of equity affiliates	(57)
<b>Profit before tax, minority interests and discontinued operations</b>	<b>562</b>
Income tax expense	(37)
<b>Income (loss) from continuing operations</b>	<b>525</b>
Income (loss) from discontinued operations	144
<b>Net income (loss)</b>	<b>669</b>
Attributable to:	
– Group share	600
– Minority interests	69
<b>Net income per share, Group share (in euros):</b>	
– Basic earnings per share	0.44
– Diluted earnings per share	0.44
<b>Net income (before discontinued operations) per share, Group share (in euros):</b>	
– Basic earnings per share	0.39
– Diluted earnings per share	0.39



> 2004 CONSOLIDATED BALANCE SHEET – IFRS STANDARDS

<b>ASSETS</b> (in millions of euros)	<b>01/01/2004</b>	<b>12/31/2004</b>
Goodwill, net	3,630	3,774
Other intangible assets, net	596	720
<b>Intangible assets, net</b>	<b>4,226</b>	<b>4,494</b>
Property, plant and equipment, gross	6,092	4,674
Depreciation	(4,656)	(3,579)
<b>Property, plant and equipment, net</b>	<b>1,436</b>	<b>1,095</b>
Share in net assets of equity affiliates	501	612
Other financial assets, net	1,043	554
Deferred taxes	1,941	1,593
Other non current assets	353	333
<b>TOTAL NON CURRENT ASSETS</b>	<b>9,500</b>	<b>8,681</b>
Inventories and work in progress, net	1,204	1,273
Amounts due from customers on construction type contracts	527	708
Trade receivables and related accounts, net	2,763	2,686
Advances and progress payments	106	90
Other current assets, net	1,837	1,439
Assets held for sale or related to discontinued activities	434	196
Current incomes taxes, short-term	77	75
Marketable securities, net	273	552
Cash and cash equivalents	6,029	4,611
<b>TOTAL CURRENT ASSETS</b>	<b>13,250</b>	<b>11,630</b>
<b>TOTAL ASSETS</b>	<b>22,750</b>	<b>20,311</b>

<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> (in millions of euros)	<b>01/01/2004</b>	<b>12/31/2004</b>
Capital stock	2,810	2,852
Additional paid-in capital	8,001	8,287
Less treasury stock at cost	(1,728)	(1,605)
Deferred compensation	(35)	(66)
Fair value and other reserves	(4,862)	(4,931)
Cumulative translation adjustments	0	(148)
Net profit (loss) - Attributable to the Group	-	600
<b>Shareholders' equity - Attributable to the Group</b>	<b>4,186</b>	<b>4,989</b>
<b>Minority interests</b>	<b>383</b>	<b>379</b>
<b>TOTAL EQUITY</b>	<b>4,569</b>	<b>5,368</b>
Accrued pension and retirement obligations	1,233	1,144
Bonds and notes issued	4,090	3,180
Other long term borrowings	571	294
Deferred taxes liabilities	62	86
Other non-current liabilities	240	200
<b>TOTAL NON CURRENT LIABILITIES</b>	<b>6,196</b>	<b>4,904</b>
Provisions	2,770	2,050
Short term portion of long term borrowings	1,162	1,123
Customers' deposits and advances	1,065	973
Amounts due to customers on construction type contracts	91	112
Trade payables and related accounts	3,620	3,350
Liabilities related to discontinued activities or to a disposal group	253	106
Current income taxes liabilities, short-term	67	112
Other current liabilities	2,957	2,213
<b>TOTAL CURRENT LIABILITIES</b>	<b>11,985</b>	<b>10,039</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>22,750</b>	<b>20,311</b>

## > SUMMARY OF ACCOUNTING POLICIES

Due to Alcatel's listing in a European Union country and in accordance with CE regulation No. 1606/2002 of July 19, 2002 the company and its subsidiaries' ("the Group") 2005 consolidated accounts will be prepared in accordance with the IFRS (International Financial Reporting Standards) framework.

Since January 1, 1999, the consolidated financial statements of the Group were prepared, in accordance with French accounting principles in compliance with the "Principles and accounting methodology relative to consolidated financial statements" regulation No. 99-02 of the "Comité de la Réglementation Comptable" approved by the decree dated June 22, 1999.

The IFRS 1 regulations governing first-time adoption of IFRS have been followed by Alcatel as a first-time adopter of the standards. The procedures followed in this respect are detailed in the following notes. Reconciliation statements for 2004 consolidated profit or loss and equity at January 1, 2004 and December 31, 2004 using the new accounting framework and the previous French standards are contained in this document. IAS standards 32 and 39 on financial instruments and IFRS 5 concerning Non-current assets held for sale and discontinued operations have been applied as from January 1, 2004.

### a. Basis of preparation

The consolidated accounts have been prepared under historical cost convention, with the exception of certain categories of assets and liabilities, in accordance with the regulations stipulated in IFRS. The categories concerned are detailed in the notes which follow.

### b. Consolidation methods

Subsidiaries (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 ("investments in associates") are accounted for under the equity method. Significant influence is assumed when the Group's interest in the voting rights is greater than or equal to 20%.

All significant intra-group transactions are eliminated.

### c. Business combinations

**Regulations governing first-time adoption:** Business combinations which predate the transition date (January 1, 2004) have not been restated, as permitted by the optional exemption included in IFRS 1. No goodwill was accounted for on business combinations prior to January 1, 2004, as these were treated in accordance with section 215 "allowed alternative method". According to this method, 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 and, the difference between this value and the acquisition cost of the shares adjusted directly against shareholders' equity.

In accordance with the position taken in Bulletin n° 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 99-02 of the "Comité de la Réglementation Comptable".

**Business combinations after January 1, 2004:** These business combinations are accounted for in accordance with the purchase method. Once a control is obtained over a com-

pany, its assets, liabilities and contingent liabilities are measured at their fair value at the acquisition date. Any difference between the fair value and the carrying value is accounted for in the respective underlying asset or liability, including minority interests and not only the Group interest (entity theory). Any excess of the cost of acquisition over the Group's share in the fair value of such net assets is recognized as goodwill (see intangible and tangible assets).

The treatment of share options for companies acquired in the context of a business combination is described in note w below.

Alcatel abandoned this "allowed alternative method" for accounts prepared in accordance with French accounting principles as from January 1, 2004 in anticipation of the transition to IFRS.

### d. Translation of financial statements denominated in foreign currencies

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

Goodwill and fair value adjustments arising from the acquisition of a foreign entity are considered as assets and liabilities of that entity. They are therefore listed in the entity's functional currency and translated using the year-end exchange rate.

**Regulations governing first-time adoption:** in accordance with the option given in IFRS 1, the accumulated total of translation adjustments at the transition date has been deemed to be zero. This amount has been reversed against the consolidated reserves, to leave the amount of shareholders' equity unchanged. Translation adjustments which predate IFRS transition will therefore not be included when calculating gains or losses arising from the future disposal of consolidated or associated entities.

### e. Translation of foreign currency transactions

Foreign currency transactions are translated at the rate of exchange applicable on the transaction date. At year-end, assets and monetary liabilities are translated at the rate of exchange prevailing on that date. The resulting exchange gains and losses are recorded in the income statement in other financial income (expense).

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". Refer to note d above for information on the treatment of translation adjustments at the transition date.

In order for a currency derivative to be eligible to hedge accounting (cash flow hedge or fair value hedge), its hedging role must be defined and documented and it must be seen to be effective for the entirety of its period of use. Fair value hedges allow companies to protect themselves against the exposure to changes in fair value of their assets, liabilities or firm commitments. Cash flow hedges allow companies to protect themselves against the exposure to variability in future cash flows (e.g. revenues generated by the company's assets).

The value used for derivatives is their fair value. Changes in the fair value of derivatives are accounted for in the following way:

- Changes in the fair value of the effective hedged amount in the case of derivatives eligible to cash flow hedge accounting are accounted for in shareholders' equity. The ineffective portion is recorded in financial income (expense).
- Changes in the fair value of derivatives eligible to fair value hedge accounting are recorded in the income statement, where they offset the changes in the fair value of the hedged assets, liabilities and firm commitments.

In 2004 hedges for commercial bids were not considered eligible for hedge accounting during the bid period. The fair value variation of such instruments was therefore included in the income statement in cost of sales.

Once the contract comes into force, the commercial bid hedge expires, to be replaced by a second hedge, which is accounted for as a fair value hedge. Sales are then accounted for using the rate prevailing on the contract's coming into force date, until expiry of the contract insofar as the exchange rate hedging is effective.

## f. Research and development expenses

In accordance with IAS 38 "Intangible assets", research and development expenses are recorded as expenses in the year in which they are incurred, except for:

- development costs, which 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 intention exists to finish the project and use or sell the products created during the project.
  - a potential market for the products created during the project exists or its usefulness, in case of internal use, is demonstrated; and
  - adequate resources required for completion of the project are available.

These development costs are amortized over the estimated useful life of the concerned projects.

Specifically for software, useful life is determined 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.

Capitalized software development costs are those incurred during the programming, codification and testing phases. Costs incurred prior to this, during design and planning, product definition and product specification stages are accounted for as expenses. The amortization of capitalized development costs begins as soon as the product in question is released.

- customer design engineering costs (recoverable amounts disbursed under the terms of contracts with customers), which are included in work in progress on construction contracts.

With regard to business combinations, 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 business combinations, Alcatel may make the decision to buy technology that has not yet been commercialized rather than develop the technology internally. Decisions of this nature are based on the consideration of existing opportunities for Alcatel to stay at the forefront of rapid technological advances in the telecommunications/data networking industry.

The fair value of in-process research and development acquired in business combination 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 consideration of 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.

Capitalized research and development costs considered as assets (either generated internally and capitalized or reflected in the purchase cost of a business combination) are amortized over 3 to 7 years.

Impairment tests are carried out if need be, using the methods described in the following paragraph.

## g. Intangible and tangible assets

In accordance with IAS 16 "Property, Plant and equipment" and with IAS 38 "Intangible Assets" only items whose cost can be reliably measured and of which the future economic benefits are likely to flow to the Group are liable for recognition in the consolidated financial statements.

In accordance with IAS 36 "Impairment of assets", whenever events or changes in market conditions indicate a risk of impairment of intangible assets 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 recoverable amount, which is defined as the higher of fair value (less costs to sell) and value in use. Value in use is measured by discounting the expected future cash flows from continuing use of the asset and its ultimate disposal.

In the event that the recoverable value should be lower than the net carrying value, the difference between the two amounts is recorded as an impairment loss. Impairment of tangible or intangible assets with finite useful lives can be reversed if the recoverable value becomes higher than the net carrying value (but only to the extent that the original impairment was recorded).

### Goodwill

Upon transition to IFRS, goodwill will no longer be amortized in accordance with IFRS 3 "Business combinations". Before January 1, 2004, goodwill is amortized using the straight-line method over a period, determined on a case by case basis, not exceeding 20 years.

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 recoverable amount of each of the Group's business divisions with the business divisions' net asset carrying value (including goodwill). Such recoverable amounts are mainly determined using discounted cash flows over five years and a discounted residual value. The discount rate used for 2004 was the Group's

weighted average cost of capital of 10.8%. Management believes the assumptions used concerning sales growth and residual values are reasonable and in line with market data available for each business division. Further impairment tests are carried out in case of triggering events indicating a potential impairment.

Equity affiliate goodwill is included with investments in associates. The requirements of IAS 39 are applied to determine whether any impairment loss has to be recognized with respect to the net investment in the associate and the impairment loss is calculated according to IAS 36 regulations.

One impairment test was carried out at the IFRS transition date and another during 2004. These impairment tests resulted in the recording of a one-off impairment loss of € 30 million in 2004 for equity affiliate securities that was accounted for in share in net income (losses) of equity affiliates.

It is not permitted to reverse any goodwill impairment loss.

#### Other intangible assets

The main inclusions under intangible assets are capitalized development costs and those acquired in business combinations, such as software-related costs. These cover software for internal use, whether in-house or purchased, and mother software for externally distributed products. Intangible assets are amortized on a straight-line basis over a 3 to 7 year period. If necessary, software amortization can be tailored to suit marketing imperatives. Amortizations and impairment losses are accounted for in the income statement under cost of sales, R&D expenses or administrative and selling expenses, depending on the designation of the asset. No intangible assets are considered to have indefinite useful lives. All intangible assets, with the exception of goodwill, are amortized over their estimated useful lives.

#### Property, plant and equipment

Property, plant and equipment are valued at historical cost for the Group minus cumulated depreciation expenses and any incidental impairment. 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 finance lease arrangements or long-term rental arrangements that transfer substantially all the risks and rewards associated with the ownership of the asset to the Group or tenant are capitalized.

Residual value, if considered to be significant, is included when calculating the depreciable amount. Tangible assets are segregated into their separate components if there is a significant difference in their expected useful lives, and depreciated accordingly.

Depreciations and impairment losses are accounted for in the income statement under cost of sales, R&D expenses or administrative and selling expenses, depending on the designation of the asset.

#### h. Investments and other financial assets

In accordance with IAS 39 "Financial instruments", investments in non-consolidated companies are classified as available-for-sale and therefore measured at their fair value. The

fair value for listed securities is their market price. If a reliable fair value cannot be established, securities are valued at cost price. Fair value variations are accounted for directly in shareholders' equity. Where there is objective evidence of impairment of a financial asset (for instance in case of significant and prolonged decline of the value of the asset) an irreversible impairment provision is recorded. This provision can only be released upon the sale of the securities concerned.

Loans are measured at amortized cost. Loans may attract impairment losses if there is objective evidence of a loss in value. The impairment represented by the difference between net carrying value and recoverable value is accounted for under the income statement and can be reversed if recoverable value rises in the future.

The portfolio of non-consolidated securities and other financial assets is examined at each closing date to detect any objective evidence of impairment. Where this is the case, an impairment loss is recorded.

#### i. 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.

Net realizable value is the estimated sales revenue for a normal period of activity less the expected selling costs.

#### j. Treasury shares

Treasury shares are valued at their cost price, as a reduction of shareholders' equity. Proceeds from the sale of such securities are included under shareholders' equity and have no impact on the income statement.

#### k. Pension and retirement obligations and other employee and post-employment benefit obligations

##### Post-employment benefits:

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 therefore is made. Defined benefit plans and other long-term employee benefits are determined as follows:

- using the Projected Unit Credit Method (with projected final salary), according to which 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, rates of employee turnover and projection of future salary levels;
- the "corridor" method is applied, recognizing, over the expected average remaining working lives of the employees participating in the plan, only actuarial gains and losses in excess of the greater of 10% of the present value of the defined benefit obligation or 10% of the fair value of any plan assets.

The expense resulting from the change in net pension and other post-retirement obligations is recorded in income from opera-

tions or in financial income (expense) excluding finance cost depending upon the nature of the underlying obligation.

**Regulations governing first-time adoption:** in accordance with the option available under IFRS 1, the accumulated total of unrecognized actuarial gains and losses at the transition date has been recorded under shareholders' equity. The corridor method has therefore been applied as from January 1, 2004.

IFRS regulations and principles as set out in IAS 19 "Employee Benefits" were applied to the 2004 accounts, otherwise prepared in accordance with French accounting standards, in order to comply with Conseil National de la Comptabilité Recommendation 2003-R.01 relating to accounting and evaluation regulations for retirement obligations and similar benefits.

Certain other post-employment benefits such as life assurance or medical cover (particularly in the United States) and long-service medals, bonuses awarded to employees for long-service in French companies in particular which is accounted for under provisions, are also determined by means of an actuarial calculation similar to the one used for retirement provisions.

Despite the larger scope of IAS 19 than French accounting standards, no significant long-term employee benefits which were not already provided for came to light at the time of transition to IFRS.

The accounting treatment used for employee stock options is detailed in note 1w below.

## I. Reserves for restructuring

Reserves for restructuring costs are recognized when the restructuring programs have been finalized and approved by Group management and have been announced before the balance sheet date of the Group's financial statements, resulting in an obligating event 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 closure of facilities. Write-offs of fixed assets, inventories and other assets directly linked to restructuring measures are also accounted for in restructuring costs.

The amounts reserved for predicted severance payments made in the context of restructuring programs are valued at their present value in cases where the settlement date is beyond the normal operating cycle of the company and the time value of money is deemed to be significant.

The impact of the passage of time is included in financing costs.

## m. Financial liabilities – compound instruments

Some financial instruments consist of a liability and equity component. This is the case with the bonds issued by the Group in 2003 (Oceane – Obligation Convertible ou Echangeable en Actions Nouvelles ou Existantes, which can be converted into or exchanged for new or existing shares) and 2002 (Orane – Obligation Remboursable et Actions Nouvelles ou Existantes, mandatorily redeemable for new or existing shares). The various components of these instruments are accounted for in shareholders' equity and in bonds and notes issued according to their classification, as defined in IAS 32 "Financial Instruments: Disclosure and Presentation".

The component classified as a financial liability is valued at issuance at the present value (taken into account the credit risk at issuance date) of the future cash flows (including interests and repayment of the nominal value) of a bond with the same characteristics (maturity, cash flows) but without any

shareholders' equity derivative components as defined in the section of IAS 32 on convertible bonds.

The Orane bond was included in the consolidated accounts under other equity and the Oceane bond under convertible bonds in financial debt, in accordance with French accounting principles.

## n. Deferred taxation

Deferred taxes are computed in accordance with the liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying 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 shareholder's equity or in the net income of the year in which the tax rate change is enacted.

Deferred 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. Deferred tax assets and liabilities are not discounted.

To assess the ability of the Group to recover such deferred tax assets, the following elements are 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.

## o. Revenues

Revenues include net sales and service revenues constituting the Group's principal business activity, net of value added taxes (VAT), and income due from licensing fees and from income grants, net of VAT.

Revenue is recognized under sales when the company has transferred the significant risks and rewards of ownership of a product to the buyer.

Sales value is recorded as the fair value of the payment received or to be received. Where a deferred payment has a significant impact on the calculation of fair value this is accounted for by discounting future payments.

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.

Under IAS 11 construction contracts are defined as contracts specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose of use (primarily those related to customized network solutions and networks build-out with a duration of more than two quarters). For revenues generated from construction contracts, 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 probable construction contract losses are recognized immediately. 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 recov-

erable, or on completion of the contract. Work in progress on construction contracts is stated at production cost, excluding administrative and selling expenses. Changes in provisions for delayed delivery or poor contract execution penalties are reported in sales.

Advance payments received on construction contracts, before corresponding works had been carried out, are recorded in customers' deposits and advances. Costs incurred to date, adjusted by profits and losses recognized (in the case of provisions for losses upon contract termination) and progress billings, is determined on a contract by contract basis. If the amount is positive it is included as an asset under "amount owed by clients for construction contracts". If the amount is negative it is included as a liability under "amount owed to clients for construction contracts".

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, in application of the principles described in the second preceding paragraph. For arrangements to sell software licenses with services, software license revenue is recognized separately from the related service revenue, providing 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 specified criteria, revenue is deferred and recognized ratably over the service period. 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 retailers 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, as a markdown of sales.

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

#### **p. Operating profit (loss) and income (loss) from operating activities**

Operating profit (loss) includes gross margin, administrative and selling expenses, research and development expenses (see note 1f), a portion of pension costs, employee profit sharing, fair value changes of derivative instruments covering commercial bids and capital gains (losses) from the disposal of intangible and tangible assets. Income (loss) from operating activities comprises operating profit (loss), restructuring costs, asset impairments (including goodwill) and share-base payments. Income (loss) from operating activities is calculated before financial income and expenses, which include the financial component of retirement expenses, financing costs, capital gains (losses) from disposal of financial assets, income tax, share of equity affiliates' income and net income from discontinued activities.

#### **q. Finance costs**

This line item includes interest charges and income relating to net consolidated debt, which consists of bonds, the liability component of compound instruments such as OCEANE and ORANE, other borrowings including lease-financing liabilities, and all cash assimilated items, including cash, cash equivalents and marketable securities.

#### **r. Structure of consolidated balance sheet**

Most of the Group's activities in the various business segments have long-term operating cycles. As a result, the consolidated balance sheet combines current assets (inventories and work in progress and accounts receivable) and current liabilities (reserves for liabilities and charges, customers' deposits and advances, trade payables and other payables) without distinction between the amounts due in less than one year and due after more than one year.

#### **s. Financial instruments and de-recognition of financial assets**

##### **Financial instruments**

The Group uses financial instruments to manage and reduce its exposure to fluctuations in interest rates and foreign currency exchange rates.

The accounting policies applied to currency hedge-related instruments are detailed in note 1e).

Financial instruments for interest rate hedges are subject to fair value hedge accounting. Financial liabilities hedged using interest rate swaps are reevaluated at the fair value of the obligation linked to interest rate movements. Fair value changes are recorded in the income statement for the year and the effective component offset by symmetrical changes in the interest rate swaps.

##### **Derecognition of financial assets**

A financial asset as defined under IAS 32 "Financial instruments" is either totally or partially derecognized when the Group expects no further cash flow to be generated by it and retains no control of the asset or transfers substantially all risks and rewards attached to it.

In the case of trade receivables, a transfer without recourse in case of default on payment by the debtor is considered as a transfer of substantially all risks and rewards, thus making such receivables eligible for derecognition. However, a more restrictive interpretation of the concept of "substantial transfer of risks and rewards" could result in an accounting treatment different from that adopted by us.

#### **t. Cash and cash equivalents**

In accordance with IAS 7 "Cash flow statement", cash and cash equivalents in the consolidated statements of cash flows includes cash as well as marketable securities that are readily convertible to known amounts of cash. Cash and cash equivalents of the statement of cash flow does not include investments in listed securities, investments exceeding a three month duration without an early exit clause 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 sheets correspond to the cash and cash equivalents defined above.

#### **u. Marketable securities**

In accordance with IAS 39 "Financial instruments", marketable securities are valued at their fair value. No securities are classified in "Held-to-Maturity". In respect of securities considered as held for trading, changes in fair value are recorded in the income statement. In respect of available-for-

sale securities changes in fair value are recorded in shareholders' capital, or, if there is objective evidence of a more than temporary decline in the fair value as impairment, in the income statement (financial revenues (expenses) relative to cash, cash equivalents and marketable securities).

#### v. 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. Changes in net loans receivable are presented in net change in current assets of the consolidated statements of cash flows.

The second category of financing is accounted for in other investments and miscellaneous, net. Changes in net loans receivable are included in cash flows from investing activities (decrease/increase in loans and other financial assets) of 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.

#### w. Stock options

In accordance with the requirements of IFRS 2 "Share-based payment", stock options granted to employees are included in the financial statements using the following principles: the stock option's fair value, which is considered to be a reflection of the fair value of the services provided by the employee

in exchange for the option, is determined on the granting date. It is accounted for in additional paid-in capital (credit) at granting date, with a counterpart in deferred compensation (debit) in equity. During the vesting period, deferred compensation is amortized in the income statement (in the "share based payment" line).

Stock option fair value is calculated using the Cox Ross Rubinstein binomial model. This permits to take into consideration the option's characteristics, such as exercise price and expiry date, market data at the time of acquisition such as the risk-free interest rate, share price, volatility and expected dividends, and behavioral factors of the beneficiary such as expected early exercise.

Only options issued after November 7, 2002 and not fully vested at January 1, 2005 are accounted for using IFRS principles.

The impact of IFRS 2 application on the year's income is accounted for on specific line item in the income statement.

Outstanding stock options at the acquisition of a company acquired in a business combination are usually converted into Alcatel stock options at par value for the newly-acquired shares and Alcatel shares. In accordance with IFRS 3 and IFRS 2 requirements, the fair value of stock options acquired at the time of acquisition is accounted for on the item "capital stock and additional paid-in capital". Unvested options at the takeover date are accounted for at their fair value as deferred compensation in shareholders' equity. The counter value of these two considerations, equivalent to the fair value of vested options, is taken into account in the acquisition price allocation.

Only acquisitions made after January 1, 2004 and for which unvested stock options as of December 31, 2004 existed at the takeover date are accounted for in the manner described above.



## > RECONCILIATION SCHEDULES FROM FRENCH GAAP TO IFRS

### I. SUMMARY OF ADJUSTMENTS: 2004 SHAREHOLDERS' EQUITY AND NET INCOME

(in millions of euros)	<b>Group's shareholders equity 1/1/2004</b>	<b>Capital stock and retained earnings</b>	<b>Net Income</b>	<b>Group's shareholders equity 12/31/2004</b>
Shareholders' equity according to French principles	3,030	57	281	3,368
Business combinations (IFRS 3)	0	(20)	408	388
Capitalization of development expenses (IAS 38)	312	(1)	12	323
Oceane and Orane (IAS 32)	701	0	33	734
Other IAS 32-39 impacts	213	31	(36)	208
Stock options (granted - IFRS 2 or with acquired companies - IFRS 3)	231	(92)	(60)	79
Pensions (IAS 19)	(223)	223		0
Impairment loss on goodwill – equity affiliates <sup>(1)</sup>			(30)	(30)
Other adjustments	4	(19)	1	(14)
<b>Total adjustments before taxes</b>	<b>1,238</b>	<b>122</b>	<b>328</b>	<b>1,688</b>
Income taxes related to the above IFRS adjustments	(62)	4	(6)	(64)
Minority interests	(20)	20	(3)	(3)
<b>Shareholders' equity – attributable to the Group - according to IFRS standards</b>	<b>4,186</b>	<b>203</b>	<b>600</b>	<b>4,989</b>

(1) cf. comment in note 4 g.

## II. RECONCILIATION OF EQUITY AS OF JANUARY 1, 2004

	Adjustments								Total adjust- ments	Reclassi- fications VI.F	IFRS
	French GAAP	R&D V.A	Orane & Oceane V.B	Other impacts IAS 32-39 V.C	Stock- options V.D	Carry back and SVF V.E	Pensions V.F	Other			
(in millions of euros)											
Goodwill, net	3,839			0				(21)	(21)	(188)	3,630
Other intangible assets, net	284	312						0	312	0	596
Property, plant and equipment, net	1,500							5	5	(69)	1,436
Share in net income of equity affiliates	391			0				32	32	78	501
Inventories and work in progress, net	1,432							0	0	(228)	1,204
Amount due from customers on construction type contracts								0	0	527	527
Trade and other receivables, net	3,364			(101)				(4)	(105)	(496)	2,763
Advances and progress payments				0				0	0	106	106
Deferred tax assets		(38)	0	0	(31)		0	(1)	(70)	2,011	1,941
Other current and non-current assets	4,053		(109)	1,126		342		0	1,359	(2,102)	3,310
Assets held for sale or related to discontinued activities				2				0	2	432	434
Cash, cash equivalents and marketable securities	6,269			48		0		0	48	(15)	6,302
<b>TOTAL ASSETS</b>	<b>21,132</b>	<b>274</b>	<b>(109)</b>	<b>1,075</b>	<b>(31)</b>	<b>342</b>	<b>0</b>	<b>11</b>	<b>1,562</b>	<b>56</b>	<b>22,750</b>
Accrued pension and retirement obligations	1,010						223	0	223	0	1,233
Other equity (notes mandatorily redeemable for shares)	645		(645)					0	(645)	0	0
Borrowings and financial debts	5,293		(165)	95		375		0	305	224	5,822
Deferred tax liabilities		0	0	0			(14)	6	(8)	70	62
Reserves for liabilities and charges	3,049			(5)		(32)		11	(26)	(253)	2,770
Customer deposits and advances	1,181			0				(0)	(0)	(116)	1,065
Amount due to customers on construction type contracts								0	0	91	91
Trade payable and related accounts	3,617			(3)				0	(3)	6	3,620
Debts linked to bank activity	224							0	0	(224)	0
Liabilities related to discontinued activities								0	0	253	253
Other current and non-current liabilities	2,720	0	0	775	(231)		0	(4)	540	5	3,265
<b>TOTAL LIABILITIES</b>	<b>17,739</b>	<b>0</b>	<b>(810)</b>	<b>862</b>	<b>(231)</b>	<b>343</b>	<b>209</b>	<b>13</b>	<b>386</b>	<b>56</b>	<b>18,181</b>
<b>NET ASSETS</b>	<b>3,393</b>	<b>274</b>	<b>701</b>	<b>213</b>	<b>200</b>	<b>(1)</b>	<b>(209)</b>	<b>0</b>	<b>1,176</b>	<b>(0)</b>	<b>4,569</b>
Capital stock and additional paid-in capital	10,131		645		35			0	680	0	10,811
Treasury stock owns by consolidated companies	(1,728)				0			0	0	0	(1,728)
Deferred compensations					(35)			0	(35)		(35)
Other reserves	(4,855)	274	56	213	200	(21)	(209)	(2)	511	(518)	(4,862)
Cumulative translation adjustment	(518)							0	0	518	0
Net income attributable to the Group	-								-	-	-
<b>Shareholders' equity attributable to the Group</b>	<b>3,030</b>	<b>274</b>	<b>701</b>	<b>213</b>	<b>200</b>	<b>(21)</b>	<b>(209)</b>	<b>(2)</b>	<b>1,156</b>	<b>0</b>	<b>4,186</b>
Minority interests - Income	33	0		0				0	0	0	33
Minority interests - Shareholders' equity	330	0				20		(0)	20	0	350
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>3,393</b>	<b>274</b>	<b>701</b>	<b>213</b>	<b>200</b>	<b>(1)</b>	<b>(209)</b>	<b>(2)</b>	<b>1,176</b>	<b>0</b>	<b>4,569</b>

Note: Each of the reconciliation columns disclosed above are explained in sections V and VI, notes as indicated, herein under.

### III. RECONCILIATION OF 2004 PROFIT OR LOSS

	French GAAP	Adjustments							Total adjust- ments	Reclassi- fications VI.H	IFRS
		R&D V.A	Orane & Oceane V.B	Other impacts IAS 32-39 V.C	Stock- options V.D	Carry back V.E	Business combi- nation V.G	Other			
(in millions of euros)											
Revenues	12,265			(31)				15	(16)	(5)	12,244
Cost of sales	(7,690)			0	0			5	5	54	(7,631)
<b>Gross profit</b>	<b>4,575</b>	<b>0</b>	<b>0</b>	<b>(31)</b>	<b>0</b>			<b>0</b>	<b>20</b>	<b>(11)</b>	<b>4,613</b>
Administrative and selling expenses	(2,010)			0				2	2	64	(1,944)
R&D costs	(1,587)	100			0			0	100	(1)	(1,488)
<b>Operating profit (loss)</b>	<b>978</b>	<b>100</b>	<b>0</b>	<b>(31)</b>	<b>0</b>			<b>0</b>	<b>22</b>	<b>91</b>	<b>1,181</b>
Share-based payment (stock options plans)					(60)			0	(60)	0	(60)
Restructuring costs	(304)							(13)	(13)	(2)	(319)
Impairment of goodwill and other intangibles assets		(88)						0	(88)	0	(88)
Amortization of goodwill	(409)						408	0	408	1	(0)
<b>Income (loss) from operating activities</b>		<b>12</b>	<b>0</b>	<b>(31)</b>	<b>(60)</b>		<b>408</b>	<b>9</b>	<b>338</b>	<b>111</b>	<b>714</b>
Interest expense on notes mandatorily redeemable for shares	(44)		44					0	44	0	(0)
Financial income net	(132)		(11)	(5)		7		(10)	(20)	57	(95)
Other revenue (expense)	364		0					(14)	(14)	(350)	0
Share in net income of equity affiliates	(97)							(20)	(20)	60	(57)
<b>Profit before tax and discontinued operations</b>		<b>12</b>	<b>33</b>	<b>(36)</b>	<b>(60)</b>	<b>7</b>	<b>408</b>	<b>(35)</b>	<b>328</b>	<b>(122)</b>	<b>562</b>
Income tax expense	(9)	0	0	0	0		0	(6)	(6)	(21)	(37)
<b>Profit (loss) from continuing operations</b>		<b>12</b>	<b>33</b>	<b>(36)</b>	<b>(60)</b>	<b>7</b>	<b>408</b>	<b>(42)</b>	<b>322</b>	<b>(143)</b>	<b>525</b>
Profit (loss) from discontinued operations									0	143	144
<b>Net income (loss)</b>	<b>347</b>	<b>12</b>	<b>33</b>	<b>(36)</b>	<b>(60)</b>	<b>7</b>	<b>408</b>	<b>(42)</b>	<b>322</b>	<b>(0)</b>	<b>669</b>
Attributable to: - Group share	281	9	33	(36)	(60)	7	408	(42)	319	(0)	600
- Minority interests	66	3				0	0	0	3	0	69

Note:

- Each of the reconciliation columns disclosed above are explained in sections V and VI, notes as indicated, herein under.
- Column "other" includes multiple adjustments of different nature (discount effect of some reserves, IFRS restatement impact from the Group's stake in Thales, deferred taxes impact etc.), individually not having a material impact.

#### IV. RECONCILIATION OF EQUITY AS OF DECEMBER 31, 2004

	Adjustments								Total adjust- ments	Reclassi- fications VI.G	IFRS
	French GAAP	R&D V.A	Orane & Oceane V.B	Other impacts IAS 32-39 V.C	Stock- options V.D	Carry back recei- vables V.E	Business combi- nations V.G	Other			
(in millions of euros)											
Goodwill, net	3,586						388	(6)	382	(194)	3,774
Other intangible assets, net	397	323							323	0	720
Property, plant and equipment, net	1,161							5	5	(71)	1,095
Share in net income of equity affiliates	454							(17)	(17)	175	612
Inventories and work in progress, net	1,527								0	(254)	1,273
Amount due from customers on construction type contracts									0	708	708
Trade and other receivables, net	3,520			(105)				(4)	(109)	(725)	2,686
Advances and progress payments									0	90	90
Deferred tax assets		(38)			(14)			(6)	(58)	1,651	1,593
Other current and non-current assets	3,281		(57)	737		158		12	850	(1,730)	2,401
Assets held for sale or related to discontinued activities									0	196	196
Cash, cash equivalents and marketable securities	5,111			64					64	(12)	5,163
<b>TOTAL ASSETS</b>	<b>19,037</b>	<b>285</b>	<b>(57)</b>	<b>696</b>	<b>(14)</b>	<b>158</b>	<b>388</b>	<b>(16)</b>	<b>1,440</b>	<b>(166)</b>	<b>20,311</b>
Accrued pension and retirement obligations	1,144								0	0	1,144
Other equity (notes mandatorily redeemable for shares)	645		(645)						(645)	0	0
Borrowings and financial debts	4,359		(146)	106		173		0	133	105	4,598
Deferred tax liabilities								6	6	80	86
Reserves for liabilities and charges	2,278			15				21	36	(264)	2,050
Customer deposits and advances	1,164			0					0	(191)	973
Amount due to customers on construction type contracts									0	112	112
Trade payable and related accounts	3,360			(3)				(0)	(3)	(7)	3,350
Debts linked to bank activity	105								0	(105)	(0)
Liabilities related to discontinued activities									0	106	106
Other current and non-current liabilities	2,238			370	(79)			(3)	288	(2)	2,524
<b>TOTAL LIABILITIES</b>	<b>15,293</b>	<b>0</b>	<b>(791)</b>	<b>488</b>	<b>(79)</b>	<b>173</b>	<b>0</b>	<b>25</b>	<b>(184)</b>	<b>(166)</b>	<b>14,943</b>
<b>NET ASSETS</b>	<b>3,744</b>	<b>285</b>	<b>734</b>	<b>208</b>	<b>65</b>	<b>(15)</b>	<b>388</b>	<b>(41)</b>	<b>1,624</b>	<b>0</b>	<b>5,368</b>
Capital stock and additional paid-in capital	10,369		645		126				771	0	11,140
Treasury stock owns by consolidated companies	(1,605)								0	0	(1,605)
Deferred compensations					(66)				(66)	0	(66)
Other reserves	(5,041)	274	56	244	68	(22)	4	1	625	(516)	(4,932)
Cumulative translation adjustments	(636)	(1)			(3)		(25)	1	(28)	516	(148)
Net income attributable to the Group	281	9	33	(36)	(60)	7	408	(42)	319	(0)	600
<b>Shareholders' equity attributable to the Group</b>	<b>3,368</b>	<b>282</b>	<b>734</b>	<b>208</b>	<b>65</b>	<b>(15)</b>	<b>387</b>	<b>(40)</b>	<b>1,621</b>	<b>(0)</b>	<b>4,989</b>
Minority interests - Income	66	3	0	0	0		0	0	3	0	69
Minority interests - Shareholders' equity	310	0	0	0	0		1	(1)		0	310
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>3,744</b>	<b>285</b>	<b>734</b>	<b>208</b>	<b>65</b>	<b>(15)</b>	<b>388</b>	<b>(41)</b>	<b>1,624</b>	<b>(0)</b>	<b>5,368</b>

Note: Each of the reconciliation columns disclosed above are explained in sections V and VI, notes as indicated, herein under.

## V. MAIN ADJUSTMENTS

### a) Capitalization of development costs (IAS 38)

As indicated in Note 1e to the Group's French GAAP consolidated financial statements as of December 31, 2004, research and development costs were expensed as incurred under French GAAP standards, with the exception of certain software development costs (€32 million in 2004, see Note 4 to the Group's French GAAP consolidated financial statements as of December 31, 2004). The application of the principles defined in IAS 38 (Intangible Assets) requires the Group to capitalize part of the development cost that used to be expensed under French GAAP. Furthermore, IFRS 1 requires retrospective application of IFRS standards at the transition date i.e. January 1, 2004. Consequently, development expenditures capitalized in the opening IFRS balance sheet corresponding to periods prior to January 1, 2004 amount to €312 million while related deferred tax assets amount to (€38) million, or a net €274 million impact in Shareholders equity.

Alcatel has put in place the information systems required to test the eligibility of development costs for capitalization, as set

out in the standard. However, full retrospective application of IAS 38 has not been possible due to the lack of complete and reliable information for prior periods. If the Group's research and development effort remains constant, this new IAS 38 implementation will have a positive impact, though decreasing, on net income (€100 million in 2004 earnings) given an average remaining amortization period of 2 to 3 years. The impact of capitalization is thus presented under a specific income statement caption to better isolate the ramp-up effect of the capitalization of development costs.

Application of IAS 38 and IAS 36 (Impairment of Assets) has caused a net adjustment in 2004 consolidated financial statements of €12 million, resulting from the aforementioned €100 million (period development expenses eligible to capitalization as per IAS 38, minus amortization charge from prior-periods' capitalized development expenses); offset to a large extent by an exceptional €88 million charge corresponding to an impairment loss related to prior periods' capitalized development costs.

Table below reflects respective adjustments at opening balance sheet and 2004 consolidated income statements (including on a quarterly basis), as well as closing balance sheet figures.

(in millions of euros)	1/1/2004	2004	12/31/2004
Other intangible assets, net	312		323
Deferred tax of assets	(38)		(38)
<b>Assets</b>	<b>274</b>		<b>285</b>
<b>Liabilities</b>	<b>0</b>		<b>0</b>
<b>NET ASSETS</b>	<b>274</b>		<b>285</b>
Other retained earnings	274		274
Cumulative translation adjustments	-		(1)
Net income (loss)	-	12	12
<b>SHAREHOLDERS' EQUITY</b>	<b>274</b>		<b>285</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
R&D expenses	32	22	24	22	100
Impairment of goodwill and other intangibles	0	0	0	(88)	(88)
<b>NET INCOME (LOSS)*</b>	<b>32</b>	<b>22</b>	<b>24</b>	<b>(66)</b>	<b>12</b>

### b. ORANE / OCEANE (IAS 32- IAS 39)

The convertible bonds (OCEANE) and notes mandatorily redeemable for shares (ORANE) issued by the Group in 2002 and 2003, respectively, are compound financial instruments that, according to IAS 32, include a debt component (none, in the case of ORANE, interests having been pre-paid at issuance date) and an equity component (see section 4/ Accounting principles, note m above).

The first-time adoption of IFRS calls for recognition of these instruments' equity component valued at the issuance date within shareholders' equity as of January 1, 2004. The ORANE bonds, reported at its nominal issuance value of €645 million in other equity under French GAAP, are reported as equity in the IFRS opening balance sheet at its issuance value reduced by the amount of related issuance expenses and pre-paid interest that had not been amortized as of December 31, 2003.

The convertible bonds OCEANE issued for a nominal value of €1,022 million and reported until maturity at that same amount as financial debt under French GAAP, are reported in IFRS opening balance as financial debt for €857 million and as shareholders' equity for €165 million.

The adjustments will affect the future level of financial expenses: positively due to the accounting for prepaid expenses (issuance costs and prepaid interests) against shareholders' equity as of January 1, 2004 for €109 million in the aggregate for the 2 instruments, and negatively due to the amortization charge of the OCEANE's equity component until their maturity in January 2011.

(in millions of euros)	1/1/2004	2004	12/31/2004
Other current and non-current assets	(109)		(57)
<b>Assets</b>	<b>(109)</b>		<b>(57)</b>
Other equity (notes mandatorily redeemable for shares)	(645)		(645)
Borrowings and financial debts	(165)		(146)
<b>Liabilities</b>	<b>(810)</b>		<b>(791)</b>
<b>NET ASSETS</b>	<b>701</b>		<b>734</b>
Capital stock and additional paid-in capital	645		645
Other retained earnings	56		56
Net income	0	33	33
<b>SHAREHOLDERS' EQUITY</b>	<b>701</b>		<b>734</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Interest expense on notes mandatorily redeemable for shares	11	11	11	11	44
Net financial income (expense)	(3)	(3)	(3)	(3)	(11)
<b>NET INCOME (LOSS)</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>33</b>

### c. Other IAS 32-39 adjustments (hedging & investments available for sale)

Under IFRS, financial assets available for sale (as defined in IAS 39) are recorded at fair value. For listed securities, the restatement will consist of recording, in opening shareholders' equity, the difference between carrying value and market value, net of any possible deferred tax impacts. Given the valuation rules used by the Group in French GAAP concerning financial assets as the lower of historical acquisition cost or market value, the impact on shareholders' equity will be positive. Thus, the Group's financial assets have been revalued at January 1, 2004 by €53 million (of which €48 million related to the Group's holding in Nexans), and at December 31, 2004 by €85 million, of which €56 million in relation to Nexans and €25 million to the Group's holding in Avanex). During 2004, Alcatel reduced its holding in Avanex from above 20% to below 20% (see note 2 to the French GAAP Group's financial statements at December 31, 2004, for changes in the consolidated companies). Accordingly, this investment was accounted for as an equity affiliate at January 1 and as a financial asset in other non current assets at December 31, 2004. Revaluation of the Group's holding in Nexans has caused an equivalent increase in the Group's net cash position at the opening and closing dates of respectively €48 million and €56 million, this stake in Nexans being accounted for as short term investment.

In accordance with the provisions of IAS 39 on financial instruments, derivatives are recorded at fair value in the balance sheet. Gains and losses resulting from reevaluation of the Group's derivative instruments at fair value at the closing date are recognized in the income statement in case of fair value hedge accounting.

Derivative instruments qualify for fair value hedge accounting when i) at the inception of the hedge there is formal identification and documentation of the hedging relationship; and ii) the hedge is expected to be highly effective, its effectiveness can be reliably measured and it indeed proves to be highly effective throughout the financial reporting periods for which the hedge has been designated.

The Group holds interest rate derivatives (cf. section 4 Accounting principles, note s above) covering the entirety of its financial debt (fixed-interest rate debt, primarily). Most of those derivatives being fully attached to a well identified financial liability qualify as fair value hedges, and therefore, the changes in their fair value are largely offset in earnings by revaluations of the underlying debt.

Currency derivatives held by the Group are of two types: forex derivatives used to hedge balance sheet items or firm commitments that are eligible for fair value accounting and derivatives used for the hedge of forex risk on commercial bids that are accounted for as trading financial instruments. "Fair value" hedges have no impact on the income statement (except for their ineffective part that is accounted for as financial expenses), changes of fair value of the derivatives being offset by the changes in fair value of the corresponding balance sheet items or firm commitments.

Derivatives related to commercial bids have an impact on net income due to their ineligibility to hedge accounting. These derivatives are marked-to-market at each financial statement closing date and corresponding changes in fair value are accounted for in net income. Changes in fair value of the underlying commercial bid can not be accounted for in accordance with IAS 39 requirements. The application of IAS 39 will lead to volatility in net income during the period preceding the effectiveness of the commercial contract. Changes in fair value of these hedging instruments for bids are presented in cost of sales.

Changes in fair value of interest rate derivatives and currency derivatives are reported under IFRS as other assets and liabilities. Due to the IAS 32 strict rules preventing the off-setting of financial assets and liabilities, the derivatives will not be offset against the hedged balance sheet items and depending on the financial instruments used, it is basically not possible to offset balance sheet items related to derivatives concerning a single hedge transaction. Application of these rules leads to a large increase in assets and liabilities.

Accounting for those derivative instruments increases the Group's retained earnings by €160 million at January 1, 2004 and by €119 million at December 31, 2004.

(in millions of euros)	1/1/2004	2004	12/31/2004
Trade receivables and related accounts, nets	(101)		(105)
Other current and non-current assets	1,126		738
Assets held for sale	2		0
Cash, cash equivalents and marketable securities	48		64
<b>Assets</b>	<b>1,075</b>		<b>697</b>
Borrowings and financial debts	95		106
Reserves for liabilities and charges	(5)		15
Trade payables and related accounts	(3)		(3)
Other current and non-current payables	775		370
<b>Liabilities</b>	<b>862</b>		<b>488</b>
<b>NET ASSETS</b>	<b>213</b>		<b>209</b>
Other retained earnings	160		160
Fair value changes of shares available for sale	53		85
Cumulative translation adjustments	0		0
Net income	0	(36)	(36)
<b>SHAREHOLDERS' EQUITY</b>	<b>213</b>		<b>209</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Revenues	(7)	(6)	(7)	(11)	(31)
Costs of sales*	(31)	6	5	20	0
<b>Gross profit</b>	<b>(38)</b>	<b>(0)</b>	<b>(2)</b>	<b>9</b>	<b>(31)</b>
Net financial income (expense)**	34	(43)	24	(20)	(5)
<b>NET INCOME (LOSS)</b>	<b>(4)</b>	<b>(43)</b>	<b>22</b>	<b>(11)</b>	<b>(36)</b>

\* Of which related to hedging of exchange risks on commercial bids amounting to €(28) million in Q1, €0 million in Q2, €10 million in Q3 and €49 million in Q4. Total impact in 2004 €31 million.

\*\* Quarterly data is susceptible to be modified in the course of 2005 resulting from a more accurate and deeper analysis of IAS 32 -39 application. Those possible modifications shall not affect the full year net financial income (expense).

#### d) Stock options (IFRS 2 & IFRS 3)

The application of IFRS 2 (Share-based Payment) implies the modification of the method of accounting for stock options granted by the Group to its employees. Alcatel has elected not to adopt the full retrospective application option allowed by the standard. Only stock option plans established after November 7, 2002, and whose stock options not yet fully vested at December 31, 2004, are restated in the IFRS opening balance sheet as of January 1, 2004. IFRS 2 treatment will apply to the 2003 and 2004 plans, and the plans resulting from business combinations completed after November 7, 2002, under which the stock options had not yet fully vested at December 31, 2004 (see notes 2 and 21c to the Group's French GAAP consolidated financial statements as of December 31, 2004), as well as to future plans.

The Group has retained a Cox-Ross-Rubinstein binomial model to measure the implied complementary compensation of stock-option grants. Their fair value has been determined at their respective granting dates and represents a deferred compensation amounting to €35 million in the IFRS opening balance sheet as of January 1, 2004 that has been booked against an additional paid-in capital for the same amount, the net impact on shareholders' equity therefore being nil. The corresponding amortization charge is to be spread over the related stock options vesting period, i.e. 4 years for most of the plans concerned. This amortization is not linear but depends of the vesting conditions attached at each plan.

Amortization charge of above referred stock options vested during 2004 amounts to €60 million in the Group's IFRS full year income statement. This impact is presented under a spe-

cific income statement caption. However, as the compensation expense does not result in an outflow of cash and as the contra entry to the expense is recorded in retained earnings, the application of this standard has no impact on shareholders' equity, either at January 1, 2004, or at December 31, 2004.

Application of this standard will also have a negative impact on future earnings, as vesting progresses. Whilst there is a ramp-up effect to be considered given limited retrospective application of IFRS 2, income statement impacts from future plans are difficult to anticipate as their fair values will depend on market or behavioral factors (e.g. stock evolution, volatility, stock-option exercise practices, etc).

The IFRS opening balance sheet also contains a net € 200 million increase in shareholders equity (€231 million from other payables partly offset by €(31) million from related deferred tax assets) for cancellation of provisions prevailing under French GAAP related to stock-options existing in companies that were acquired by the Group before January 1, 2004. Those reserves were booked based on the intrinsic value of existing stock-options at the acquisition date, a treatment that does not comply with the IFRS 2 and IFRS 3 (Business combinations) rules. At year-end 2004, those liabilities amounted to €79 million and related deferred tax assets to €(14) million, therefore, causing a net change on shareholders equity of €65 million.

(in millions of euros)	1/1/2004	2004	12/31/2004
Deferred tax assets	(31)		(14)
<b>Assets</b>	<b>(31)</b>		<b>(14)</b>
Other current and non-current payables	(231)		(79)
<b>Liabilities</b>	<b>(231)</b>		<b>(79)</b>
<b>NETS ASSETS</b>	<b>200</b>		<b>65</b>
Capital stock and additional paid-in-capital	35		126
Deferred compensation	(35)		(66)
Other retained earnings	200		68
Cumulative translation adjustments	0		(3)
Net income	0	(60)	(60)
<b>SHAREHOLDERS' EQUITY</b>	<b>200</b>		<b>65</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Share-based payment (stock option plans)	(7)	(17)	(18)	(18)	(60)
<b>NET INCOME</b>	<b>(7)</b>	<b>(17)</b>	<b>(18)</b>	<b>(18)</b>	<b>(60)</b>

## e) SVF trust and sale of a carry-back tax receivable

IFRS requires that certain off-balance sheet commitments and off-balance sheet financial assets and liabilities prevailing under the Group's French GAAP financial statements, namely the structured securitization schemes and the sale of a carry back tax receivable be consolidated on balance sheet. The Group's off balance sheet commitments are described in note 31 to the consolidated financial statements as of December 31, 2004, under French GAAP.

### Securitization schemes

At December 31, 2003, the Group participated in two structured securitization schemes (the SVF program and a customer receivable securitization program). The special purpose vehicle used in the SVF program was consolidated in the Group's French GAAP financial statements with effect from January 1, 2004, following changes in the French accounting regulations. Corresponding impact on the IFRS

opening balance sheet as of January 1, 2004 is of €200 million reported as "other assets" and €212 million as "financial liability". Insofar as those items were consolidated under French GAAP in 2004 and the program was terminated during 2004, there is no restatement impact in 2004 closing financial statements.

The special purpose entity used in the customer receivables securitization program was already consolidated at December 31, 2003 under French GAAP, therefore, the application of IFRS to this program has no impact on the consolidated financial statements.

### Carry-back tax receivable

The recognition of the carry-back receivable sold in 2002, is reported under IFRS, at the asset side of the balance sheet, as "other non current asset" at its discounted value using the discount rate applied in the sale transaction by the intervening credit institution and as a "financial liability" at its discounted value using the French state bonds' discount rate, at the liability side of the balance sheet.



The SVF and carry-back recognition impacts as of January 1 and December 31, 2004 are as follows:

(in millions of euros)	1/1/2004	2004	12/31/2004
Other current and non current assets	342		158
<b>Assets</b>	<b>342</b>		<b>158</b>
Financial debt	375		173
Provisions	(32)		0
<b>Liabilities</b>	<b>343</b>		<b>173</b>
<b>NETS ASSETS</b>	<b>(1)</b>		<b>(15)</b>
Capital stock and additional paid-in capital	0		0
Deferred compensation	0		0
Other retained earnings	(21)		(22)
Cumulative translation adjustments	0		0
Net income	0	7	7
Minority interests	20		0
<b>SHAREHOLDERS' EQUITY</b>	<b>(1)</b>		<b>(15)</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Net financial income (expense)	2	2	1	2	7
<b>NET INCOME</b>	<b>2</b>	<b>2</b>	<b>1</b>	<b>2</b>	<b>7</b>

#### f) Pension and retirement obligations (IAS 19)

The methods for determining pensions and other post-employment benefits, as described in notes 1i and 24 to the Group's French GAAP consolidated financial statements as of December 31, 2004, are compliant with IAS 19 (Employee Benefits). At December 31, 2004 and in anticipation of IFRS implementation the Group applied with a retroactive effect as of January 1, 2004 the "Conseil National de la Comptabilité" recommendation (2003-R.01). The pre-tax impact on shareholders' equity as of January 1, 2004 of applying this recommendation equals to a €223 million decrease (see note 24 b to the Group's French GAAP 2004 financial statements as of December 31, 2004). That impact only appears as an IFRS adjustment at January 1, 2004 opening balance but no longer at 2004 year end.

#### g) Business combinations (IFRS 3)

As indicated in the Accounting principles section above, note 3 c, the Group abandoned the "French pooling of interests" method for consolidated financial statements under French accounting principles as from January 1, 2004 in anticipation of the transition to IFRS. The Pooling of interest method is prohibited by IFRS 3 (Business Combinations).

As permitted by IFRS 1 (First-time adoption of IFRS), business combinations completed before January 1, 2004 have not been restated in accordance with IFRS 3. The transition to IFRS results in no restatement between French GAAP and IFRS opening balance sheets at January 1, 2004.

In application of IFRS 3, as of January 1, 2004, goodwill is no longer amortized, causing an adjustment from French GAAP to IFRS closing balance sheets at December 31, 2004 amounting to €388 million in the Group's shareholders equity (of which €408 million in net income).

(in millions of euros)	1/1/2004	2004	12/31/2004
Goodwill, net	0		388
<b>Assets</b>	<b>0</b>		<b>388</b>
<b>Liabilities</b>	<b>0</b>		<b>0</b>
<b>NETS ASSETS</b>	<b>0</b>		<b>388</b>
Capital stock and additional paid-in capital	0		0
Deferred compensation	0		0
Other retained earnings	0		5
Cumulative translation adjustments	0		(25)
Net income	0	408	408
<b>SHAREHOLDERS' EQUITY</b>	<b>0</b>		<b>388</b>

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Amortization of goodwill	105	102	103	98	408
<b>NET INCOME</b>	<b>105</b>	<b>102</b>	<b>103</b>	<b>98</b>	<b>408</b>

## VI. RECLASSIFICATIONS

Under IAS 1 (Presentation of financial statements), IFRS balance sheet is to be presented following a current/non-current presentation. Under French GAAP, the Group presents its balance sheet according to liquidity of its assets and liabilities. Therefore, the Group balance sheet format has been reviewed in order to report current / non-current items separately under IFRS. Assets and liabilities related to the operating cycle and other items maturing within 12 months from the date of closing of the financial statements are classified as current; all other assets and liabilities are classified as non current. In addition, certain specific rules governing the off setting of assets and liabilities (for example, certain reserves for product sales relating to construction contracts that have to be deducted from contract assets in accordance with IAS 11- Construction contracts- rules) result in reclassifications compared to French GAAP practice. Also in application of IAS 1, minority interests are now included in equity. For comprehension sake, however, we are also presenting the breakdown of shareholders equity into Group's part and minority interests' part.

Thus, the application of IAS 1 (as revised December 2003), IAS 12 (Income Taxes), IAS 11 (Construction contracts), IFRS 1 (First-time adoption of IFRS), IAS 28 (Investments in Associates) and IFRS 5 (Non-current Assets Held for Sale and Discontinued Operations) have significant consequences on the manner of presenting the financial information as explained below.

### a) IAS 1 and IAS 12

Main balance sheet impacts from the application of this principle are i) the identification of deferred tax assets and liabilities (as non current assets or liabilities ) in an isolated caption, instead of being grouped within other assets and other liabilities, and ii) the consideration of the Group's debt linked to the bank activity as financial debt (€224 million at January 1, 2004 and €105 million at December 31, 2004).

From the income statement perspective, the application of this standard have implied that exceptional or non recurrent results like, for example, capital gain/losses from fixed assets disposals (these amounting to €94 million in 2004) or from the disposal of financial investments (these amounting to €256 million in 2004) are reclassified from "other revenues/(expense)" under French GAAP into the other income statement lines that reflect the function of the underlying assets, such as cost of sales, SG&A, R&D, financial income (loss) or result from discontinued activities.

### b) IAS 11 construction contracts

The principles of IAS are very close to those already used by the Group to account for construction contracts (or long-term contracts). In particular, the percentage of completion method of accounting applied by the Group (see note 11 to the Group consolidated financial statements under French GAAP at December 31, 2004) complies with IAS 11. Contract segmentation and combination rules are also basically equivalent to the Group's principles.

The way of accounting for penalty reserves (changes are recorded in contract revenues under IFRS but in cost of sales in the Group's financial statements under French GAAP), and the way of accounting for the financial impact in net sales of deferred payments when they are material, have had a limited effect on 2004 income statement restatement. Thus, penalties related to construction contracts during the full year have meant a €27 million reclassification adjustment in the Group's consolidated 2004 income statement reducing sales and cost of sales by the same amount with no effect on either the Group's gross profit or on IFRS opening shareholders' equity.

On the balance sheet side, the adjustments introduced by this standard are more important. The presentation of assets and liabilities related to construction contracts under specific balance sheet captions and the application of specific offset rules as required by IAS 11, reduces the Group's working capital, due primarily to certain reserves for product sales (contract losses and other product sales reserves) that are now included in the definition of working capital needs, in contrast with the French GAAP practice. That treatment implies a reduction in working capital needs of €178 million at January 1, 2004 and of €185 million at December 31, 2004. Indeed, each construction contract is measured on a stand alone basis and the difference between costs incurred plus recognized profits; less the sum of recognized losses and progress billings (corresponding mainly to accrued receivables, work-in-progress and some product sales reserves) is presented either as "amount due from customers" when the net balance is a debit, or in "amounts due to customers" when the net balance is a credit. This reclassification has implied a reduction on assets and on liabilities of €190 million at January 1, 2004 and of €269 million at December 31, 2004.

### c) IFRS 1 first-time adoption – cumulative translation adjustments

IFRS 1 (First adoption of IFRS) allows companies to reclassify cumulative translation adjustments in consolidated reserves at January 1, 2004. As a result, if in the future a Group's business or company that is labeled in a foreign currency is disposed of, the resulting gain or loss reported in the period income statement will contain no positive or negative impact from monetary fluctuations generated prior to the transition date. The adoption of this treatment causes an opening balance sheet's reclassification adjustment of €518 million, which has no impact on the shareholders' equity at January 1, 2004.

### d) IAS 28 investment in associates

In application of this standard, the goodwill related to companies consolidated using equity method which is currently presented as goodwill under French GAAP, is to be reclassified into "Share in net assets of equity affiliates", therefore increasing the latter balance by an equivalent amount. This treatment causes an opening balance sheet impact, of €188 million at January 1, 2004, and of €194 million at December 3, 2004, but no shareholders' impact.

### e) IFRS 5 non-current assets held for sale and discontinued operations

Net assets of disposal Group or tangible assets identified as held to be sold, as defined in IFRS 5, are reported as assets/liabilities to be sold, without offsetting of related assets and liabilities being possible under IFRS. Property, plant and equipment reported as "assets held to be sold" are no longer depreciated.

The reclassification impact in the Group's consolidated balance sheet amounted to €247 million as of January 1, 2004 and €103 million as of December 31, 2004 (of which SAFT and other assets to be disposed of represented €432 million in assets to be sold and €253 million in liabilities of a disposal group at January 1, 2004 and SAFT Power System activities and other assets represented respectively €196 million of assets to be sold and €106 million of liabilities in a disposal group at December 31, 2004).

The application of this standard has no material impact in the Group's 2004 earnings, except for the various reclassification operated among different income statement lines. Thus, the net capital gain resulting from the disposal of SAFT activities and from the respective transfer of the optical fiber and mobile phone activities to the Draka JV and TAMP JV, that amounted overall to €211 million in 2004, is reclassified from "other revenue (expense)" into "income (loss) from discontinued operations".

The net result of these discontinued activities from January 1, 2004 to the date of disposal, reported under French GAAP into "share in net income of equity affiliates" for €66 million is also reclassified under IFRS into "income (loss) from discontinued operations" for €145 million.

Several reclassification tables are disclosed below summarizing all the reclassification adjustments in the Group's consolidated balance sheet at January 1 and at December 31, 2004, as well as in the Group's full year 2004 consolidated income statement.

### f) Balance sheet as of January 1, 2004 – Reclassification

(in millions of euros)	IAS 1 Specific line item	IAS 11 Construction contracts	IFRS 1 Translation adjustment	IAS 28 Associates	IFRS 5 Actifs Discontinued - held for sale and Other	TOTAL
Goodwill, nets				(188)		(188)
Intangible assets, net					(69)	(69)
Share in net assets of equity affiliates				188	(110)	78
Inventories and work in progress, nets		(228)				(228)
Amounts due from customers on construction type contracts		527				527
Trade receivables and related accounts, net		(489)			(7)	(496)
Advances and progress payments	106					106
Deferred tax of assets	2,011					2,011
Other current and non-current assets	(2,118)				16	(2,102)
Assets held for sale					432	432
Cash, cash equivalents and marketable securities					(15)	(15)
<b>Assets</b>	<b>(1)</b>	<b>(190)</b>	<b>0</b>	<b>0</b>	<b>247</b>	<b>56</b>
Borrowings and financial debts	224				0	224
Reserves for liabilities and charges		(253)				(253)
Deferred tax liabilities	70					70
Advances and customers deposits		(33)			(83)	(116)
Amounts due to customers on construction contracts type		91				91
Trade payables and related accounts		6				6
Debt linked to bank activity	(224)					(224)
Debt of discontinued activities					253	253
Other current and non-current payables	(71)	(1)			77	5
<b>Liabilities</b>	<b>1</b>	<b>(190)</b>	<b>0</b>	<b>0</b>	<b>247</b>	<b>56</b>
<b>NET ASSETS</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Other retained earnings			(518)			(518)
Cumulative translation adjustments			518			518
<b>SHAREHOLDERS' EQUITY</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

### g) Balance sheet as of December 31, 2004 – Reclassification

(in millions of euros)	IAS 1 Specific line item	IAS 11 Construction contracts	IFRS 1 Translation adjustment	IAS 28 Associates	IFRS 5 Actifs Discontinued - held for sale and Other	TOTAL
Goodwill, nets				(194)		<b>(194)</b>
Intangible assets, net					(71)	(71)
Share in net assets of equity affiliates				194	(19)	175
Inventories and work in progress, nets		(254)				(254)
Amounts due from customers on construction type contracts		708				708
Trade receivables and related accounts, net		(723)			(2)	(725)
Advances and progress payments	90					90
Deferred tax of assets	1,651					1,651
Other current and non-current assets	(1,741)				11	(1,730)
Assets held for sale					196	196
Cash, cash equivalents and marketable securities					(12)	(12)
<b>Assets</b>	<b>0</b>	<b>(269)</b>	<b>0</b>	<b>0</b>	<b>103</b>	<b>(166)</b>
Borrowings and financial debts	105					105
Reserves for liabilities and charges		(264)				(264)
Deferred tax of liabilities	80					80
Advances and customers deposits		(109)			(79)	(191)
Amounts due to customers on construction type contracts		112				112
Trade payables and related accounts		(7)				(7)
Debt linked to bank activity	(105)					(105)
Debt of activities to be disposed of					106	106
Other current and non-current payables	(80)	(2)			76	(2)
<b>Liabilities</b>	<b>0</b>	<b>(269)</b>			<b>103</b>	<b>(166)</b>
<b>NET ASSETS</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Other retained earnings			(518)		2	(516)
Cumulative translation adjustments			518		(2)	516
<b>SHAREHOLDERS' EQUITY</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

### h) Income statement – Reclassification

(in millions of euros)	IAS 1 Disposal of assets	IAS 11 Construction contracts	IFRS 1 Disposal of financial assets	IFRS 5 Discontinued - held for sale	Other	TOTAL
Revenues		(27)			22	(5)
Costs of sales	23	27			4	54
<b>Gross profit</b>	<b>23</b>	<b>0</b>	<b>0</b>		<b>26</b>	<b>49</b>
Administrative and selling expenses	71				(7)	64
R&D costs					(1)	(1)
<b>Operating profit (loss)</b>	<b>94</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>18</b>	<b>112</b>
Share-based payment						
Restructuring costs					(2)	(2)
Impairment of goodwill and other intangibles						
Amortization of goodwill					1	1
Interest expense on notes mandatorily redeemable						
Net financial income (expense)			45		11	57
Other revenue (expense)	(94)		(45)	(211)		(350)
Share in net income of equity affiliates				66	(6)	60
Income tax					(21)	(21)
Net income of discontinued activities				145	(2)	143
<b>NET INCOME (LOSS)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## VII. RECONCILIATION OF WORKING CAPITAL AND NET CASH (FINANCIAL DEBT) POSITION AS OF JANUARY 1 AND DECEMBER 31, 2004

### a) Working capital as of January 1, 2004 – Reconciliation

	Adjustments					IFRS
	French GAAP	Other impacts IAS 32-39 V.C	Other	Total Adjustments	Reclassifications VI.F	
Inventories and work in progress, net	1,432			0	(228)	1,204
Amount due from customers on construction type contracts				0	527	527
Trade and other receivables, net	3,364	(101)	(4)	(105)	(496)	2,763
Advances and progress payments	106	0		0	0	106
Advances and customer deposits	(1,181)	0	0	0	116	(1,065)
Amount due to customers on construction type contracts				0	(91)	(91)
Trade payable and related accounts	(3,617)	3	0	3	(6)	(3,620)
Currency derivatives on working capital <sup>(1)</sup>		98	0	98		98
<b>Operating working capital - net</b>	<b>104</b>	<b>0</b>	<b>(4)</b>	<b>(4)</b>	<b>(178)</b>	<b>(78)</b>

Note:

- Each of the reconciliation columns disclosed above are explained in sections V and VI in this document, notes as indicated.
- (1) Accounted for in other current assets and liabilities.

### b) Net cash (financial debt) as of January 1, 2004 – Reconciliation

	Adjustments				Total Adjustments	Reclassifications VI.F	IFRS
	French GAAP	Orane & Oceane V.B	Other impacts IAS 32-39 V.C	Carry back and SVF V.E			
Cash, cash equivalents and marketable securities	6,269		48		48	(15)	6,302
Borrowings and other	(5,293)	165	(95)	(375)	(305)	(224)	(5,822)
Derivatives relative to the net financial debt			107		107		107
<b>Net cash (financial debt)</b>	<b>976</b>	<b>165</b>	<b>60</b>	<b>(375)</b>	<b>(150)</b>	<b>(239)</b>	<b>587</b>

Note:

- Each of the reconciliation columns disclosed above are explained in sections V and VI, notes as indicated.
- Reclassification relative to the Group's bank activity (€224 million) presented as financial debt under IFRS in contrast to its classification as a specific line item under French GAAP.
- Other IAS 32-39 impacts reflect the revaluation of the Group's stake in Nexans by €48 million which is accounted for as short term investment, and the revaluation of the financial debt to take into account impact of changes in interest rate, largely offset by the revaluation of the underlying interest derivative.
- The €375 million restatement refers to the SVF consolidation (€212 million) and to the recognition of the carry-back sold (€163 million).

### c) Working capital as of December 31, 2004 – Reconciliation

	Adjustments					IFRS
	French GAAP	Other impacts IAS 32-39 V.B	Other	Total Adjustments	Reclas-sifications VI.G	
Inventories and work in progress, net	1,527				(253)	1,273
Amount due from customers on construction type contracts					708	708
Trade and other receivables, net	3,520	(105)	(4)	(109)	(725)	2,686
Advances and progress payments	89		1	1	(0)	90
Advances and customer deposits	(1,164)		0	0	191	(973)
Amount due to customers on construction type contracts					(112)	(112)
Trade payable and related accounts	(3,360)	3	0	3	7	(3,350)
Currency derivatives on working capital <sup>(1)</sup>		102		102		102
<b>Operating working capital - net</b>	<b>612</b>	<b>0</b>	<b>(3)</b>	<b>(3)</b>	<b>(185)</b>	<b>424</b>

Note:

- Each of the reconciliation columns disclosed above are explained in sections V and VI within this document, notes as indicated.
- (1) Accounted for in other current assets and liabilities.

### d) Net cash (financial debt) as of December 31, 2004 – Reconciliation

	Adjustments					IFRS	
	French GAAP	Orane & Oceane V.B	Other impacts IAS 32-39 V.C	Carry back and SVF V.E	Total Adjustments		Reclas-sifications VI.G
Cash, cash equivalents and marketable securities	5,111		64	0	64	(12)	5,163
Borrowings and financial debts	(4,359)	146	(106)	(173)	(133)	(105)	(4,597)
Derivatives relative to the net financial debt			105		105		105
<b>Net cash (financial debt)</b>	<b>752</b>	<b>146</b>	<b>63</b>	<b>(173)</b>	<b>36</b>	<b>(117)</b>	<b>671</b>

Note:

- Each of the reconciliation columns disclosed above are explained in sections V and VI, notes as indicated.
- Reclassification relative to the Group's bank activity (€105 million) presented as financial debt under IFRS in contrast to its classification as a specific line item under French GAAP.
- Other IAS 32-39 impacts mainly reflect the revaluation of the Group's stake in Nexans by €56 million which is accounted for as short term investment, and the revaluation of the financial debt to take into account impact of changes in interest rate, largely offset by the revaluation of the underlying interest derivative.
- The €173 million restatement refers to the carry-back receivable sold. Note that the consolidation of the SVF has no impact at December 31, 2004 since it was already reflected in the Group's financial statements under French GAAP in 2004 and the program was terminated during 2004.

## VIII. IMPACTS OF IFRS ADJUSTMENTS ON CONSOLIDATED STATEMENT OF CASH FLOWS

IFRS adjustments have no impact on consolidated statements of cash flows (accounting for available for sale investments at fair value, deferred compensation related to share-based payments, fair value hedge accounting etc.).

The cash flow statements as defined in IAS 7 is very similar to the consolidated statement of cash flows already presented by the Group. We anticipate no major change concerning the way of presentation of consolidated statement of cash flows under IFRS in comparison with information given in the 2004 consolidated financial statements under French GAAP.

> 2004 CONSOLIDATED INCOME STATEMENTS BY QUARTER, IFRS STANDARDS

a) IFRS Consolidated Income statements by quarter

(in millions of euros)	Q1-2004	Q2-2004	Q3-2004	Q4-2004	2004
Revenues	2,515	2,899	3,024	3,806	12,244
Costs of sales	(1,607)	(1,714)	(1,865)	(2,445)	(7,631)
<b>Gross profit</b>	<b>908</b>	<b>1,185</b>	<b>1,159</b>	<b>1,361</b>	<b>4,613</b>
Administrative and selling expenses	(487)	(532)	(429)	(496)	(1,943)
R&D costs	(337)	(390)	(364)	(397)	(1,488)
<b>OPERATING PROFIT (LOSS)</b>	<b>84</b>	<b>263</b>	<b>366</b>	<b>468</b>	<b>1,181</b>
Share-based payment (stock options plans)	(7)	(17)	(18)	(18)	(60)
Restructuring costs	(65)	(68)	(18)	(168)	(319)
Impairment of goodwill	0	0	0	(88)	(88)
<b>Income (loss) from operating activities</b>	<b>12</b>	<b>178</b>	<b>330</b>	<b>194</b>	<b>714</b>
Net financial income (expense) <sup>(1)</sup>	8	(39)	(50)	(14)	(95)
Share in net income of equity affiliates	6	(3)	(30)	(30)	(57)
<b>Profit before tax, minority interests and discontinued operations</b>	<b>26</b>	<b>136</b>	<b>250</b>	<b>150</b>	<b>562</b>
Income tax	20	28	(14)	(71)	(37)
<b>Profit (loss) from continuing operations</b>	<b>46</b>	<b>164</b>	<b>236</b>	<b>79</b>	<b>525</b>
Profit (loss) from discontinued operations	229	(46)	(6)	(33)	144
<b>Net profit (loss)</b>	<b>275</b>	<b>118</b>	<b>230</b>	<b>46</b>	<b>669</b>
Attributable to:					
– Group share	278	97	200	25	600
– Minority interests	(3)	21	30	21	69
<b>Net income per share, Group share (in euros):</b>					
– Basic earnings per share	0.20	0.07	0.15	0.02	0.44
– Diluted earnings per share	0.20	0.07	0.15	0.02	0.44
<b>Net income per share (in euros):</b>					
– Basic earnings per share	0.03	0.12	0.18	0.06	0.39
– Diluted earnings per share	0.03	0.12	0.17	0.06	0.39

Note:

- The data provided above corresponds to quarterly information given in disclosure note 37 of the 2004 consolidated financial statements under French GAAP restated to take into account IFRS valuation principles.
- (1) cf. note in chapter 5 section V – c above.

## b) Reconciliation of profit or loss for the first quarter 2004

(in millions of euros)	French GAAP	Adjustments						Total adjust- ments	Reclas- sifications	IFRS		
		R&D	ORANE & OCEANE	Other impacts IAS 32-39	Stock- options	Carry back	Business combi- nations				Other	
Revenues	2,533			(7)				5	(2)	(16)	2,515	
Cost of sales	(1,562)			(31)				1	(30)	(15)	(1,607)	
<b>Gross profit</b>	<b>971</b>	<b>0</b>	<b>0</b>	<b>(38)</b>	<b>0</b>			<b>0</b>	<b>6</b>	<b>(32)</b>	<b>(31)</b>	<b>908</b>
Administrative and selling expenses	(498)								(2)	(2)	13	(487)
R&D costs	(369)	32							1	33	(1)	(337)
<b>Operating profit (loss)</b>	<b>104</b>	<b>32</b>	<b>0</b>	<b>(38)</b>	<b>0</b>			<b>0</b>	<b>5</b>	<b>(1)</b>	<b>(19)</b>	<b>84</b>
Share-based payment (stock options plans)					(7)				0	(7)	0	(7)
Restructuring costs									(1)	(1)	0	(65)
Impairment of goodwill and other intangibles assets	(64)								0	0	0	0
Amortization of goodwill	(105)								105	1	106	0
<b>Income (loss) from operating activities</b>		<b>32</b>	<b>0</b>	<b>(38)</b>	<b>(7)</b>			<b>105</b>	<b>6</b>	<b>97</b>	<b>(20)</b>	<b>12</b>
Interest expense on notes mandatorily redeemable for shares	(11)		11						0	11	0	(0)
Net financial income (expense)	(40)		(3)	34		2			1	34	14	8
Other revenue (expense)	245		0	0					(1)	(1)	(244)	0
Share in net income of equity affiliates	(16)								1	1	21	6
<b>Profit before tax and discontinued operations</b>		<b>32</b>	<b>8</b>	<b>(4)</b>	<b>(7)</b>	<b>2</b>	<b>105</b>		<b>6</b>	<b>142</b>	<b>(229)</b>	<b>26</b>
Income tax	16	0							4	4	0	20
<b>Profit (loss) from continuing operations</b>		<b>32</b>	<b>8</b>	<b>(4)</b>	<b>(7)</b>	<b>2</b>	<b>105</b>		<b>10</b>	<b>146</b>	<b>(229)</b>	<b>46</b>
Profit (loss) from discontinued operations									(0)	(0)	229	229
<b>Net income (loss)</b>	<b>129</b>	<b>32</b>	<b>8</b>	<b>(4)</b>	<b>(7)</b>	<b>2</b>	<b>105</b>		<b>10</b>	<b>146</b>	<b>(0)</b>	<b>275</b>
Attributable to: – Group share	134	30	8	(4)	(7)	2	105	10		144	(0)	278
– Minority interests	(5)	2				0	0	0		2	0	(3)



### c) Reconciliation of profit or loss for the second quarter 2004

(in millions of euros)	French GAAP	Adjustments							Total adjust- ments	Reclas- sifications	IFRS
		R&D & OCEANE	ORANE	Other impacts IAS 32-39	Stock- options	Carry back	Business combi- nations	Other			
Revenues	2,911			(6)				3	(3)	(9)	2,899
Cost of sales	(1,755)			6				3	9	32	(1,714)
<b>Gross profit</b>	<b>1,156</b>	<b>0</b>	<b>0</b>	<b>(0)</b>	<b>0</b>			<b>0</b>	<b>6</b>	<b>23</b>	<b>1,185</b>
Administrative and selling expenses	(532)			0				(1)	(1)	1	(532)
R&D costs	(413)	22		0				1	23	0	(390)
<b>Income (loss) from</b>	<b>211</b>	<b>22</b>	<b>0</b>	<b>(0)</b>	<b>0</b>			<b>0</b>	<b>6</b>	<b>28</b>	<b>263</b>
Share-based payment (stock options plans)				0	(17)			0	(17)	0	(17)
Restructuring costs	(67)			0				1	1	(2)	(68)
Impairment of goodwill and other intangibles assets				0				0	0	0	0
Amortization of goodwill	(102)			0			102		102	0	(0)
<b>Income (loss) from operating activities</b>		<b>22</b>	<b>0</b>	<b>(0)</b>	<b>(17)</b>			<b>102</b>	<b>7</b>	<b>114</b>	<b>178</b>
Interest expense on notes mandatorily redeemable for shares	(11)		11	0				0	11	0	(0)
Net financial income (expense)	(3)		(3)	(43)		2		(1)	(45)	9	(39)
Other revenue (expense)	32		0	0				0	0	(32)	0
Share in net income of equity affiliates	(43)							(0)	(0)	40	(3)
<b>Profit before tax and discontinued operations</b>		<b>22</b>	<b>8</b>	<b>(43)</b>	<b>(17)</b>	<b>2</b>	<b>102</b>	<b>5</b>	<b>79</b>	<b>40</b>	<b>136</b>
Income tax	28	0						0	0	(0)	28
<b>Profit (loss) from continuing operations</b>		<b>22</b>	<b>8</b>	<b>(43)</b>	<b>(17)</b>	<b>2</b>	<b>102</b>	<b>5</b>	<b>79</b>	<b>40</b>	<b>164</b>
Profit (loss) from discontinued operations								(6)	(6)	(40)	(46)
<b>Net income (loss)</b>	<b>45</b>	<b>22</b>	<b>8</b>	<b>(43)</b>	<b>(17)</b>	<b>2</b>	<b>102</b>	<b>(1)</b>	<b>73</b>	<b>(0)</b>	<b>118</b>
Attributable to: – Group share	23	22	8	(43)	(17)	2	102	0	74	(0)	97
– Minority interests	22					0	0	(1)	(1)	0	21

## d) Reconciliation of profit or loss for the third quarter 2004

(in millions of euros)	French GAAP	Adjustments						Total adjust- ments	Reclas- sifications	IFRS		
		R&D & OCEANE	ORANE	Other impacts IAS 32-39	Stock- options	Carry back	Business combi- nations				Other	
Revenues	3,009			(7)				4	(3)	18	3,024	
Cost of sales	(1,872)			5				5	10	(3)	(1,865)	
<b>Gross profit</b>	<b>1,137</b>	<b>0</b>	<b>0</b>	<b>(2)</b>	<b>0</b>			<b>0</b>	<b>9</b>	<b>7</b>	<b>1,159</b>	
Administrative and selling expenses	(486)			0				1	1	56	(429)	
R&D costs	(381)	24		0				(8)	16	1	(364)	
<b>Operating profit (loss)</b>	<b>270</b>	<b>24</b>	<b>0</b>	<b>(2)</b>	<b>0</b>			<b>0</b>	<b>2</b>	<b>24</b>	<b>72</b>	<b>366</b>
Share-based payment (stock options plans)				0	(18)			0	(18)	0	(18)	
Restructuring costs	(14)			0				(4)	(4)	0	(18)	
Impairment of goodwill and other intangibles assets				0				0	0	0	0	
Amortization of goodwill	(103)			0			103	0	103	0	(0)	
<b>Income (loss) from operating activities)</b>		<b>24</b>	<b>0</b>	<b>(2)</b>	<b>(18)</b>			<b>103</b>	<b>(2)</b>	<b>105</b>	<b>72</b>	<b>330</b>
Interest expense on notes mandatorily redeemable for shares	(11)		11					0	11	0	(0)	
Net financial income (expense)	(44)		(3)	24		1		2	25	(31)	(50)	
Other revenue (expense)	47		0	0				(6)	(6)	(41)	(0)	
Share in net income of equity affiliates	(19)							(24)	(24)	13	(30)	
<b>Profit before tax and discontinued operations</b>		<b>24</b>	<b>8</b>	<b>22</b>	<b>(18)</b>	<b>1</b>	<b>103</b>	<b>(30)</b>	<b>111</b>	<b>13</b>	<b>250</b>	
Income tax	(13)							(1)	(1)	0	(14)	
<b>Profit (loss) from continuing operations</b>		<b>24</b>	<b>8</b>	<b>22</b>	<b>(18)</b>	<b>1</b>	<b>103</b>	<b>(31)</b>	<b>110</b>	<b>13</b>	<b>236</b>	
Profit (loss) from discontinued operations								7	7	(13)	(6)	
<b>Net income (loss)</b>	<b>113</b>	<b>24</b>	<b>8</b>	<b>22</b>	<b>(18)</b>	<b>1</b>	<b>103</b>	<b>(24)</b>	<b>117</b>	<b>0</b>	<b>230</b>	
Attributable to: – Group share	84	24	8	22	(18)	1	103	(24)	115	0	200	
– Minority interests	29					0			1	0	30	

## e) Reconciliation of profit or loss for the fourth quarter 2004

(in millions of euros)	French GAAP	Adjustments						Total adjust- ments	Reclas- sifications	IFRS
		R&D & OCEANE	Other impacts IAS 32-39	Stock- options	Carry back	Business combi- nations	Other			
Revenues	3,812		(11)				3	(8)	2	3,806
Cost of sales	(2,501)		20				(4)	16	40	(2,445)
<b>Gross profit</b>	<b>1,311</b>	<b>0</b>	<b>0</b>	<b>9</b>	<b>0</b>		<b>0</b>	<b>(1)</b>	<b>42</b>	<b>1,361</b>
Administrative and selling expenses	(494)		0				4	4	(5)	(496)
R&D costs	(424)	22					5	27	(1)	(397)
<b>Operating profit (loss)</b>	<b>393</b>	<b>22</b>	<b>0</b>	<b>9</b>	<b>0</b>		<b>0</b>	<b>8</b>	<b>36</b>	<b>468</b>
Share-based payment (stock options plans)				(18)			0	(18)	0	(18)
Restructuring costs	(159)						(8)	(8)	(1)	(168)
Impairment of goodwill and other intangibles assets		(88)					0	(88)	0	(88)
Amortization of goodwill	(99)						98	1	99	(0)
<b>Income (loss) from operating activities</b>		<b>(66)</b>	<b>0</b>	<b>9</b>	<b>(18)</b>		<b>98</b>	<b>1</b>	<b>35</b>	<b>194</b>
Interest expense on notes mandatorily redeemable for shares	(11)		11				0	11	0	(0)
Net financial income (expense)	(45)		(3)	(20)		2	(12)	(33)	64	(14)
Other revenue (expense)	40		0	0			(8)	(8)	(33)	(0)
Share in net income of equity affiliates	(19)						3	3	(14)	(30)
<b>Profit before tax and discontinued operations</b>		<b>(66)</b>	<b>8</b>	<b>(11)</b>	<b>(18)</b>	<b>2</b>	<b>98</b>	<b>(16)</b>	<b>52</b>	<b>150</b>
Income tax	(40)		(0)				(11)	(11)	(20)	(71)
<b>Profit (loss) from continuing operations</b>		<b>(66)</b>	<b>8</b>	<b>(11)</b>	<b>(18)</b>	<b>2</b>	<b>98</b>	<b>(27)</b>	<b>32</b>	<b>79</b>
Profit (loss) from discontinued operations							(1)	(1)	(32)	(33)
<b>Net income (loss)</b>	<b>60</b>	<b>(66)</b>	<b>8</b>	<b>(11)</b>	<b>(18)</b>	<b>2</b>	<b>98</b>	<b>(28)</b>	<b>(0)</b>	<b>46</b>
Attributable to: – Group share	40	(66)	8	(11)	(18)	2	98	(28)	(0)	25
– Minority interests	20			0				1	0	21

## > INFORMATION BY BUSINESS SEGMENT AND BY GEOGRAPHICAL SEGMENT

### a) Information by business segment

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
<b>Revenues:</b>					
– Fixed communications	1,086	1,305	1,203	1,531	5,125
– Mobile communications	617	712	893	1,091	3,313
– Private communications	849	921	957	1,219	3,946
– Other	3	2	3	5	13
– Between segments	(40)	(41)	(32)	(40)	(153)
<b>TOTAL</b>	<b>2,515</b>	<b>2,899</b>	<b>3,024</b>	<b>3,806</b>	<b>12,244</b>
<b>Operating profit (loss):</b>					
– Fixed communications	46	170	182	178	576
– Mobile communications	80	71	117	150	418
– Private communications	28	42	90	109	269
– Other	(70)	(20)	(23)	31	(82)
<b>TOTAL</b>	<b>84</b>	<b>263</b>	<b>366</b>	<b>468</b>	<b>1,181</b>

### b) Information by geographical segment

(in millions of euros)	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
<b>Revenues by subsidiary location:</b>					
– France	877	930	1,072	1,492	4,371
– Germany	241	295	331	324	1,191
– Other western Europe	472	549	525	763	2,309
– Rest of Europe	41	57	60	96	254
– Asia – Pacific	294	362	384	384	1,424
– North America	426	524	426	438	1,814
– Rest of world	164	182	226	309	881
<b>TOTAL</b>	<b>2,515</b>	<b>2,899</b>	<b>3,024</b>	<b>3,806</b>	<b>12,244</b>
<b>Revenues by geographical market:</b>					
– France	323	408	324	622	1,677
– Germany	173	196	197	233	799
– Other western Europe	560	633	667	851	2,711
– Rest of Europe	156	193	274	272	895
– Asia – Pacific	421	474	450	522	1,867
– North America	404	520	428	416	1,768
– Rest of world	478	475	684	890	2,527
<b>TOTAL</b>	<b>2,515</b>	<b>2,899</b>	<b>3,024</b>	<b>3,806</b>	<b>12,244</b>
<b>Operating profit (loss):</b>					
– France	31	18	83	159	291
– Germany	(2)	21	28	62	109
– Other western Europe	10	49	88	93	240
– Rest of Europe	3	5	8	15	31
– Asia – Pacific	11	39	74	21	145
– North America	28	123	83	96	330
– Rest of world	3	8	2	22	35
<b>TOTAL</b>	<b>84</b>	<b>263</b>	<b>366</b>	<b>468</b>	<b>1,181</b>

Business and geographical segments presented above are the same as the segments presented in the French GAAP consolidated financial statements.

## > SPECIAL PURPOSE REPORT OF THE INDEPENDENT AUDITORS

This is a free translation into English of the statutory auditors' report relating to the IFRS reconciliation tables for 2004 issued in 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.

### Special purpose audit report of statutory auditors on the IFRS Reconciliation Tables for 2004

Dear Shareholders,

Pursuant to your request and in our capacity as statutory auditors of Alcatel, we have audited the accompanying reconciliation tables presenting the impact of the transition to International Financial Reporting Standards (IFRSs), as adopted in the European Union, on equity and the consolidated net income of the company for the year ended December 31, 2004 (the "IFRS reconciliations").

The IFRS reconciliations have been prepared by management and reviewed by the audit committee. These reconciliations have been prepared in connection with the transition to IFRS, as adopted in the European Union, to draw up consolidated financial statements for fiscal year 2005, based on the consolidated financial statements for the year ended December 31, 2004 prepared in accordance with French GAAP (the "consolidated financial statements"), which we have audited in accordance with the professional standards applicable in France. Based on our audit, we issued an unqualified opinion on these consolidated financial statements. It is our responsibility, based on our audit, to express an opinion on the IFRS reconciliations.

We conducted our audit in accordance with the professional standards applicable in France. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the IFRS reconciliations are free of material misstatement. An audit includes examining, on a test

basis, evidence supporting the amounts and disclosures in the reconciliations. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the IFRS reconciliations have been prepared, in all material respects, in accordance with the rules described in the notes to the financial statements, which specify how IFRS 1 and the other international accounting standards adopted in the European Union have been applied, and indicate, according to management, the standards, interpretations, accounting rules and methods, which should be applied for the preparation of the consolidated financial statements for fiscal year 2005 in accordance with IFRS as adopted in the European Union.

Without qualifying our opinion, we draw your attention to Note No. 1/b, which describes the reasons for which the IFRS reconciliations relating to fiscal year 2004 presented in the consolidated financial statements for fiscal year 2005 may differ from the IFRS reconciliations accompanying this report.

Moreover, these IFRS reconciliations should not be considered as consolidated financial statements prepared in accordance with IFRS as adopted in the European Union since the purpose of such reconciliations is to prepare for the transition to IFRS with respect to the preparation of the consolidated financial statements for fiscal year 2005. As a result, these reconciliations do not provide a fair presentation, under IFRS, of the assets, liabilities, financial position and results of the companies included in the consolidation.

Neuilly sur Seine, March 30, 2005  
The Statutory Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES  
ERNST & YOUNG

Christian Chiarasini

PARENT COMPANY ACCOUNTS

## > FINANCIAL RESULT

The net income of Alcatel, the parent company, amounted to €2,178.2 million in 2004 compared to a loss of €(3,255.4) million in 2003.

Total assets decreased from €27.4 billion at the end of 2003 to €26.5 billion at the end of 2004. Shareholders' equity after appropriation increased from €12.3 billion to €14.7 billion over the same period.

## > APPROPRIATION OF INCOME AND DIVIDEND DISTRIBUTION

The 2004 net income of Alcatel, the parent company, totaled €2,178,214,148.03.

No dividend will be proposed to the Annual Shareholders' Meeting to be held on May 20, 2005.

The following appropriation will therefore be proposed to the Annual Shareholders' Meeting to be held on May 20, 2005:

(in euros)

<b>Available for distribution</b>	
Income of the year	2,178,214,148.03
Retained earnings brought forward (see note 12)	(10,555,574.00)
<b>Total</b>	<b>2,167,658,574.03</b>
<b>Appropriation</b>	
Transfer to legal reserve	15,374,184.59
Proposed dividend	-
Retained earnings	2,152,284,389.44
<b>Total</b>	<b>2,167,658,574.03</b>

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

	<b>2004 (proposal)</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Number of A shares eligible for dividends	1,305,455,461 461	1,284,410,224	1,239,193,498 498	1,215,254,797
Number of O shares eligible for dividends	-*	-*	25,515,000 000.00	25,515,000
Par value	2.00	2.00	2.00	2.00
Total number of shares	1,305,455,461	1,284,410,224	1,264,708,498	1,240,769,797
<b>A shares:</b>				
Dividend per share including tax credit	-	-	-	0.24
Net dividend per share	-	-	-	0.16
Tax credit ("avoir fiscal") per share	-	-	-	0.08
<b>O shares:</b>				
Dividend per share including tax credit	-	-	-	0.15
Net dividend per share	-	-	-	0.10
Tax credit ("avoir fiscal") per share	-	-	-	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.

The dividends mentioned above would have given, rise to the 50% credit, as indicated by the art.93 of the 2003-1311 law dated December 30,2003, for shareholders eligible to its application.

## > PARENT COMPANY INCOME STATEMENTS

(in millions of euros)	Notes	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net sales		753.3	747.7	852.4
Other revenues		26.2	38.3	42.0
<b>Operating revenues</b>		<b>779.5</b>	<b>786.0</b>	<b>894.4</b>
Purchases of services and other expenses		(786.0)	(783.7)	(906.3)
Taxes and similar payments, excluding income tax		(39.9)	(41.3)	(44.7)
Payroll costs		(6.7)	(4.8)	(3.0)
<b>Operating expenses</b>		<b>(832.6)</b>	<b>(829.8)</b>	<b>(954.0)</b>
<b>Operating income (loss)</b>	(2)	<b>(53.1)</b>	<b>(43.8)</b>	<b>(59.6)</b>
Interest on notes mandatorily redeemable for shares		(43.7)	(47.2)	(1.2)
<b>Interest on other equity</b>	(13)	<b>(43.7)</b>	<b>(47.2)</b>	<b>(1.2)</b>
Revenues from investments in subsidiaries and associates	(3)	73.2	103.1	280.5
Interest income and similar revenues		964.9	1,315.0	2,171.1
Interest expense and similar expenses		(766.5)	(1,414.8)	(2,001.0)
Net change in financial provisions and amortization of bond premiums	(4)	1,298.5	5,018.3	(15,471.0)
Other financial revenues (expenses)		(518.3)	69.2	87.4
<b>Financial income (loss)</b>	(2)	<b>1,051.8</b>	<b>5,090.8</b>	<b>(14,933.0)</b>
<b>Income (loss) before non-recurring items and income tax</b>	(2)	<b>955.0</b>	<b>4,999.8</b>	<b>(14,993.8)</b>
Non-recurring revenues*		540.3	2,968.1	440.7
Non-recurring expenses**		(537.8)	(11,057.9)	(511.4)
<b>Non-recurring income (loss)</b>	(2)	<b>2.5</b>	<b>(8,089.8)</b>	<b>(70.7)</b>
Income tax	(2)/(5)	1,220.7	(165.4)	354.0
<b>Net income (loss) after tax</b>		<b>2,178.2</b>	<b>(3,255.4)</b>	<b>(14,710.5)</b>

\* 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	2004			2003	2002
		Gross value	Amortization and depreciation	Net value	Net value	Net value
Intangible assets		21.7	(19.8)	1.9	3.5	4.0
Land		-	-	-	-	-
Buildings		0.1	(0.1)	-	-	-
Other property, plant and equipment		0.4	(0.3)	0.1	0.1	0.1
<b>Property, plant and equipment</b>		<b>0.5</b>	<b>(0.4)</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>
Investments in subsidiaries and associates	(7)	20,856.9	(10,478.5)	10,378.4	9,738.9	13,659.6
Receivables from subsidiaries and associates	(8)	0.6	(0.6)	-	0.5	0.5
Other financial assets	(8)	9,806.3	(203.6)	9,602.7	2,029.1	2,374.8
<b>Investments and other non-current assets</b>		<b>30,663.8</b>	<b>(10,682.7)</b>	<b>19,981.1</b>	<b>11,768.5</b>	<b>16,034.9</b>
<b>TOTAL NON-CURRENT ASSETS</b>		<b>30,686.0</b>	<b>(10,702.9)</b>	<b>19,983.1</b>	<b>11,772.1</b>	<b>16,039.0</b>
Accounts receivable and other current assets	(9)/(16)	3,257.6	(0.4)	3,257.2	10,767.9	11,330.8
Marketable securities	(9)	1,766.7	(46.5)	1,720.2	1,275.7	497.4
Cash	(9)	1,428.9	-	1,428.9	3,034.7	3,584.0
<b>TOTAL CURRENT ASSETS</b>		<b>6,453.2</b>	<b>(46.9)</b>	<b>6,406.3</b>	<b>15,078.3</b>	<b>15,412.2</b>
Prepayments and deferred charges		115.9	-	115.9	587.7	257.5
<b>TOTAL ASSETS</b>	(6)	<b>37,255.1</b>	<b>(10,749.8)</b>	<b>26,505.3</b>	<b>27,438.1</b>	<b>31,708.7</b>

## LIABILITIES AND STOCKHOLDERS' EQUITY

(In millions of euros)	Notes	2004		2003	2002
		Before appropriation	After appropriation (*)	After appropriation	After appropriation
Capital stock	(11)	2,610.9	2,610.9	2,568.8	2,529.4
Additional paid-in capital	(12)	7,757.6	7,757.6	7,562.4	21,601.8
Reserves	(12)	2,119.0	2,134.4	2,119.0	2,284.1
Retained earnings	(18)	(10.6)	2,152.2	-	(11,066.3)
Net income for the year		2,178.2	-	-	-
Statutory provisions		-	-	-	-
<b>SHAREHOLDERS' EQUITY</b>	(12)	<b>14,655.1</b>	<b>14,655.1</b>	<b>12,250.2</b>	<b>15,349.0</b>
<b>OTHER EQUITY ITEMS</b>	(13)	<b>645.0</b>	<b>645.0</b>	<b>645.0</b>	<b>645.0</b>
<b>RESERVES FOR LIABILITIES AND CHARGES</b>	(14)/(18)	<b>2,826.2</b>	<b>2,826.2</b>	<b>3,485.9</b>	<b>3,467.8</b>
Bonds convertible in new or existing shares ("OCEANE")	(15)/(16)	1,022.4	1,022.4	1,022.4	-
Other bonds and notes issued	(15)/(16)	2,741.8	2,741.8	3,782.1	5,324.7
Bank borrowings and overdrafts	(16)	160.5	160.5	198.8	297.4
Miscellaneous borrowings	(16)	227.6	227.6	244.7	190.5
<b>FINANCIAL DEBT</b>		<b>4,152.3</b>	<b>4,152.3</b>	<b>5,248.0</b>	<b>5,812.6</b>
Taxation and social security	(16)	14.7	14.7	4.8	3.0
Other liabilities	(16)	4,211.7	4,211.7	5,794.9	6,431.2
<b>LIABILITIES</b>		<b>4,226.4</b>	<b>4,226.4</b>	<b>5,799.7</b>	<b>6,434.2</b>
Currency translation adjustment		0.3	0.3	9.3	0.1
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>26,505.3</b>	<b>26,505.3</b>	<b>27,438.1</b>	<b>31,708.7</b>

\* Proposal.

## > PARENT COMPANY STATEMENTS OF CHANGES IN FINANCIAL POSITION

(in millions of euros)	<b>2004</b>	<b>2003</b>	<b>2002</b>
<b>Sources of funds</b>			
Net income (loss)	2,178.2	(3,255.4)	(14,710.5)
Depreciation and amortization	3.0	0.5	0.7
Changes in valuation allowances and other reserves, net	(957.2)	(5,169.8)	15,234.9
Net (gain)/loss on disposal of non-current assets	(16.6)	8,171.1	111.5
<b>Funds provided (used) by operations</b>	<b>1,207.4</b>	<b>(253.6)</b>	<b>636.6</b>
Increase in capital stock	9.9	156.7	223.9
Increase in other equity	-	-	645.0
Increase in convertible bonds ("OCEANE")	-	1,022.4	-
Increase in other bonds	462.0	-	-
Increase in long-term debt	-	-	7.8
Property, plant and equipment sold	-	-	-
Investments sold	28.9	4,047.8	375.7
Other sources of funds	-	-	-
<b>Total sources</b>	<b>1,708.2</b>	<b>4,973.3</b>	<b>1,889.0</b>
<b>Application of funds</b>			
Increase in property, plant, equipment and intangible assets	1.4	-	-
Increase in investments	-	3,585.3	301.7
Dividend payable	-	-	-
Conversion of bonds into shares	-	-	-
Other application of funds	1,532.3	1,586.2	1,040.5
<b>Total application</b>	<b>1,533.7</b>	<b>5,171.5</b>	<b>1,342.2</b>
<b>Analysis of changes in working capital</b>			
Accounts receivable and other current assets	(100.3)	(130.0)	117.2
Non-financial debt*	1,166.7	(185.2)	462.3
Cash and cash equivalents:			
- short-term financial debt	381.3	764.3	270.2
- cash	(1,709.3)	(1,425.6)	(348.8)
- marketable securities	436.1	778.3	45.9
<b>Increase (decrease) in current funding</b>	<b>174.5</b>	<b>(198.2)</b>	<b>546.8</b>

\* The net change in income tax reserve is shown on the line "Non-financial debt".

## > NOTES TO THE ANNUAL STATUTORY ACCOUNTS

### 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 recent 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: 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 n°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, with earlier application possible as from accounting periods starting on January 1, 2000. The text sets out that a liability can only be recorded when an entity has a present obligation towards a third party and that it is probable or certain that the obligation will result in an out-flow of resources without at least an offsetting equivalent in-flow of resources. The obligation must exist at the period end in order for a provision to be recognized. Alcatel has applied this regulation as from January 1, 2002. In accordance with the requirements of this regulation, all non-compliant provisions, with the exception of those provisions relating to the changeover to the euro, have been written back to shareholders’ equity.

#### 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.

#### h) Taxes

Alcatel and its subsidiaries, held directly or indirectly more than 95%, form a tax group as defined in article 223 A of

the French General Tax Code. Each company belonging to this French Tax Group calculates its income tax charge on the basis of its own tax results for the year. Alcatel, as parent company of the French Tax Group, takes into account its own results and the tax consolidation entries when determining the Tax Group's taxable result.

The income tax charge or income recorded in the income statement by Alcatel consists of the following items:

- income tax paid to Alcatel by the taxable subsidiaries (income);
- income tax paid to the Tax Authorities for the French Tax Group;
- changes in the Tax Group's suspense account relating to the utilization by the Group of tax loss carry forwards,

which could be utilized in the future by the subsidiaries themselves when they become taxable;

- potential adjustments to prior years' tax charge;
- potential reserves for tax risks.

The Tax Group's suspense account is analyzed at each year-end closing to assess the likelihood of giving back tax savings to the subsidiaries. Subsidiaries that are no longer part of the French tax Group do not benefit from any tax saving.

## i) Pensions

As from January 1, 2004, Alcatel applies the "Conseil National de la Comptabilité"'s regulation N° 2003-R01 on pensions and other long-term benefits.

## NOTE 2 - INCOME STATEMENT ANALYSIS

Net income totaled €2 178.2 million in 2004, compared with €(3 255.4) million in 2003. The increase is analyzed below:

(in millions of euros)	2004	2003
Operating income (loss)	(53.1)	(43.8)
Interest on other equity	(43.7)	(47.2)
Financial income (loss)	1,051.8	5,090.8
<b>Income (loss) before non-recurring items and income tax</b>	<b>955.0</b>	<b>4,999.8</b>
Non-recurring items	2.5	(8,089.8)
Income tax	1,220.7	(165.4)
<b>Net income (loss) after tax</b>	<b>2,178.2</b>	<b>(3,255.4)</b>

**1)** In 2004, operating activities resulted in a loss of €53.1 million, as compared to a loss of €43.8 million in 2003.

The increase in operating loss results primarily from non-recurring bank fees and commissions incurred on financing operations in 2004.

Revenues, which derive principally from the subsidiaries' contributions to the financing of the Group's shared system of research, remained stable (€689.9 million in 2004 compared to €690.1 million in 2003); globally, the funding paid to the subsidiaries remained proportional.

**2)** Interests on notes mandatorily redeemable for new or existing shares, issued in December 2002, decreased from €47.2 million in 2003 to €43.7 million in 2004 due to the effect of discounting the interest prepaid on January 2, 2003.

**3)** Financial income decreased from €5 090.8 million in 2003 to €1 051.8 million in 2004, as a result of three principal factors:

- the net change in financial reserves and depreciation resulted in income of €1 298.5 million in 2004 compared to €5 018.3 million in 2003.

In view of the valuation performed on Alcatel's investment portfolio:

- depreciation reversals were booked in 2004, in particular on the investment in Coralec (€272.3 million), Compagnie Financière Alcatel (€361.3 million), Alcatel Space (€94.2 million) and Alcatel Submarine Networks (€16.7 million). These investments were depreciated in

2003 respectively for €12.2 million for Coralec, €1 406.0 million for Compagnie Financière Alcatel, €286.6 million for Alcatel Space and €920.8 million for Alcatel Submarine Networks.

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

- reserves for depreciation were made on the investments in Saft Participations (€60.6 million in 2004) and Alcatel Norway (€33.3 million in 2004 compared to €29.0 million in 2003).

- financial risk reserves covering Alcatel's commitment regarding Alcatel Canada Inc were reversed in the amount of €80 million in 2004 (increase in reserve in the amount of €30.0 million in 2003 - see note 19).

€95.3 million of reserves recorded in previous years for guarantees given were utilized in 2004 and €71.8 million was released for non-occurrence of risk.

The reserve for potential foreign exchange losses, which amounted to €419.2 million at December 31, 2003, was utilized during 2004 as a consequence of the reorganization of the USD loans with Alcatel USA Inc;

- the dividends received from subsidiaries decreased from €103.1 million in 2003 to €73.2 million in 2004 (see note 3);

■ interest paid on long-term borrowings decreased as a result of repurchases and cancellation of bonds (€133.1 million in 2004 compared to €251.0 million in 2003). Profits on short-term cash management, including the Group's system of guaranteeing the exchange rates of subsidiaries' commercial bids in foreign currencies, remained stable (around €400 million).

**4)** Non-recurring items resulted in a net profit of €2.5 million in 2004 compared to a loss of €8 089.8 million in 2003.

The 2003 net loss included 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 dis-

posal of the investment in Alcatel Cable France to Alcatel Participations and €67.6 million on the disposal of Florelec to Coralec as well as 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").

**5)** The income tax profit of €1 220.7 million relates to the French Tax Group (see note 5).

### NOTE 3 - REVENUES FROM INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES

(in millions of euros)

	2004	2003
<b>Subsidiaries</b>		
Electro Banque	40.0	99.9
Saft Participations	26.2	-
Radio Frequency Systems	4.0	0.1
Société Immobilière Nieuport	2.2	2.3
Other	-	0.1
<b>Associates</b>		
Nexans	0.7	0.7
<b>Total</b>	<b>73.2</b>	<b>103.1</b>

### NOTE 4 - NET CHANGE IN RESERVES

(in millions of euros)	2004		2003	
	Increase	(Write-back)	Increase	(Write-back)
Reserves for investments in subsidiaries and associates	94.9	(746.7)	2,654.6	(7,546.2)
Reserves for other financial investments and other financial assets	-	(33.3)	14.0	(140.4)
Reserves for marketable securities	0.2	(8.6)	-	(36.9)
Reserves for financial risks	62.3	(671.7)	487.4	(456.9)
Amortization of premiums on bonds	4.4	-	6.1	-
<b>Total</b>	<b>161.8</b>	<b>(1,460.3)</b>	<b>3,162.1</b>	<b>(8,180.4)</b>

2004 write-backs of reserves for investments in subsidiaries and associates relate mainly to Coralec (€272.6 million), Compagnie Financière Alcatel (€361.3 million), Alcatel Space (€94.2 million) and Alcatel Submarine Networks (€16.7 million). In 2003, they related 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 Saft Participations (€60.6 million)

and Alcatel Norway (€33.3 million). They related also in 2003 to Compagnie Financière Alcatel (€1,405.9 million), Alcatel Submarine Networks (€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 2005 to 2009 and on a terminal value in 2009. The discount rate used of 10.8% was the weighted average cost of the Group's capital in 2004. 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 €23.3 million in 2004 (write-back of €140.4 million in 2003).

Reserves for financial risks cover Alcatel's commitment to buy back a part of the investment in Alcatel Canada Inc. (€2 580.0 million in the balance sheet – see note 19 following the release of €80.0 million in 2004), risks on guarantees given 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 45 in 2004, compared to 55 in 2003. The main subsidiaries belonging to the French Tax Group are mentioned in the investment portfolio at December 31, 2004.

b) The tax income recorded in the 2004 income statement results from:

- the difference between the 2004 income tax receivable from taxable subsidiaries and the income tax payable to non-taxable subsidiaries because of their 2004 tax losses; and
- the adjustment of the payable to subsidiaries, recorded by the parent company in a tax group suspense account, which represents the parent company's risk of having to reimburse tax savings to its subsidiaries that it has realized because of the subsidiaries' past tax losses.

Due mainly to the change in the 2004 tax law on income tax relating to long-term capital gains and to the departure from the French Tax Group during 2004 of certain disposed subsidiaries, it is now unlikely that Alcatel will be required to give back to the subsidiaries the monies that it has recorded in the tax group suspense account. At December 31, 2004, the tax group suspense account no longer exists. At December 31, 2003, the tax group suspense amounted to €1 195.6 million.

### 2) Tax charge breakdown

The annual parent company tax charge breaks down as follows:

(in millions of euros)	2004		2003	
	Pre-tax amount	Tax	Pre-tax amount	Tax
Operating income (loss)	(53.1)	38.4	(43.8)	(71.2)
Interest on other equity	(43.7)	-	(47.2)	-
Financial income (loss)	1,051.8	(48.4)	5,090.8	(149.3)
<b>Income (loss) before non-recurring items and income tax</b>	<b>955.0</b>	<b>(10.0)</b>	<b>4,999.8</b>	<b>(220.5)</b>
Non-recurring items	2.5	9.9	(8,089.8)	55.1
French Tax Group's suspense account recognized in the income statement*	-	1,220.8	-	-
<b>Total tax benefit (charge)</b>	<b>1,220.7</b>	<b>1,220.7</b>	<b>(165.4)</b>	<b>(165.4)</b>
<b>Net income (loss) after tax</b>	<b>2,178.2</b>	<b>-</b>	<b>(3,255.4)</b>	<b>-</b>

\* This amount takes into account the 2004 movements due to the payment by the subsidiaries of the 2003 income tax.

Note: non-deductible expenses defined in article 39.4 of the French General Tax Code amounted to €0.2 million.

## NOTE 6 - BALANCE SHEET

Total assets decreased from €27.4 billion at the end of 2003 to €26.5 billion at the end of 2004. Significant changes in the 2004 balance sheet include the following:

- Investments in subsidiaries and associates increased from €9.7 billion at the end of 2003 to €10.4 billion at the end of 2004 (see notes 4 and 7);
- other financial assets increased from €2.0 billion at the end of 2003 to €9.6 billion at the end of 2004, mainly as a result of the reclassification to long-term assets of loans from Alcatel's Central Treasury to subsidiaries within the context of the Group's treasury convention. The other current assets caption decreases similarly;

- Shareholders' equity after appropriation increased from €12.3 billion to €14.7 billion mainly due to the income for the year; the main increases in capital in 2004 were linked to the acquisition of Spatial Wireless, to the reimbursement of bonds redeemable for shares issued by Coralec for the acquisition of Imagic TV Inc, TiMetra Inc, Astral Point and Telera, and to the exercising of stock options (see notes 11 and 12);
- Financial debt decreased from €5.2 billion at the end of 2003 to €4.2 billion at the end of 2004 as a result of reimbursements, buy-backs and exchange of debt made during 2004;
- Other liabilities decreased by €1.6 billion (€4.2 billion in 2004 compared to €5.8 billion in 2003); 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)	<b>Gross value</b>	<b>Depreciation</b>	<b>Net value</b>
<b>December 31, 2003</b>			
Subsidiaries	19,776.6	(10,574.9)	9,201.7
Associates	1,092.6	(555.4)	537.2
<b>Total</b>	<b>20,869.2</b>	<b>(11,130.3)</b>	<b>9,738.9</b>
Acquisitions	207.2		207.2
Disposals	(219.5)		(219.5)
(Increases)/Write-backs of provisions	-	651.8	651.8
<b>December 31, 2004</b>			
Subsidiaries	19,764.3	(9,854.7)	9,909.6
Associates	1,092.6	(623.8)	468.8
<b>Total</b>	<b>20,856.9</b>	<b>(10,478.5)</b>	<b>10,378.4</b>

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

- the acquisition of Spatial Wireless (€207.2 million) and its simultaneous disposal to Compagnie Financière Alcatel,
- the cancellation of the investment in Eurelec (€12.2 million), a company which was dissolved and merged with Alcatel using the "Transmission Universelle de Patrimoine" procedure.



## 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
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
<b>December 31, 2003</b>	<b>2,267.0</b>	<b>(237.4)</b>	<b>2,029.6</b>
Increases	8,121.6		8,121.6
Decreases	(581.8)		(581.8)
(Increases)/Write-backs of provisions		33.3	33.3
<b>December 31, 2004</b>	<b>9,806.8</b>	<b>(204.1)</b>	<b>9,602.7</b>
Alcatel shares held	471.9	(181.7)	290.2
Long-term loans to subsidiaries	9,317.0	(4.7)	9,312.3
Other financial assets	17.9	(17.7)	0.2
<b>December 31, 2004</b>	<b>9,806.8</b>	<b>(204.1)</b>	<b>9,602.7</b>

The increase in long-term loans results from the reclassification during 2004 of advances to subsidiaries within the context of the Group's Treasury Convention that were previously classified as short-term.

The market value of Alcatel shares owned by the company amounted to €290.2 million, based on the average stock market prices for December 2004. No acquisition or disposal of such shares occurred in 2004.

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

The net amounts of short-term financial assets and debts (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)	2004	2003
Cash	1,428.9	3,034.7
Group's Treasury Convention with subsidiaries	3,096.6	10,564.2
<b>Total cash and cash equivalents*</b>	<b>4,525.5</b>	<b>13,598.9</b>
<b>Marketable securities**</b>	<b>1,720.2</b>	<b>1,275.7</b>
Short-term bank loans and overdrafts	(102.9)	(15.5)
Short-term miscellaneous borrowings	(227.6)	(244.4)
Group's Treasury Convention with subsidiaries	(3,897.3)	(4,265.0)
<b>Total short-term financial debt***</b>	<b>(4,227.8)</b>	<b>(4,524.9)</b>
<b>Total</b>	<b>2,017.9</b>	<b>10,349.7</b>

\* 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 € 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 rates risks are analyzed below.

### a) Currency risks

As of December 31, 2004, the off-balance sheet financial instruments, held for hedging purposes, are summarized below:

(in millions of euros)	Buy / lend		Sell / borrow	
	Principal amount	Fair value	Principal amount	Fair value
Forward exchange contracts	1,686.2	(38.7)	2,809.4	180.0
Exchange rate swaps	131.6	(1.8)	355.4	4.3
Currency swaps	-	-	-	-
Currency option contracts:				
- call	1,406.4	18.5	1,454.8	(17.4)
- put	3,031.8	85.9	2,652.7	(72.2)

Analysis by maturity date and interest rate:

	Maturity dates	
	Earliest	Latest
Forward exchange contracts	01/03/2005	04/28/2006
Exchange rate swaps	01/04/2005	06/30/2005
Currency swaps	-	-
Currency option contracts:		
- call	01/11/2005	10/20/2005
- put	01/07/2005	11/28/2005

### b) Interest rate risks

At December 31, 2004, off-balance sheet financial instruments held to manage interest rate risks are as follows:

(in millions of euros)	Pay floating rate		Pay fixed rate	
	Principal amount	Fair value	Principal amount	Fair value
Interest rate swaps	7,177.5	205.1	3,856.5	(19.1)
FRA	-	-	-	-
CAPS	3,726.5	13.2	2,969.6	(11.3)
Floors	367.1	1.9	367.1	(1.9)
Options on interest rate swaps:				
- call	-	-	-	-
- put	-	-	-	-

Analysis by maturity date and interest rate:

	Maturity date		Interest rates	
	Earliest	Latest	Lowest	Highest
Interest rate swaps	01/10/2005	04/07/2014	1.820%	7.685%
FRA	-	-	-	-
CAPS	01/10/2005	10/01/2008	2.500%	5.750%
Floors	02/10/2005	02/10/2005	4.250%	4.250%
Options on interest rate swaps:				
- call	-	-	-	-
- put	-	-	-	-

### c) Credit rating and financial covenant

As of January 8, 2005, Alcatel's credit ratings were as follows:

Rating Agency	Long-term Debt	Short-term Debt	Outlook	Last Update
Standard & Poor's	BB	B	Stable	November 10, 2004
Moody's	Ba3	Not Prime	Positive	September 8, 2004

In 2004, Standard and Poor's decided to revise Alcatel's long-term debt credit rating from B+ to BB-, outlook stable and Moody's revised its long-term rating from B1 to Ba3, maintaining an outlook positive.

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

Date	Standard & Poor's		Date	Moody's	
November 10, 2004	BB	Outlook stable	September 8, 2004	Ba3	Outlook positive
March 10, 2004	BB-	Outlook stable	May 10, 2004	B1	Outlook positive
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

#### Rating clauses affecting Alcatel debt at December 31, 2004

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 bank credit facility

On June 21, 2004, Alcatel closed a €1,300 million 3-year multi-currency revolving credit facility. This facility replaced the undrawn euro 1,375 million syndicated facility maturing in April 2005 that was put in place on April 9, 2002 (for an initial amount of €2,075 million, of which €700 million matured within one year).

The availability of this syndicated credit facility of €1,300 million is not dependent upon Alcatel's credit ratings. At December 31, 2004, the credit facility had not been drawn and remained undrawn at the date of approval of the 2004 financial statements by the Board of Directors. Alcatel's ability to draw on this facility is conditioned upon its compliance with certain financial covenants. 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 net debt. As the Group had cash and cash equivalents in excess of its gross financial debt at December 31, 2004 and December 31, 2003, the above-mentioned ratios were not applicable at these dates.

## NOTE 11 - CAPITAL STOCK

Capital stock, consisting of 1 305 455 461 ordinary shares of nominal value €2, increased from €2 568.8 million at the end of 2003 to €2 610.9 million at the end of 2004. 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)

<b>At December 31, 2003</b>	<b>1,284,410,224</b>
Capital increase arising from:	
- repayment of bonds reimbursable in shares ("ORA"):	
- issued in 2002 - Astral Point acquisition*	300,000
- issued in 2002 - Telera acquisition*	400,000
- issued in 2003 - TiMetra acquisition*	1,000,000
- issued in 2003 - Imagic TV acquisition*	50,000
- issued in 2004 - Spatial Wireless acquisition*	17,783,297
- repayment of notes mandatorily redeemable for new or existing shares ("ORANE") 7.91% 2002-2005	3,212
- stock options exercised during 2004	1,508,728
<b>At December 31, 2004</b>	<b>1,305,455,461</b>

\* 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 Astral Point, Telera, TiMetra, Imagic TV and Spatial Wireless (later renamed Alcatel Wireless).

## 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)

<b>At December 31, 2003</b>	<b>7,562.4</b>
- repayment of bonds reimbursable in shares ("ORA"):	
- issued in 2002 - Astral Point acquisition*	4.3
- issued in 2002 - Telera acquisition*	1.3
- issued in 2003 - TiMetra acquisition*	6.1
- issued in 2003 - Imagic TV acquisition*	0.3
- issued in 2004 - Spatial Wireless acquisition*	176.3
- repayment of notes mandatorily redeemable for new or existing shares ("ORANE") 7.91% 2002-2005	-
- stock options exercised during 2004	6.9
<b>At December 31, 2004</b>	<b>7,757.6</b>

\* 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 Astral Point, Telera, TiMetra, Imagic TV and Spatial Wireless (later renamed Alcatel Wireless).

At December 31, 2004 and considering the proposed allocation of accumulated losses, additional paid-in capital and reserves were as follows:

(in millions of euros)	2004		2003
	Before appropriation	After appropriation	After appropriation
Additional paid-in capital	7,757.6	7,757.6	7,562.4
Legal reserve	245.7	261.1	245.7
Statutory reserves	1,873.3	1,673.3	1,873.3
Other reserves	-	195.0	-
<b>Total</b>	<b>9,876.6</b>	<b>9,887.0</b>	<b>9,681.4</b>

In view of the above-mentioned proposed allocation of losses, the legally distributable reserves amount to €1 868.3 million.

The retained earnings brought forward were affected during 2004 by:

- the effect of applying, as from January 1, 2004, the "Conseil National de la Comptabilité"'s regulation N° 2003-R01 on pensions and other long-term benefits (€5.5 million);
- the effect of accruing for the special tax on long-term capital gains reserves set up by the 2004 French tax law (€5 million).

### NOTE 13 - OTHER EQUITY

On December 19, 2002, Alcatel issued 120 786 517 notes, of nominal value €5.34 each, mandatorily redeemable for new or existing shares ("ORANE") (one share for each note),

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 note.

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 2004, 3 600 notes (2 338 in 2003) were repaid by issuance of 3 212 new shares (the difference corresponding to the reimbursement of prepaid interest by the note holders).

Interest due on the ORANES for 2004 amounted to €43.8 million. Pre-paid interest of €39.6 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 2004 were as follows:

(in millions of euros)	12/31/2003	Additions	(Write-backs)	(Utilizations)	12/31/2004
Reserve for unrealized foreign exchange losses	419.7	25.8	(419.7)	-	25.8
Reserve for financial risks (see note 4)	2,872.2	36.5	(156.5)	(95.3)	2,656.9
Reserves for legal disputes, guarantees given on investments sold and other reserves	175.7	8.9	(66.7)	(0.3)	117.6
Reserves for pension and retirement indemnities	17.8	4.9	(2.3)	-	20.4
Other reserves	0.5	5.0	-	-	5.5
<b>Total</b>	<b>3,485.9</b>	<b>81.1</b>	<b>(645.2)</b>	<b>(95.6)</b>	<b>2,826.2</b>
Recorded in shareholders' equity (see notes 12 and 18)		7.6	-		7.6
Effect of mergers		0.3	-		0.3
Recorded in operating income (loss)		7.0	(2.3)		4.7
Recorded in financial income (loss)		62.3	(576.2)		(513.9)
Recorded in non-recurring income (loss)		3.9	(66.7)		(62.8)
<b>Total charge (credit) to income statement</b>		<b>73.2</b>	<b>(645.2)</b>		<b>(572.0)</b>

## NOTE 15 - BONDS ISSUED

At December 31, 2004, outstanding Alcatel bonds amounted to €3,764.2 million compared to €4,804.5 at December 31, 2003. These amounts result from the following transactions in 2004:

(in millions of euros)	12/31/2003	Repayment of bonds maturing in 2003	Buy-backs and cancellations	New issuances	12/31/2004
<b>Convertible bonds (OCEANE)</b>					
- Bonds convertible into new or existing shares 2003-2011	1,022.4	-	-	-	1,022.4
	<b>1,022.4</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,022.4</b>
<b>Other bonds</b>					
- FRF 2 billion bond 5.75% 1994-2004	183.9	(183.1)	(0.8)	-	-
- FRF 1.5 billion bond 5.625% 1997-2007	193.4	-	(38.9)	-	154.5
- FRF 1 billion bond zero coupon 2006	152.4	-	(111.2)	-	41.2
- €1 120 million bond 1999-2009	1,009.8	-	-	-	1,009.8
- €500 million bond 1999-2004	359.2	(336.4)	(22.8)	-	-
- €1 billion bond 2000-2005	793.4	-	(217.1)	-	576.3
- €1.2 billion bond 2001-2006	1,090.0	-	(592.0)	-	498.0
- €462 million bond 2004-2014	-	-	-	462.0	462.0
	<b>3,782.1</b>	<b>(519.5)</b>	<b>(982.8)</b>	<b>462.0</b>	<b>2,741.8</b>
<b>Total</b>	<b>4,804.5</b>	<b>(519.5)</b>	<b>(982.8)</b>	<b>462.0</b>	<b>3,764.2</b>

### Offer to exchange bonds

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 €412.0 million, due 2014. The new bonds bear interest at 6.375% per annum and produce a return of 6.49%. Additional bonds having a nominal value of €50.0 million, which are interchangeable with the new bonds, were also issued. The total nominal value of the new and additional bonds, due 2014, amounts to €462.0 million. The exchange offer closed on April 7, 2004. The loss arising on the exchange offer (42.9 million of euros) is included in non-recurring income (loss).

### Other 2004 bond repurchases

In addition to the tender offer to repurchase bonds, several bonds were subject to buy-back and cancellation in 2004, amounting to €643.1 million, corresponding to a nominal value of €616.9 million, detailed as follows:

(in euros)	Nominal value repurchased
Maturity February 2004	762,245
Maturity October 2004	22,819,000
Maturity September 2005	217,102,000
Maturity June 2006	111,191,052
Maturity December 2006	226,209,000
Maturity March 2007	38,874,495
	<b>616,957,792</b>

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

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

(in millions of euros)	<b>Amount at 12/31/2004</b>	<b>Less than one year</b>	<b>1-5 years</b>	<b>After 5 years</b>	<b>out of which accruals</b>
<b>Financial debt</b>					
- convertible bonds (OCEANE)	1,022.4	-	-	1,022.4	-
- other bonds	2,741.8	576.3	1,703.5	462.0	-
- bank loans and overdrafts	160.5	102.9	57.6	-	11.2
- miscellaneous borrowings	227.6	227.6	-	-	129.7
<b>Tax and social liabilities</b>	<b>14.7</b>	<b>14.7</b>	<b>-</b>	<b>-</b>	<b>3.8</b>
<b>Other liabilities (after appropriation)</b>	<b>4,211.7</b>	<b>4,205.3</b>	<b>6.4</b>	<b>-</b>	<b>204.4</b>
<b>Total liabilities</b>	<b>8,378.7</b>	<b>5,126.8</b>	<b>1,767.5</b>	<b>1,484.4</b>	<b>349.1</b>

### Analysis of other liabilities at December 31, 2004

Advances from subsidiaries - Group's Treasury Convention	3,897.3
Accounts payable	221.2
Other	93.2
	4,211.7

(in millions of euros)	<b>Amount at 12/31/2004</b>	<b>Less than one year</b>	<b>1-5 years</b>	<b>After 5 years</b>	<b>out of which accruals</b>
Tax and social receivables	4.5	4.5	-	-	-
Other accounts receivable and other current assets	3,252.7	3,169.8	82.9	-	35.1
<b>Total accounts receivable and other current assets</b>	<b>3,257.2</b>	<b>3,174.3</b>	<b>82.9</b>	<b>-</b>	<b>35.1</b>

### Analysis of accounts receivable and other current assets at December 31, 2004

Advances to subsidiaries - Group's Treasury Convention	3,096.6
Accounts receivable	67.8
Other	88.3
	3,252.7

## NOTE 17 - RELATED PARTY TRANSACTIONS

(in millions of euros)	<b>Net balance sheet amount</b>	<b>of which consolidated or related companies</b>
<b>Investments and other non-current assets</b>		
- Investments in subsidiaries and associates	10,378.4	10,368.6
- Due from subsidiaries and associates	-	-
- Other financial assets	9,312.2	9,312.2
- Other investments	290.5	290.2
<b>Accounts receivable</b>	<b>3,257.2</b>	<b>3,143.3</b>
<b>Marketable securities</b>	<b>1,720.1</b>	<b>-</b>
<b>Financial debt</b>		
- Convertible bonds and other bonds	3,764.2	-
- Bank loans and overdrafts	160.5	-
Miscellaneous borrowings	227.6	33.4

(in millions of euros)

	Net income statement amount	of which consolidated or related companies
<b>Financial income (loss)</b>		
– Revenues from investments in subsidiaries and associates	73.2	72.5
– Interest income and similar revenues	964.9	445.6
– Interest expenses and similar expenses	(766.5)	(188.2)
– Other financial revenues (expenses)	780.2	885.8

## NOTE 18 - PENSIONS AND RETIREMENT INDEMNITIES

At December 31, 2004, Alcatel's pensions and retirement indemnity obligations were either reserved (the reserve amounts to €20.4 million – see note 14) or were covered by insurance contracts.

The "Conseil National de la Comptabilité"'s regulation N° 2003-R01 on pensions and other long-term benefits has been applied as from January 1, 2004.

Actuarial gains and losses due to experience adjustments and effects of changes in actuarial assumptions existing at December 31, 2003 have been transferred to shareholders' equity, as allowed by the "Conseil National de la Comptabilité"'s press release dated July 22, 2004.

Actuarial gains and losses computed as from January 1, 2004 have been recorded using the "corridor" method. Consequently they have been recorded as an adjustment to the pension reserve and they are amortized if they exceed a given amount.

The effects of applying this regulation are the following:

- Actuarial gains and losses existing at December 31, 2003, as defined above, have been transferred to shareholders' equity;
- The valuation method of pensions and similar benefits has been changed and is now commonly applied throughout the Group.

The effect of applying this regulation amounts to €5.5 million on shareholders' equity at December 31, 2004 (out of which €2.6 million are recorded in pension reserves and €2.9 million in prepayments and deferred charges).

## 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 was acquired by Lubelec in exchange for Alcatel shares, which were 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 2004 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 €10.0 million for 2004.

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.

In April 2004, as part of a reassessment of its financing requirements and credit facilities and with a view to optimizing its financial costs, Alcatel decided to cancel this securitization program.

### d) Guarantees on cash pooling

Guarantees given in respect to Alcatel's centralized treasury management amounted to approximately €605 million at year-end 2004, 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 12/31/2004	Less than one year	1-5 years	After 5 years
Guarantees granted to subsidiaries or other Group companies (*)	118.2	107.2	11.0	-
Assets pledged to secure Alcatel's financial debt	-	-	-	-
Guarantees given on:				
- commercial contracts	2,590.3	829.0	1,085.2	676.1
- loans	61.9	61.9	-	-
- other items	521.7	179.0	143.2	199.5
Discounted receivables	-	-	-	-
<b>Total</b>	<b>3,292.1</b>	<b>1,177.1</b>	<b>1,239.4</b>	<b>875.6</b>

\* of which €53.3 million is recorded in financial risk reserves as of December 31, 2004.

## NOTE 20 - CONTINGENCIES

In addition to legal proceedings incidental to the conduct of its business (including employment-related collective actions in France and the US) which management believes are adequately reserved against in the financial statements or will not result in any significant costs to the Group, Alcatel is involved in the following legal proceedings:

### 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 client, France Telecom, based on an audit of production costs conducted in 1989 in the transmission division, and in 1992 in the switching division. Two settlement agreements were entered into with France Telecom, one in 1993 in relation to the transmission division, and the other in May 2004 in relation to the switching activity: in the latter it was recognized that the parties' dispute on pricing did not involve fraud by Alcatel CIT.

In April 1999, Alcatel 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. Since then, the file has been the subject of several procedural developments, including appeals relating to the closing of the investigation phase with respect to a former employee of Alcatel CIT, who has been indicted. At the end of November 2004, the investigating magistrate again declared his investigation closed, following which three other indicted defendants took new procedural steps. It is therefore unlikely that the investigating magistrate will be able to close his investigation before June 2005 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 the former Optronics division's 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. Amount of damages sought by these lawsuits has not yet been specified.

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. Alcatel filed a motion to dismiss this action on January 31, 2003 and a decision on the motion was rendered on March 4, 2005. The judge rejected a certain number of the plaintiffs' demands with prejudice. He also rejected all the remaining claims under the federal securities laws for lack of specificity in the pleadings, but with leave to file a further amended complaint.

### Costa Rica

Beginning in early October 2004, Alcatel learned that investigations had been launched in Costa Rica by the Costa Rican Attorney General and the National Congress, regarding payments alleged to have been made by a consultant on behalf of an Alcatel subsidiary to various state and local officials in Costa Rica, two political parties in Costa Rica and representatives of ICE, the state owned telephone company, in connection with the procurement by the Alcatel subsidiary of several contracts for network equipment and services from ICE. Upon learning of these allegations, Alcatel

immediately commenced and is continuing an investigation into this matter.

In Costa Rica and other countries, Alcatel retains consultants to assist it with its local operations and contracts. Alcatel's contracts with persons through whom Alcatel deals locally strictly prohibit the provision of any pecuniary or other advantage in contravention of applicable laws. In addition, Alcatel has a strict Statement of Business Practice (a copy of which is available on its web site, [www.alcatel.com](http://www.alcatel.com), under the heading Sustainable Development - Values and Charters) that imposes the highest standards of legal and ethical conduct on its employees. Alcatel rigorously enforces this Statement of Business Practice across the entire company and, when violations occur, Alcatel takes prompt and appropriate action against the persons involved.

Alcatel has terminated the employment of the president of Alcatel de Costa Rica and a vice president-Latin America of a French subsidiary. Alcatel is also in the process of pursuing criminal actions against the former president of Alcatel de Costa Rica, the local consultants and the employee of the French subsidiary based on its suspicion of their complicity in an improper payment scheme and misappropriation of funds. The contracts with the local consultants were limited to the specific projects involved and are no longer in effect or are terminated, and any payments due under those contracts have been suspended. Alcatel's internal investigation is continuing.

Alcatel contacted the United States Securities and Exchange Commission and the United States Department of Justice and informed them that Alcatel will cooperate fully in any inquiry or investigation into these matters. The SEC is conducting an inquiry into the allegations. If the Department of Justice or the SEC determines that violations of law have occurred, it could seek civil or, in the case of the Department of Justice, criminal sanctions, including monetary penalties against Alcatel. Neither the Department of Justice nor the SEC has informed Alcatel what action, if any, they will take.

Several investigations have been launched in Costa Rica concerning this matter by both the Costa Rican Attorney General and the Costa Rican National Congress. On November 25, 2004, the Costa Rican Attorney General's Office commenced a civil lawsuit against Alcatel CIT to seek compensation for the pecuniary damage caused by the alleged payments described above to the people and the Treasury of Costa Rica, and for the loss of prestige suffered by the Nation of Costa Rica. On February 1, 2005, ICE commenced a lawsuit against Alcatel CIT to seek compensation for the pecuniary damage caused by the alleged payments described above to ICE and its customers, and for the tarnishment to the reputation of ICE resulting from these events. The amount of damages sought by these lawsuits has not yet been specified. Alcatel intends to defend these actions vigorously and deny any liability or wrongdoing with respect to these litigations.

Alcatel is unable to predict the outcome of these investigations and civil lawsuit and their effect on our business. If the Costa Rican authorities conclude criminal violations have occurred, Alcatel may be banned from participating on public contracts within Costa Rica for a certain period and fines or penalties may be imposed on Alcatel, in an amount which Alcatel is not able to determine at this time. Alcatel expects to generate approximately €9 million in revenue from Costa

Rican contracts in 2005. Based on the amount of revenue received from these contracts, Alcatel does not believe a loss of business in Costa Rica would have a material adverse effect on Alcatel as a whole. However, these events may have a negative impact on the image of its company in Latin America.

## Taiwan

Certain employees of Alcatel Taisel, a Taiwanese subsidiary of Alcatel, and Siemens Taiwan, along with a few suppliers and a legislative aide, have been the subject of an investigation by the Taipei Investigator's Office of the Ministry of Justice relating to an axle counter supply contract awarded to Alcatel Taisel by Taiwan Railways in 2003. It has been alleged that persons in Alcatel Taisel and Siemens Taiwan and subcontractors hired by them were involved in a bid rigging and payment arrangement for the Taiwan Railways contract.

Upon learning of these allegations, Alcatel immediately commenced and is continuing an investigation into this matter. Alcatel terminated the former country senior officer of Alcatel Taisel. A director of international sales and marketing development of a German subsidiary who was involved in the Taiwan Railways contract has resigned and is under ongoing investigation by the Taiwanese authorities.

On February 21, 2005, the former country senior officer of Alcatel Taisel and Alcatel Taisel were indicted for violation of the Taiwanese Government Procurement Act. If the former country senior officer is found guilty of the allegations in the indictment, Alcatel Taisel may be banned from participating in governmental contracts within Taiwan for a certain period and fines or penalties may be imposed on Alcatel, in an amount not to exceed €25,000. As a group, Alcatel expects to generate approximately €80 million in all or part of this revenue from Taiwanese contracts in 2005. Based on the amount of revenue received from these contracts, Alcatel does not believe a loss of business in Taiwan would have a material adverse effect on Alcatel as a whole.

## Effect of the investigations

Alcatel reiterates that its policy is to conduct its business with transparency, and in compliance with all laws and regulations, both locally and internationally. Alcatel will fully cooperate with all governmental authorities in connection with the investigation of any violation of those laws and regulations.

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 or its income from operations. 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.

## NOTE 21 - REMUNERATION OF DIRECTORS AND EXECUTIVE OFFICERS

Directors' fees for 2004 amounted to €0.6 million (€0.6 million in 2003).

The 2004 remuneration of the eleven executive officers comprising Alcatel's Executive Committee amounted to €11.6 million (€7.5 million in 2003) 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 <sup>(1)</sup>	Alcatel percentage of ownership (%)
<b>Detailed information relating to subsidiaries and associates with book value in excess of 1% of Alcatel's capital stock</b>			
<b>A - Subsidiaries (at least 50% of capital stock held by Alcatel)</b>			
CFA - Compagnie Financière Alcatel 54, rue La Boétie - 75008 Paris	3,162.0	409.2	100.0
Coralec - 12, rue de La Baume - 75008 Paris	8,586.4	(5,196.4)	100.0
Electro Banque - 12, rue de La Baume - 75008 Paris	106.0	645.1	99.9
Saft Participations - 12, rue de La Baume - 75008 Paris	196.8	248.4	100.0
Alcatel Submarine Networks - Route de Nozay 91625 La Ville-du-Bois Cedex	112.0	48.4	100.0
Alcatel Norway A/S - Ostre Aker vei 33 Oker 0508 Oslo (Norway)	10.2	26.3	100.0
SIKL - Sté Immobilière Kléber Lauriston 12, rue de La Baume - 75008 Paris	16.3	31.6	100.0
<b>B - Associates (10% to 50% of capital stock held by Alcatel)</b>			
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	(60.9)	25.0
<b>Information relating to other subsidiaries and associates</b>			
<b>A - Subsidiaries (at least 50% of capital stock held by Alcatel)</b>			
a - French subsidiaries	-	-	-
b - Foreign subsidiaries	-	-	-
<b>B - Associates (10% to 50% of capital stock held by Alcatel)</b>			
a - French subsidiaries	-	-	-
b - Foreign subsidiaries	-	-	-

(1) Before appropriation.

(2) Last financial year.

<b>Gross value of investments held</b>	<b>Net book value of investments held</b>	<b>Outstanding loans and advances</b>	<b>Guarantees given</b>	<b>Net sales</b> (2)	<b>Net income (loss)</b> (2)	<b>Dividends received in 2004 by Alcatel</b>
8,274.0	4,472.0	1,075.6	-	189.1	669.8	-
8,726.6	3,683.0	729.6	-	-	(272.6)	-
581.3	581.3	-	-	32.2	40.7	40.0
539.9	479.2	-	-	-	32.9	26.2
1,282.6	407.0	19.3	-	204.9	(89.6)	-
164.8	88.6	-	-	56.0	(4.2)	-
155.1	47.0	-	-	-	1.1	-
795.0	335.4	-	-	1,277.2	50.7	-
295.9	295.9	-	-	-	128.5	-
34.9	32.7	-	-	-	-	6.3
5.1	5.1	-	-	-	-	-
-	-	-	-	-	-	0.7
-	-	-	-	-	-	-

## > INVESTMENT PORTFOLIO AT DECEMBER 31, 2004

		<b>Number of shares held</b>	<b>Net book value</b> (in thousands of euros)	<b>Alcatel percentage of ownership</b>	<b>Alcatel Group percentage of ownership</b>
<b>I - Investments in subsidiaries and associates</b>					
Compagnie Financière Alcatel	(TG)	451,711,205	4,472,010	100.0	100.0
Coralec	(TG)	572,428,045	3,662,618	100.0	100.0
Electro Banque	(TG)	10,592,213	581,303	99.9	100.0
Saft Participations	(TG)	13,121,159	479,234	100.0	100.0
Alcatel Submarine Networks	(TG)	35,470,941	378,534	100.0	100.0
Alcatel Deutschland		1	295,926	25.0	100.0
Alcatel Space	(TG)	39,077,463	335,402	48.9	100.0
Alcatel Norway		8,400,000	88,569	100.0	100.0
SIKL	(TG)	214,623	46,977	100.0	100.0
Radio Frequency Systems France	(TG)	15,357	7,562	100.0	100.0
Electro Re		6,650	5,100	95.0	100.0
Sardelec	(TG)	152,499	3,255	100.0	100.0
CGE	(TG)	30,000	457	100.0	100.0
FIPP		81,044	200	74.6	74.6
Other			384		
<b>II - Other financial investments</b>					
Alcatel		25,343,255	290,180	2.0	4.9
<b>III - Investments in real estate companies</b>					
			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)
- Saft Power Systems (subsidiary of Saft Participations)

## > FIVE-YEAR SUMMARY OF FINANCIAL DATA

Nature des indications	2004	2003	2002	2001	2000
<b>Capital stock at year end</b>					
a) Capital stock (in thousands of euros)	2,610,911	2,568,820	2,529,417	2,481,540	2,457,421
b) Number of A shares	1,305,455,461	1,284,410,224	1,239,193,498	1,215,254,797	1,212,210,685
c) Number of O shares	-	-	25,515,000	25,515,000	16,500,000
d) Total number of shares after division	1,305,455,461	1,284,410,224	1,264,708,498	1,240,769,797	1,228,710,685
<b>Potential capital</b>					
a) Capital stock (in thousands of euros)	3,222,896	3,170,035	2,974,011	2,688,391	2,530,046
b) Total number of shares	1,611,448,098	1,585,017,673	1,487,005,573	1,344,195,736	1,265,022,926
<b>Results</b>					
(in thousands of euros)					
a) Revenues from investments portfolio	73,171	103,101	280,502	393,542	1,077,056
b) Income (loss) before tax, depreciation, amortization and provisions	(388,386)	(8,126,141)	379,442	697,755	1,647,969
c) Income tax	1,220,747	165,356	(353,964)	(97,504)	95,420
d) Employee profit sharing	-	-	-	-	-
e) Income (loss) after tax, depreciation amortization and provisions	2,178,214	(3,255,426)	(14,710,546)	(2,966,106)	1,395,711
f) Dividends (including distribution tax)	- (1)	-	-	196,993	583,511
<b>Earnings per Share</b>					
(in euros)					
a) Income (loss) after tax, but before depreciation amortization and provisions	(1.23) (2)	(6.46)	0.58	0.64	1.26
b) Income (loss) after tax, depreciation amortization and provisions	1.67 (2)	(2.53)	(11.63)	(2.39)	1.14
c) Dividend attributable to each A Share having a nominal value of euros 2	- (1)	-	-	0.16	0.48
d) Dividend attributable to each O Share having a nominal value of euros 2	- (1)	-	-	0.10	0.10
<b>Personnel</b>					
a) Average number of staff employed during the year	5	5	4	5	5
b) Payroll (in thousands of euros)	5,000	2,911	1,889	3,343	3,655
c) Social security and employee benefits (in thousands of euros)	1,540	1,662	955	779	933

(1) Proposal.

(2) This value takes into account the total of Alcatel shares (A shares and O shares) for the years 2000 to 2002.

## > STATUTORY AUDITORS' REPORT ON THE ANNUAL FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 2004

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. This report includes information specifically required by French law in all audit reports, whether qualified or not, and this is presented below the opinion on the financial statements. This information includes explanatory paragraphs discussing the auditors' assessment of certain significant accounting matters. These assessments were made for the purpose of issuing an opinion on the financial statements taken as a whole and not to provide separate assurance on individual account captions or on information taken outside of the consolidated financial statements. The report also includes information relating to the specific verification of information in the group management report.

This report (together with the statutory auditors' report addressing financial and accounting information in the Presidents' report on internal control), should be read in conjunction with, and is construed in accordance with French law and professional auditing standards applicable in France.

Dear Alcatel shareholders,

In compliance with the assignment entrusted to us by your Shareholders' Meeting, we hereby report to you, for the year ended December 31, 2004, on:

- the audit of the accompanying financial statements of the Alcatel Company, as attached to this report
- the justification of our assessments,
- the specific verifications and information required by law.

These financial statements have been approved by the Board of Directors. Our role is to express an opinion on these financial statements based on our audit.

### I. - Opinion on the financial statements

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

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2004 and the results of its operations for the year then ended, in accordance with the accounting rules and principles applicable in France.

Without qualifying our opinion, we draw attention to the matter discussed in Note 1.i) and 12 of the notes to financial statements related to the change in method resulting from the initial implementation, beginning on January 1, 2004, of 2003 - R-01 CNC recommendation on accounting and evaluation principles on pensions and other long-term benefits.

### II. - Justification of assessments

In accordance with the requirements of article L. 225-235 of the French company Law (Code de commerce) relating to the justification of our assessments, 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 €10,378.4 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.

The accounting principles related to the French Tax Group, and among others the accounting treatment of the tax group suspense account amounting to €1,195.6 million during 2004, are described in the Note 5 to the financial statements. Our assessment was based on the analysis of the French Tax Group suspense account conducted by the company, following principally the change in the 2004 tax law on income tax relating to long-term capital gains and the disposal from the French Tax Group during 2004 of certain disposed subsidiaries.

The assessments were thus made in the context of the performance of our audit of the financial statements taken as a whole and therefore contributed to the formation of our unqualified audit opinion expressed in the first part of this report.

### III. - Specific verifications and information

We have also performed the specific verifications required by law in accordance with professional standards applicable in France. We have no matters to report regarding the fair presentation and the conformity with the financial statements of the information given in the Directors' Report and in the documents addressed to the shareholders with respect to the financial position and the financial statements.

In accordance with French law, we have ensured that the required information concerning the purchase of investments and controlling interests and the names of the principal shareholders (and holders of the voting rights) has been properly disclosed in the Directors' Report.

Neuilly-sur-Seine, March 30, 2005

The Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES  
ERNST & YOUNG

Christian Chiarasini

## > SPECIAL REPORT 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 2004, the income recorded by Alcatel came to €689,875,000.

Charges due from Alcatel and its subsidiaries, in accordance with the principles stated above, came to €731,527,000.

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, 2005

The Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES  
ERNST & YOUNG

Christian Chiarasini



# 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, 2004.
- Special reports of the statutory auditors on regulated agreements, on the powers to be delegated to the board of directors to reduce the capital of the company, on the financial powers to be delegated to the board of directors, on the powers relating to employee shareholding and on the granting of share subscription options and share purchase options.

### Matters to be considered by the ordinary shareholders' meeting

1. Approval of the parent company financial statements for the fiscal year ended December 31, 2004
2. Approval of the consolidated financial statements for the fiscal year ended December 31, 2004.
3. Result for the fiscal year – Appropriation.
4. Approval of regulated agreements.
5. Renewal of the term of Mr. David Johnston as Director.
6. Renewal of the term of Mr. Pierre-Louis Lions as Director.
7. Renewal of the term of Mr. Philippe Bissara as Director.
8. Renewal of the term of Mr. Frank W. Blount as Director.
9. Renewal of the term of Mr. Jean-Pierre Halbron as Director.
10. Renewal of the term of Mr. Peter Mihatsch as Director.
11. Renewal of the term of Mr. Thierry de Loppinot as Director.
12. Renewal of the term of Mr. Bruno Vaillant as Director.
13. Formal acknowledgment of the continuation by Deloitte & Associés of the mandate of principal statutory auditor following the merger of Deloitte Touche Tohmatsu into that firm.
14. Authorization to be given to the board of directors to allow the company to purchase and sell its own shares.
15. Authorization to be given to the board of directors to reduce the capital of the company.
16. Amendment of article 7 of the articles of incorporation and bylaws of the company relating to the notifications required by such articles when share ownership reporting thresholds are reached.
17. Amendment of article 11 of the articles of incorporation and bylaws of the company relating to the issuance of securities representing debt pursuant to Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning the issuance of securities.
18. Amendment of article 18 of the articles of incorporation and bylaws relating to the age limit for chairman, chief executive officer and deputy executive officers (“mandataires sociaux”) of the company.
19. Delegation of power to the board of directors to issue ordinary shares of the company and any securities conferring an immediate or future right to shares of the company or of affiliated companies, with preservation of preferential subscription rights, and to increase the capital of the company by the capitalization of premiums, reserves, profits or other funds.
20. Delegation of power to the board of directors to issue ordinary shares of the company and any securities conferring an immediate or future right to shares of the company or of affiliated companies, with cancellation of preferential subscription rights.
21. Authorization to be given to the board of directors to increase the number of shares to be issued in the event of an increase in the capital of the company, with or without preferential subscription rights, pursuant to the nineteenth and twentieth resolutions.
22. Authorization to be given to the board of directors to increase the capital of the company, by a public offering of shares without preferential subscription rights, by the issuance of ordinary shares, and any securities conferring a right, immediately or in the future, to the capital, of the company or of affiliated companies, and to set the issuance price thereof.
23. Delegation of power to the board of directors to increase the capital of the company, to compensate for contributions in kind in the form of shares or securities conferring a right to the capital of unaffiliated companies.
24. Overall limits on the amount of issuances to be made pursuant to the nineteenth, twentieth, twenty-first, twenty-second and twenty-third resolutions.
25. Authorization to be given 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 delegations of power and authorizations to effect a capital increase.
26. Authorization to be given to the board of directors to allocate existing shares of the company, or shares to be issued by the company, free of charge.
27. Authorization to be given to the board of directors to grant share subscription options or share purchase options in the company.
28. Powers to implement the decisions of the shareholders' meeting and to carry out the corresponding formalities.

### Matters to be considered by the extraordinary shareholders' meeting

15. Authorization to be given to the board of directors to reduce the capital of the company.
16. Amendment of article 7 of the articles of incorporation and bylaws of the company relating to the notifications required by such articles when share ownership reporting thresholds are reached.
17. Amendment of article 11 of the articles of incorporation and bylaws of the company relating to the issuance of securities representing debt pursuant to Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning the issuance of securities.

## > 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 2004, 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, 2004, which reflect a profit of €2,178,214,148.03;
- by voting in favor of the second resolution, to approve the consolidated financial statements of Alcatel at December 31, 2004;
- by voting in favor of the third resolution, to approve the proposed appropriation of the result, namely to appropriate the distributable profit, after the funding of the Legal reserve, to Retained earnings.

It is noted that in the context of the transition of the Alcatel group in 2005 to the IFRS for the reporting of its consolidated financial statements and in order to ensure that the methods of calculation of provisions for retirement benefits are identical in the parent company financial statements and the consolidated financial statements, it was decided to apply recommendation 2003-R.01 of the "Conseil National de la Comptabilité" relating to the accounting rules for and evaluation of pension and similar benefits as of the beginning of the 2004 fiscal year.

Consequently, an amount of €5,568,074, representing the provision calculated in accordance with the recommendation referred to above, was recorded against shareholders' equity, thus resulting in "Retained earnings" being (€5,568,074.00).

In addition, in accordance with article 39 of the amended finance law of 2004 published on December 30, 2004, the obligation to appropriate funds to the "Special long-term gains reserve" no longer applies to gains taxed in fiscal years starting on or after January 1, 2004.

Consequently, the company has decided to transfer part of the sums appropriated to this special reserve reflected in the balance sheet as of January 1, 2005, to another ordinary reserves account, before December 31, 2005, subject to a limit of €200 million. The sums mandatorily transferred will be subject to an exceptional tax of 2.5%, subject to an allowance of €500,000. The amount of this tax, namely €4,987,500, has been accounted for, while awaiting its payment, as a debit to the line item "Retained earnings", as of December 31, 2004, resulting in "Retained earnings" being (€10,555,574.00). Upon the transfer from the Special long-term gains reserve, the ordinary reserves account will be debited for the amount of this tax by the credit of the Retained earnings account.

The board of directors has decided to propose to the shareholders' meeting, after appropriation of funds to the legal reserve account, within the limit of 10% of the capital of the company, to appropriate the entire balance of the distributable profit to "Retained earnings". Consequently, there is no proposal to distribute a dividend in respect of the 2004 fiscal year.

You have not been informed of the amount of distributed revenue which is or is not eligible for the tax allowance of 50% provided for by article 158-3 of the Tax Code, since according to article 38-II of the amended finance law for 2004, this obligation only applies to distributed revenue paid out on or after January 1, 2005.

- by voting in favor of the fourth resolution, to approve agreements of the kind referred to in article L. 225-38 of the Commercial Code which remained in force during the fiscal year (no new agreement having been entered into), which are explained to you in detail in the special report of the statutory auditors contained in the annual report.

#### II – Renewal of the term of eight directors of the fourteen in office (5th, 6th, 7th, 8th, 9th, 10th, 11th and 12th resolutions) and formal acknowledgment of continuation of the mandate of principal statutory auditor by the firm of Deloitte & Associés (13th resolution).

The terms as directors of Messrs. Philippe Bissara, Frank W. Blount, Jean-Pierre Halbron, David Johnston, Pierre-Louis Lions, Thierry de Loppinot, Peter Mihatsch and Bruno Vaillant expire at the end of the shareholders' meeting called to approve the 2004 financial statements.

In accordance with the articles of incorporation and bylaws of the company, it is proposed that you renew the above-mentioned terms in a staggered manner with a view to the regular renewal of the members of the board.

The fifth and sixth resolutions are intended to renew the terms as director of Messrs. David Johnston and Pierre-Louis Lions for a period of 4 years, that is, until the shareholders' meeting called to approve the financial statements for the financial year ending December 31, 2008.

The seventh, eighth, ninth and tenth resolutions are intended to renew the terms as director of Messrs. Philippe Bissara, Frank W. Blount, Jean-Pierre Halbron and Peter Mihatsch for a period of 3 years, that is, until the shareholders' meeting called to approve the financial statements for the financial year ending December 31, 2007.

The eleventh and twelfth resolutions are intended to renew the terms as director of Messrs. Thierry de Loppinot and Bruno Vaillant for a period of one year, that is, until the shareholders' meeting called to approve the financial statements for the financial year ending December 31, 2005. These directors are at the same time employees of the company or of a subsidiary, and participants in a mutual fund known as "Actionnariat Alcatel" (FCP3A), in accordance with the provisions of article 12 of the articles of incorporation and bylaws.

The thirteenth resolution is intended to acknowledge formally that the firm of Deloitte & Associés continues the mandate of principal statutory auditor following the merger of Deloitte Touche Tohmatsu into that firm.

### III – Authorization to buy back shares (14th resolution)

The fourteenth resolution is intended to renew the authorization to buy back shares which was conferred on the board of directors by your shareholders' meeting held on June 4, 2004, in accordance with articles L.225-209 and following of the Commercial Code. Alcatel did not effect any purchases or sales of its own shares during 2004.

This resolution provides that the company may 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 eighteen 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, 2005.

This new authorization is in accordance with the provisions of the European regulation on the purchase by a company of its own shares enacted pursuant to the "Market Abuse" Directive, and which entered into force on October 13, 2004.

In addition to repurchasing shares for the purposes of canceling the shares and of covering obligations related to securities conferring a right to the capital or to share option plans or other share allocations to employees, in respect of which the company has the benefit of an irrefutable presumption of legitimacy, Alcatel intends to reserve the possibility, in accordance with European and share exchange regulations:

- to enter into a liquidity agreement with an investment services provider in conformity with a code of conduct recognized by the French share exchange and securities regulator, with a view to ensuring the liquidity of the shares or stimulating the market;
- to purchase shares for the purpose of holding them and subsequently using them in an exchange or as payment, particularly in the context of eventual external growth transactions; and
- to engage in any market practice accepted by the French share exchange and securities regulator and in any other transaction in conformity with the regulations in force.

Consequently, the objectives of the share purchase program have been redefined. Shares could therefore be purchased:

- with a view to their cancellation by way of a reduction of the capital of the company within the limits set by law;
- for the purpose of allocating them to employees and executives of the group under the terms and conditions provided by law (share purchase options, employee profit sharing, allocation of shares free of charge, etc.);
- with a view to honoring obligations arising from the issuance of securities conferring a right to the capital of the company;
- for the purpose of holding them and using them in an eventual exchange or as payment, particularly in the context of external growth transactions initiated by the company by way of tender offer or otherwise;
- with a view to ensuring liquidity and to stimulate the market in Alcatel shares through the intervention of an investment services provider with which a liquidity agreement

would be entered into conforming to a code of conduct recognized by the French share exchange and securities regulator; and

- with a view to engaging in any market practice which might be accepted by the French share exchange and securities regulator, and more generally any other transaction in conformity with the regulations in force.

The number of shares that Alcatel may purchase in this way shall not exceed 10% of the total number of shares comprising the capital of the company. The minimum and maximum prices for intervention on the share exchange shall be €2 and €40 per share, respectively.

### Resolutions to be considered by the extraordinary shareholders' meeting

#### IV – Cancellation of shares purchased by the company in the context of the share purchase program (15th resolution)

In this resolution, it is proposed that 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 repurchase 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.

#### V – Amendments to the articles of incorporation and bylaws (16th, 17th and 18th resolutions)

1/ Amendment of article 7 of the articles of incorporation and bylaws relating to the notifications to be made when the ownership reporting thresholds are reached (16th resolution)

- Reduction of the deadline for the notification to the company from 15 to 5 days

The articles of incorporation and bylaws of the company (article 7) provide for a deadline for the notification to be made to the company when the ownership reporting threshold of 0.5% is reached of 15 days from the date the threshold is reached. This deadline was in line with the deadline provided for the notification to be made when the legal ownership reporting thresholds were reached, before the publication of the financial security law of August 1, 2003, which reduced this deadline from 15 to 5 trading days.

In order to unify the time limits for the declarations to be made by shareholders when the thresholds provided by law and by the articles of incorporation and bylaws are exceeded, it is proposed that you amend article 7 of the articles of incorporation and bylaws so as to reduce the time limit for declarations to be made thereunder to 5 trading days.

- Raising of the ownership reporting threshold from 0.5% to 2% of the capital of the company.

The articles of incorporation and bylaws of the company (article 7) provide for a notification that the ownership threshold has been reached as soon as a shareholder owns a number of shares equal to or greater than 0.5% of the total number of shares of the company.

It is proposed that this threshold be increased to 2% of the total number of issued shares of the company and, beyond this threshold, that a notification be required every time a further threshold of 1% of the capital is reached.

This amendment is intended to simplify the constraints encountered by a large number of investors in the management of their investments. In 2004, less than a dozen shareholders sent notifications to the company that they had reached the ownership reporting thresholds, and a number among them were registered intermediaries acting essentially on behalf of their clients.

2/ Amendment of article 11 of the articles of incorporation and bylaws relating to the issuance of securities representing debt as a result of Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning the issuance of securities (17th resolution).

The articles of incorporation and bylaws (article 11) provide that the issuance of bonds is within the powers of an ordinary shareholders' meeting, in the absence of legal provisions to the contrary.

Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning the issuance of securities allows the board of directors to decide on or authorize the issuance of "simple" bonds (as opposed to securities conferring a right to the capital or to the allocation of debt securities).

We propose to you to amend this article 11 so that the board of directors may issue bonds based on its sole decision, depending on need and market opportunities, on condition that the bonds issued do not confer a right to the capital or a right to the allocation of debt securities. The Board will be able, in this case, to delegate its powers to the chief executive officer.

At your last shareholders' meeting you renewed the authorization given to the board of directors, with the power to sub-delegate, to issue any security representing debt of the company, up to an amount of €10 billion for a period of 26 months. To date, this authorization has not been used by the board of directors and its cancellation is not being requested.

Consequently, if you adopt the new version of article 11, the board of directors may decide to issue:

- "simple" bonds, in accordance with the new legislation and with the articles of incorporation and bylaws,
- securities representing debt and conferring a right to the allocation of debt securities, pursuant to the authorization given by the sixth resolution of the shareholders' meeting of June 4, 2004.

The purpose of the amendment of article 11 of the articles of incorporation and bylaws proposed to you is the harmonization of the articles of incorporation and bylaws with the new provisions of the law.

3/ Amendment of article 18 of the articles of incorporation and bylaws relating to the age limit for the chief executive officer and deputy chief executive officers (18th resolution)

The articles of incorporation and bylaws (article 18) set the age limit for executive directors (chairman, chief executive officer, deputy executive officer(s)) at 68 years of age, without any particular distinction depending on whether the

board of directors has chosen to combine or separate the offices of chairman and chief executive officer in accordance with article 16 of the articles of incorporation and bylaws. The term of office then terminates on the date of the ordinary shareholders' meeting called to approve the financial statements for the fiscal year during which the interested party reached 68 years of age.

Your board proposes to you to make the age limits set by the articles of incorporation and bylaws more consistent. The age limits set for directors, on one side, and for the chief executive officer and, if applicable, the deputy executive officer(s) on the other side, would remain unchanged, at 70 years and 68 years, respectively. On the other hand, when the office of chairman is separated from that of chief executive officer by a decision of the board of directors, the chairman, who is then only responsible for the organization of the work of the board of directors without exercising executive functions, could hold office at the latest up to the date of the ordinary shareholders' meeting called to approve the financial statements for the fiscal year in which he shall have attained 70 years of age. He will be able to remain a director in the terms set forth in article 13.

The amendment to article 18 of the articles of incorporation and bylaws proposed to you is to this effect.

#### **VI – Authorizations to issue ordinary shares and securities conferring a right to the capital of the company (19th, 20th, 21st, 22nd, 23rd and 24th resolutions)**

The board of directors benefits from authorizations granted by the shareholders' meeting which enable the company to enter into financial transactions the rapid completion of which is often essential to their success.

The shareholders' meeting held on June 4, 2004 had renewed for a period of 26 months the delegations of power relating to issuances of shares, warrants or securities conferring a right to the capital where the preferential subscription right was maintained (9th resolution) and where the preferential subscription right was cancelled (10th resolution).

We propose that you terminate the current authorizations and authorize new delegations of power to the board of directors taking into account the new provisions in force provided by Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning securities issued by commercial companies.

The amendments proposed to you are meant to achieve two principal objectives:

- for the sake of consistency, to include in these new delegations of power the rules and provisions that will be applied to issuances of ordinary shares and securities conferring a right to the capital (19th and 20th resolutions) and particularly the new rules for the determination of the issuance price in accordance with this Ordinance; and
- to give the company the new powers provided by law, such as the power to increase the number of shares in the context of capital increase in order to meet excess demand (21st resolution), the possibility for the shareholders' meeting to leave the matter of setting the issuance price, in accordance with terms provided by the shareholders' meeting, to the board of directors, subject to a limit of 10% of the capital of the company per year (22nd resolution), the possibility for the shareholders' meeting to delegate pow-

ers to effect capital increases to compensate for contributions in kind (23rd resolution).

These new proposals would not have the effect of increasing the initial global limit to an amount greater than that which currently exists, and which has been unchanged since the authorization given by the shareholders' meeting on May 16, 2000.

Thus, the maximum nominal amount of issuances of shares with or without preferential subscription rights which could be decided by the Board would be €750 million, and that of issuances of debt securities would be €6 billion, it being noted that this limit will not apply to capital increases by incorporation of reserves or other similar increases and that capital increases for the benefit of employees will be subject to specific limitations.

The number of shares or securities conferring a right to the capital of the company would be limited to 375 million shares, or 28.7% of the number of shares comprising the capital of the company as at December 31, 2004.

#### ISSUANCES WITH AND WITHOUT PREFERENTIAL SUBSCRIPTION RIGHTS (19th and 20th resolutions)

These two new delegations of power would have the effect of cancelling the authorizations in force with respect to the balance thereof which has not yet been used. They would be granted for a new term of validity of twenty-six months.

The previous delegation of power relating to issuances without a preferential subscription right in respect of shares, warrants or securities conferring a right to the capital, which was renewed by the shareholders' meeting on June 4, 2004, was used by the board of directors in the context of the acquisition in the United States of Spatial Communications Technologies Inc. in December 2004.

This transaction gave rise to the issuance of bonds repayable in Alcatel shares by Coralec, a subsidiary of the group, for a global nominal amount of €226.2 million, which could represent, at maturity, 19 million Alcatel shares, or 1.5% of the capital of the company as at December 31, 2004. On that date, 1.2 million bonds were still in circulation.

This transaction was the subject of a prospectus approved by the French share exchange and securities regulator on December 15, 2004 under number 04-971, which explained the company's objectives and the terms of completion of the transaction. This prospectus is available at the registered office and on the Alcatel website.

In accordance with article L. 225-136 of the Commercial Code as amended by the Ordinance of June 24, 2004 and decree no. 2005-112 of February 10, 2005, the "ten from twenty" rule, which required listed companies to set an issuance price, without preferential subscription rights, at least equal to the average price recorded on 10 successive trading days chosen from among the last 20 trading days preceding the issuance, has been cancelled. From now on, the issuance price of shares must be at least equal to the weighted average of the share price during the last three trading sessions preceding the setting of the price, eventually reduced by a maximum discount of 5%.

The Board draws the attention of shareholders to the fact that the preferential subscription right, maintained in the 19th resolution, only relates to the primary securities or shares issued

pursuant to this delegation of power, and not to the shares to which those securities confer a right on maturity, since this delegation of power automatically entails the express waiver by the shareholders of their preferential subscription right in respect of those shares.

#### OVERALLOTMENT (21st resolution)

By voting in favor of this resolution, you will enable the board of directors to increase the number of securities to be issued in the event of excess demand for each of the issuances decided pursuant to the 19th and 20th resolutions.

This market practice was legalized by the Ordinance of June 24, 2004.

The maximum number of shares to be issued is limited to 15% of the initial issuance. This power may be used within 30 days of the closure of the subscription and at the same price as was used for the initial issuance.

#### ISSUANCES WITH PRICING FLEXIBILITY (22nd resolution)

By voting in favor of this resolution, It is proposed that you authorize the board of directors to issue ordinary shares or securities by way of public offering and without preferential subscription rights, setting the issuance price freely within the limits defined by the shareholders' meeting.

This new power that would be provided to the board of directors would enable it, eventually, to not be bound by the terms and conditions for setting the price provided by article L. 225-136 of the Commercial Code and the decree of February 10, 2005. It is limited to 10% of the capital of the company per year.

Consequently, It is proposed that you authorize the board of directors to set the issuance price of the shares and/or securities to be issued in accordance with one of the following two methods:

- an issuance price equal to the average price recorded over a maximum period of six months preceding the issuance,
- an issuance price equal to the weighted average price of the Alcatel share on the market on the day preceding the issuance (VWAP 1) with a maximum discount of 20%.

It is noted that any issuance in this context could include a period of priority of subscription in favor of the shareholders.

#### ISSUANCE IN THE EVENT OF CONTRIBUTIONS IN KIND (23rd resolution)

By voting in favor of this resolution, you will enable the board of directors to issue ordinary shares and securities with a view to compensating contributions in kind and consisting of shares or securities conferring a right to the capital of an unaffiliated company.

This new power that would be provided to the board of directors is limited to 10% of the authorized share capital of Alcatel. Any issuance in this context will require the intervention of an auditor to assess the fairness of the valuations in kind.

The principal characteristics of the securities issued pursuant to the 19th, 20th, 21st, 22nd and 23rd resolutions, and the conditions under which they could, if applicable, confer rights to a proportionate amount of the capital of the company, will therefore not be determined until the date the issuance is decided and, in accordance with article 155-2

of the decree of March 23, 1967, an additional report will be prepared at the appropriate time describing the final conditions of the contemplated transactions.

This report will be made available to the shareholders within fifteen days of the date on which the issuance is decided by the board of directors and will be brought to the attention of the shareholders' at their first meeting after the date on which the board of directors or the chief executive officer, acting on a delegation of power, decides to effect an issuance. The report of the statutory auditors on this issuance will be prepared at the time the board of directors makes use of this delegated power.

#### TOTAL LIMITATIONS ON THE FINANCIAL AUTHORIZATIONS (24th resolution)

By voting in favor of this resolution, you will limit the nominal amount of issuances decided by the board of directors pursuant to these five new delegations of power or authorizations, with or without preferential subscription rights, to €750 million in the case of immediate and/or future issuances of shares and to €6 billion in the case of issuances of debt securities, for a period of 26 months.

#### VII - Employees' shareholding (25th and 26th resolutions)

##### ISSUANCES RESERVED FOR EMPLOYEES IN THE CONTEXT OF A COMPANY SAVINGS PLAN (25th resolution)

This resolution is intended to enable the issuance of new shares and, if applicable, the free distribution of shares or other securities conferring a right to the capital of the company, to members of a company savings plan, including in the event of use of the authorizations to increase the capital (19th, 20th and 22nd resolutions) and to grant share subscription options (27th resolution), in the context of the provisions of the Commercial Code and particularly its articles L. 225-138 and L. 225-129-6, and separately, articles L. 443-1 and following of the Labor Code.

The shareholders' meeting of June 4, 2004 authorized the board of directors to effect capital increases reserved for employees of the group subject to a limit of 3% of the capital of the company existing at the time of each issuance.

We propose to you the termination of this authorization which has not been used and, by voting in favor of the 25th resolution, to give the board of directors a new authorization for a period of 26 months, to issue shares for the benefit of group employees on new conditions.

Having regard to the fact that the incentives provided to employees to participate in the development of the company are an essential factor to 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.

The price at which beneficiaries would subscribe for shares could not be more than 5% lower (instead of the discount of the 20% maximum provided by law and authorized by the previous resolution), nor higher, than the average of the opening prices quoted on the Euronext Market of Euronext Paris during the twenty trading sessions preceding the date on which the board of directors made its decision to increase the capital of the company and to issue the corresponding shares.

The resolution would contain an express waiver by the shareholders of their preferential subscription rights, in favor of the beneficiaries.

#### FREE DISTRIBUTION OF SHARES (26th resolution)

The 2005 finance law has made it possible for issuers to authorize the board of directors to distribute shares free of charge to their employees and executive officers subject to a limit of 10% of the authorized share capital, such persons then having the benefit, under certain conditions, of a more favorable tax treatment than that applicable to emoluments and salaries and of an exemption from social security contributions.

It is proposed that you supplement the mechanism contemplated for employee shareholders and authorize the board of directors to distribute existing company shares or company shares to be issued, free of charge, subject to a limit such that the increase in the capital that might result does not exceed 6% of the capital of the company when added to the increase that might result from the exercise of options granted by use of the 27th resolution. The use of this authorization is also subject to the condition that the company have sufficient reserves to be incorporated into the capital in consideration of the free distributions of shares envisaged.

Pursuant to the provisions of article L. 225-197-1 of the Commercial Code, the allocation of shares to their beneficiaries shall become final upon the expiry of an acquisition period the minimum term of which will be determined by the extraordinary shareholders' meeting. The extraordinary shareholders' meeting will also determine the minimum duration of the beneficiaries' obligation to retain the shares, which shall run from the date on which the shares are definitively allocated. We propose to you to set the minimum duration of the acquisition period and of the obligation to retain the shares as set forth in the provisions of the Commercial Code in force on the date of the decision of the board of directors. On the date hereof, these minimum periods are set at two years.

#### VIII - Allocation of options to subscribe for or purchase company shares (27th resolution)

It is proposed that the authorization given to the board of directors by the shareholders' meeting of April 18, 2002 to grant share options to subscribe for or purchase shares be cancelled in respect of the unused balance thereof, and that the board of directors be authorized to grant share options to subscribe for or purchase shares for a further period of thirty-eight months.

This new authorization differs in two respects from the authorization currently in force :

- the total number of options granted may not confer a right to subscribe for a number of new shares in excess of 6% of the total number of shares comprising the capital of the company, it being noted that the total number of new shares allocated free of charge pursuant to the twenty-sixth resolution shall count towards this limit;
- in accordance with provisions of article L. 225-177 of the Commercial Code, the authorization in force provided for the possibility of setting a subscription price with a maximum discount of 20% below the average quoted prices. No discount has been applied to share option plans adopted since 1998. In accordance with this practice of the board of directors, it is proposed that you authorize the granting of options at an exercise price excluding any discount.

The subscription or purchase price of the shares to beneficiaries shall be determined on the day on which the options are granted by the board of directors (or by the chief executive officer pursuant to a delegation of power) and shall not be less than average of the first prices quoted on the Eurolist Market of Euronext Paris during the twenty trading sessions preceding the day on which the share subscription options are granted.

In the case of share purchase options, the purchase price of the share shall not be less than the average purchase price of the shares owned by the company pursuant to articles L. 225-208 or L. 225-209 of the Commercial Code.

The period for the exercise of options may not exceed ten years with effect from the grant of the options by the board of directors.

Pursuant to article L. 225-178 of the Commercial Code, this authorization would entail the express waiver by shareholders in favor of beneficiaries of the shareholders' preferential subscription right in respect of shares issued as and when options are exercised.

The Board will inform the shareholders' meeting each year of the transactions effected pursuant to these authorizations.

Consequently, we would ask you to approve the resolutions proposed to you by your board of directors, after having read the reports of the statutory auditors.

## > TEXT OF THE RESOLUTION

### MATTERS TO BE CONSIDERED BY THE ORDINARY SHAREHOLDERS' MEETING

#### FIRST RESOLUTION

#### Approval of the parent company financial statements for the fiscal year ended December 31, 2004

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 report of the statutory auditors, approve in their entirety the manage-

ment report of the Board and the annual parent company financial statements for the fiscal year ended December 31, 2004 as prepared and presented to them, and which reflect a profit of €2,178,214,148.03.

The shareholders expressly approve the amount of non-deductible charges (Article 39-4 of the Tax Code) mentioned in the financial statements presented by the board of directors.

#### SECOND RESOLUTION

#### Approval of the consolidated financial statements for the fiscal year ended December 31, 2004

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, 2004, 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, after having read the reports of the board of directors, approve the appropriation of the result for the fiscal year ended December 31, 2004 proposed by the board of directors, and resolve to make the following appropriations:

Result for the fiscal year	€2,178,214,148.03
Previous retained earnings	€ (10,555,574.00)
Transfer to the legal reserve	€ (15,374,184.59)
Distributable profit	€2,152,284,389.44
Retained earnings	€2,152,284,389.44

Consequently, no dividend shall be distributed to shareholders in respect of the 2004 fiscal year.

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	Distribution to shareholders	Net dividend per share	Tax credit per share	Total income per share
2003	NA	1,284,410,224	0	0	-	-
2002	NA	1,264,708,498	0	0	-	-
2001	O Shares	25,515,000	€2,551,500,00	€0.10	€0.05	€0.15
	A Shares	1,215,254,797	€194,440,767,52	€0.16	€0.08	€0.24

The amount of the distributed profit which is either eligible or not eligible for the 50% tax allowance provided by article 158-3 of the Tax Code only has to be stated in respect of distributed revenues paid out on or after January 1, 2005 (art. 38-II of the amended finance law for 2004).

The shareholders' meeting formally notes the transfer to be made in 2005 of a sum of 200 million from the special long term gains reserve to an ordinary reserves line item, in accordance with the amended finance law of 2004 and,

insofar as necessary, authorizes the transfers relating to the exceptional tax affecting the Retained earnings account and the ordinary reserves line item.

#### 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. David Johnston as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. David Johnston'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, 2008

#### SIXTH RESOLUTION

##### **Renewal of the term of Mr. Pierre-Louis Lions as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Pierre-Louis Lions' 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, 2008.

#### SEVENTH RESOLUTION

##### **Renewal of the term of Mr. Philippe Bissara as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Philippe Bissara's term as Director for a period of three 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.

#### EIGHTH RESOLUTION

##### **Renewal of the term of Mr. Frank W. Blount as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Frank W. Blount's term as Director for a period of three 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.

#### NINTH RESOLUTION

##### **Renewal of the term of Mr. Jean-Pierre Halbron as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Jean-Pierre Halbron's term as Director for a period of three 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.

#### TENTH RESOLUTION

##### **Renewal of the term of Mr. Peter Mihatsch as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Peter Mihatsch's term as Director for a period of three years, to expire in any event at the end of the shareholders' meet-

ing called to approve the financial statements for the fiscal year ending December 31, 2007.

#### ELEVENTH RESOLUTION

##### **Renewal of the term of Mr. Thierry de Loppinot as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Thierry de Loppinot's term as Director, in his dual capacity as employee of the company or of a subsidiary and as a participant in the mutual fund known as "Actionariat Alcatel" (FCP3A), in accordance with the provisions of article 12 of the articles of incorporation and bylaws, for a period of one year, 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, 2005.

#### TWELFTH RESOLUTION

##### **Renewal of the term of Mr. Bruno Vaillant as Director**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders renew Mr. Bruno Vaillant's term as Director, in his dual capacity as employee of the company or of a subsidiary and as a participant in the mutual fund known as "Actionariat Alcatel" (FCP3A), in accordance with the provisions of article 12 of the articles of incorporation and bylaws, for a period of one year, 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, 2005.

#### THIRTEENTH RESOLUTION

##### **Formal acknowledgment of the continuation by Deloitte & Associés of the mandate of principal statutory auditor following the merger of Deloitte Touche Tohmatsu into that firm**

Voting under the quorum and majority requirements of an ordinary shareholders' meeting, the shareholders acknowledge formally that the firm of Deloitte & Associés continues the mandate of principal statutory auditor following the merger of Deloitte Touche Tohmatsu into that firm.

#### FOURTEENTH 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 share exchange and securities regulator (Autorité des marchés financiers) relating to the repurchase 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 share exchange or otherwise shares of the company, under the following conditions:

- maximum purchase price per share: €40
- minimum purchase 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 179-1 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, 2004, is 130,545,546, for a theoretical maximum amount of €5,221,821,840, 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 share split or of a reverse share 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 shareholders' meeting resolves that acquisitions of shares may take place:

- with a view to their cancellation by way of a reduction of the capital of the company within the limits set by law, subject to the adoption of the fifteenth resolution below;
- for the purpose of allocating them to employees and executives of the group under the terms and conditions provided by law (share purchase options, employee profit sharing, allocation of shares free of charge, etc.);
- with a view to honoring obligations arising from the issuance of securities conferring a right to the capital of the company;
- for the purpose of holding them and using them in an eventual exchange or as payment, particularly in the context of external growth transactions initiated by the company by way of tender offer or otherwise;
- with a view to ensuring the liquidity of and to stimulate the market in Alcatel shares through the intervention of an investment services provider under the terms of a liquidity agreement conforming to a code of conduct recognized by the French share exchange and securities regulator; and
- with a view to engaging in any market practice which might be accepted by the French share exchange and securities regulator, and more generally any other transaction in accordance with the regulations in force.

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. 225-177 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, 2005. With effect

from the date of this meeting, it cancels and replaces the authorization previously granted to the board of directors by the 7th resolution of the Joint shareholders' meeting held on June 4, 2004.

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 share 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 share 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**

##### **FIFTEENTH 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 special report of the statutory auditors, authorize the board of directors in accordance with Article L. 225-209, paragraph 5, 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, 2005:

- 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 laws in force at the time this authorization is used.

##### **SIXTEENTH RESOLUTION**

#### **Amendment of article 7 of the articles of incorporation and bylaws of the company relating to the notifications required by such articles when share ownership reporting thresholds are reached**

Voting under the quorum and majority requirements of an Extraordinary shareholders' meeting, the shareholders, having read the report of the board of directors:

- resolve to amend paragraphs "1/" and "2/" of the 2nd paragraph of article 7 of the articles of incorporation and bylaws of the company, in the following manner:  
"1/ 2% of the total number of the shares must, within a period of five trading days from the date on which this

shareholding threshold is reached, inform the company of the total number of shares that he owns, by letter or fax. This notification shall be renewed under the same conditions each time a further threshold of 1% is reached.

2/ 3% of the total number of the shares must, within a period of five trading days from the date on which this shareholding threshold is reached, request the registration of his shares. This obligation to register shares shall apply to all the shares already held as well as to any which might be acquired subsequently in excess of this threshold. The copy of the request for registration, sent by letter or fax to the company within fifteen days from the date on which this shareholding threshold is reached, shall be equivalent to a notification that the threshold has been reached. A further request shall be sent in the same conditions each time a further threshold of 1% is reached, up to 50%."

- resolve to amend the 6th paragraph 7 of the articles of incorporation and bylaws of the company, in the following manner:

"Any shareholder whose shareholding falls below either of the thresholds provided for in (1) and (2) above must also inform the company thereof, within the same period of five days and in the same manner."

#### SEVENTEENTH RESOLUTION

##### **Amendment of article 11 of the articles of incorporation and bylaws of the company relating to the issuance of securities representing debt pursuant to Ordinance no. 2004-604 of June 24, 2004 reforming the legal provisions concerning the issuance of securities**

Voting under the quorum and majority requirements of an Extraordinary shareholders' meeting, the shareholders, having read the report of the board of directors, resolve to amend article 11 of the articles of incorporation and bylaws of the company in the following manner:

"Article 11 – Issuance of securities representing debt

The company may contract borrowings as and when needed by means of the issuance of securities representing debt, under the conditions provided by law."

#### EIGHTEENTH RESOLUTION

##### **Amendment of article 18 of the articles of incorporation and bylaws relating to the age limit for the chairman, chief executive officer and deputy executive officers ("mandataires sociaux") 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, resolve to amend article 18 of the articles of incorporation and bylaws of the company in the following manner:

"Article 18 – Age limit for chief executive officer and deputy executive officers

The chief executive officer and deputy executive officers may hold office for the period set by the board of directors, but this period shall not exceed their term of office as directors, if applicable, nor in any event shall such period extend beyond the date of the ordinary shareholders' meeting called to approve the financial statements for the fiscal year in which

they shall have attained 68 years of age. The same age limit shall apply to the chairman of the board of directors when he is also chief executive officer. When the chairman does not also occupy the position of chief executive officer, he may hold office for the period set by the board of directors, but this period shall not exceed his term of office as director, if applicable, nor in any event shall such period extend beyond the date of the ordinary shareholders' meeting called to approve the financial statements for the fiscal year in which he shall have attained 70 years of age. He shall be able to remain a director in the terms set forth in article 13."

#### NINETEENTH RESOLUTION

##### **Delegation of power to the board of directors to issue ordinary shares of the company and any securities conferring an immediate or future right to shares of the company or of affiliated companies, with preservation of preferential subscription rights, and to increase the capital of the company by the capitalization of premiums, reserves, profits or other funds**

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 special 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 June 4, 2004, but without retroactive effect and only with respect to the balance of such authorization remaining unused as of the date of this shareholders' meeting;

2/ delegate to the board of directors, acting on its own initiative, the power, on one or more occasions, in France or abroad, in such proportions and at such times as it may deem advisable, and in euros or in any other currency or in any unit of account established by reference to a basket of currencies, and with or without a premium:

a) to issue ordinary shares and securities (including warrants) conferring an immediate or future right, at any time or on a fixed date, to shares of the company or of a company in which Alcatel directly or indirectly owns more than half the capital, or of a company which owns, directly or indirectly, more than half the capital of Alcatel, subject to the authorization of the company as to which such rights will be exercised, whether by way of subscription, conversion, exchange, repayment, presentation of warrants or in any other manner;

b) to increase the capital of the company 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 shareholders' 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 effected 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;

- resolve that the board of directors may 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;

- formally note that this delegated power shall automatically entail the waiver by shareholders of their preferential subscription rights in respect of the shares to which the securities being issued confer a right;

6/ resolve that the board of directors shall have all necessary powers, with power of sub-delegation, to implement this delegated power under the conditions set by law and, in particular:

- for any issuance covered by 2(a) above:

- to determine the nature and number of the ordinary shares and securities to be issued, their characteristics, the amount of the issuance premium as well as the other terms of the issuance and, in particular, the date from which the new shares shall confer a right to dividends, which may even be retroactive;

- to set the terms pursuant to which the company shall, if applicable, have the option to purchase or exchange on the share exchange the securities issued or to be issued, at any time or during set periods,

- 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, the balance being available to be appropriated in any way decided by the board of directors or the ordinary shareholders' meeting,

- in the case of any capitalization of premiums, reserves, profits or other funds:

- to set the amount of the sums to be capitalized, the number of shares to be issued and/or the amount by which the nominal value of the shares comprising the capital of the company shall be increased,

- to resolve, if necessary, and in accordance with provisions of article L. 225-130 of the Commercial Code, that fractional rights shall neither be negotiable nor transferable, and that the corresponding shares shall be sold, the proceeds from such sale being allocated to the holders of the rights within the period set by the regulations in force;

- 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 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.

#### TWENTIETH RESOLUTION

**Delegation of power to the board of directors to issue ordinary shares of the company and any securities conferring an immediate or future right to shares of the company or of affiliated companies, 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 special report of the statutory auditors:

1/ cancel the authorization given to the board of directors by the 10th resolution of the shareholders' meeting held on June 4, 2004, 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, acting on its own initiative, the power, on one or more occasions, in France or abroad, in such proportions and at such times as it may deem advisable, and in euros or in any other currency or in any unit of account established by reference to a basket of currencies:

- to issue ordinary shares and securities (including warrants) conferring an immediate or future right, at any time or on a fixed date, to shares of the company or of a company in which Alcatel directly or indirectly owns more than half the capital, or of a company which directly or indirectly owns more than half the capital of Alcatel, subject to the authorization of the company as to which such rights will be exercised, whether by way of subscription, conversion, exchange, repayment, presentation of warrants or in any other manner,

it being noted that such securities may be issued (i) 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, (ii) in the context of any other transaction having the same effect as a public exchange offer initiated by the company in respect of the securities of another company whose securities are admitted for trading on a regulated market governed by foreign law;

- and/or to issue securities indicated above, following the issuance by one of the companies in which Alcatel directly or indirectly owns more than half the capital or by a company which directly or indirectly owns more than half the capital of Alcatel, of any other securities conferring a right, at any time or on a fixed date, whether by way of subscription, conversion, exchange, repayment, presentation

of a warrant or in any other manner, to the allocation of shares which are or will be issued for this purpose and representing a portion of the capital of Alcatel, and specially for the purpose of effecting an external growth transaction and, in particular, the acquisition of any company, against a short-term or deferred payment with shares of the company;

- 3/ set the period of validity of this delegated power at 26 months starting from the date of this shareholders' meeting;
- 4/ resolve to cancel the preferential subscription right of the shareholders in respect of the securities the subject of this resolution, while leaving the board of directors with the power, if it deems it appropriate, to give to the shareholders, in respect of all or part of the issuance made, a subscription priority which does not give rise to the creation of negotiable rights, for such period as it may determine but which shall not however be less than the period provided by law, to define the characteristics of such priority right and particularly to decide to limit the number of securities to which it shall give a right for each subscription order issued;
- 5/ 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 eventually need to be effected in order to preserve the rights of the holders of such securities in accordance with law;
  - the maximum nominal amount of securities representing debt of the company which may be issued in this manner may not exceed the limit of €6 billion or the equivalent of such amount in other currencies;
- 6/ formally note that this delegated power shall automatically entail the waiver by shareholders of their preferential subscription rights in respect of the shares to which the securities which may be issued pursuant to this delegation confer a right;
- 7/ 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 the weighted average price of the share quoted on the Eurolist Market of Euronext Paris during the three last trading sessions preceding the setting of the price, reduced, eventually, by a maximum discount of 5%. 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;
- 8/ give all necessary powers to the board of directors, with power of sub-delegation, to implement this delegated power under the conditions set by law and, in particular:

- to determine the nature and number of the ordinary shares and securities to be issued, their characteristics, the amount of the issuance premium as well as the other terms of their issuance, and in particular, the date from which the new shares shall confer a right to dividends, which may even be retroactive;
- to set the terms pursuant to which the company shall, if applicable, have the option to purchase or exchange on the share exchange the securities issued or to be issued, at any time or during set periods;
- more particularly, in the event of the issuance of securities for the purpose of delivering them against securities tendered in the context of a public exchange offer or a transaction having the same effect:
  - 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,
  - 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 capital of the company after each increase, the balance being available to be appropriated in any way decided by the board of directors or ordinary shareholders' meeting;
- 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 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.

#### TWENTY-FIRST RESOLUTION

**Authorization to be given to the board of directors to increase the number of shares to be issued in the event of an increase in the capital of the company, with or without preferential subscription rights, pursuant to the nineteenth and twentieth 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 special report of the statutory auditors, authorize the board of directors, if it notes excess demand to subscribe for shares upon an increase in the capital of the company decided upon pursuant to the nineteenth and twentieth resolutions of this shareholders' meeting, to increase the number of securities in accordance with the provisions of Article L. 225-135-1 of the Commercial Code, within thirty days of the closure of the subscription, subject to a limit of 15% of the initial issuance and at the same price as was used for the initial issuance. The period of validity of this delegated power is 26 months starting from the date of this shareholders' meeting.

#### TWENTY-SECOND RESOLUTION

Authorization to be given to the board of directors to increase the capital of the company by a public offering without preferential subscription rights, by the issuance of ordinary shares, and of any securities conferring a right, immediately or in the future, to shares, of the company or affiliated companies, and to set the issuance price thereof

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 special report of the statutory auditors:

1. authorize the board of directors, in the context of Article L. 225-136 of the Commercial Code and subject to a limit of 10% of the authorized share capital of the company per year, to issue by way of a public offering and without preferential subscription rights on the part of the shareholders, any ordinary shares and securities conferring a right, immediately or in the future, to shares of the company or of a company in which Alcatel directly or indirectly owns more than half the capital, or of a company which directly or indirectly owns more than half the capital of Alcatel, and to set the issuance price for such shares or securities using either of the two following methods:
  - an issuance price equal to the average Alcatel share price on the Eurolist Market of Euronext Paris recorded over a maximum period of six months preceding the issuance,
  - an issuance price equal to the weighted average Alcatel share price on the Eurolist Market of Euronext Paris on the day preceding the issuance (VWAP 1) with a maximum discount of 20%;
2. resolve that the nominal amount of the increase in the capital of the company resulting from the issuance of the securities defined in paragraph 1 / above, shall count towards the amount of the overall limit for increases in the capital of the company set in the twenty-fourth resolution;
3. formally note that this delegated power shall automatically entail the waiver by the shareholders of their preferential subscription rights in respect of the shares to which the securities issued pursuant to this delegated power confer a right;
4. set the period of validity of this authorization at 26 months starting from the date of this shareholders' meeting;
5. give all necessary powers to the board of directors, with power of sub-delegation, to implement these issuances on such terms as it may decide, and in particular:
  - to set the nature and number of the ordinary shares and the securities to be created, their characteristics and the terms of their issuance;
  - to charge the expenses of the capital increase 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 of the company after each increase, the balance being available to be appropriated in any way decided by the board of directors or the ordinary shareholders' meeting;
  - to make any necessary amendments to the articles of incorporation and bylaws.

#### TWENTY-THIRD RESOLUTION

Delegation of power to the board of directors to increase the capital of the company, to compensate for contributions in kind in the form of shares or securities conferring a right to the capital of unaffiliated companies

Voting under the quorum and majority requirements of an Extraordinary shareholders' meeting, the shareholders, having read the report of the board of directors:

1. delegate to the board of directors, in accordance with Article L. 225-147 of the Commercial Code, the powers necessary to increase the capital of the company subject to a limit of 10% of the capital of the company, by the issuance of ordinary shares and any other securities conferring a right to the capital of the company for the purpose of compensating contributions in kind made to the company consisting of shares or securities conferring a right to the capital of unaffiliated companies, when the provisions of Article L. 225-148 of the Commercial Code do not apply;
2. resolve that the nominal amount of the increase in the capital of the company resulting from the issuance of the securities defined in paragraph 1 / above shall count towards the amount of the overall limit for increases in the share capital set in the twenty-fourth resolution;
3. set the period of validity of this delegation at 26 months starting from the date of this shareholders' meeting;
4. give all necessary powers to the board of directors, with power of sub-delegation, to implement these issuances on such terms as it may decide, and in particular:
  - to set the nature and number of the ordinary shares and the securities to be created, their characteristics and the terms of their issuance,
  - to approve the valuation of the assets contributed,
  - to charge the expenses, charges and duties of the capital increase 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 of the company after each increase, the balance being available to be appropriated in any way decided by the board of directors or the ordinary shareholders' meeting,
  - to make any necessary amendments to the articles of incorporation and bylaws.

#### TWENTY-FOURTH RESOLUTION

**Overall limits on the amount of issuances to be made pursuant to the nineteenth, twentieth, twenty-first, twenty-second and twenty-third 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 special report of the statutory auditors, resolve to set the following limits on the amounts of the issuances which could be decided upon by the board of directors pursuant to the delegated powers or authorizations contained in the nineteenth, twentieth, twenty-first, twenty-second and twenty-third resolutions of the shareholders' meeting held on the date hereof:

1. 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 curren-

cies, increased by the nominal amount of the capital increase resulting from the issuance of shares which may eventually 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 maximum nominal amount of securities representing debt of the company which may be issued may not exceed the limit of €6 billion or the equivalent of such amount in other currencies.

#### TWENTY-FIFTH RESOLUTION

**Authorization to be given 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 use of the delegated powers and authorizations to effect a capital increase**

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 special 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 June 4, 2004, 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. 225-129-6 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 issuance 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;
3. resolve that the beneficiaries of the capital increases authorized hereby shall be the participants in a company savings plan of Alcatel or of companies affiliated 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. resolve to cancel the preferential subscription right of the shareholders in respect of the shares thus issued, in favor of the said employees;
5. set the period of validity of this authorization at 26 months starting from the date of this shareholders' meeting;
6. resolve to limit the maximum number of shares of the company which may be issued pursuant to this resolution to 3% of the capital of the company at the time of each issuance;
7. resolve that the subscription price for the shares to be paid by the beneficiaries referred to above shall not be more than 5% lower than the average opening prices of the shares quoted on the Eurolist Market of Euronext Paris during the twenty trading sessions preceding the date on which the board of directors makes its decision setting the opening date of the subscription, nor shall it be higher than this average, which shall, if necessary, be corrected

in the event of a difference between the dates on which the shares are entitled to dividends;

8. authorize the board of directors, pursuant to this authorization, to issue any securities conferring a right to the capital of the company which might be authorized in the future by the laws or regulations then in force;
9. resolve that, in the event that pursuant to the powers delegated to the board of directors by this shareholders' meeting pursuant to the nineteenth, twentieth, twenty-second and twenty-seventh resolutions, the Board should decide on a capital increase to be subscribed in cash or on an allocation of options to subscribe for shares of the company, it shall issue its opinion on the appropriateness of increasing the capital pursuant to Article L.225-129-6 of the Commercial Code, and authorize the board of directors, with power of sub-delegation, 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 shall have decided upon pursuant to the powers delegated to it and authorizations provided by the aforementioned nineteenth, twentieth and twenty-second resolutions and the twenty-seventh resolution below;
10. give all necessary powers to the board of directors, with power of sub-delegation, to implement this authorization, subject to the limitations and under the conditions specified above, in order, in particular:
  - to determine the companies whose employees shall be entitled to benefit from the subscription offer, and to set the conditions to be satisfied by the beneficiaries,
  - to set the nature of the securities to be created, their characteristics and the manner of their issuance,
  - to decide that the subscriptions may be effected directly or through a mutual fund or another entity in accordance with the legislation in force,
  - to decide and set the terms of free distributions of shares or of other securities conferring a right to the capital of the company, pursuant to the authorization granted above,
  - to set the period granted to subscribers to pay for their shares,
  - to set the date from which the new shares shall confer a right to dividends, which may even be retroactive.
  - formally to record the completion of the capital increase 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,
  - 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 capital of the company after each increase, the balance being available to be appropriated in any way decided by the board of directors or the ordinary shareholders' meeting;
  - in general, to take any steps to complete the capital increases, to carry out any formalities required in connection therewith and to make any necessary amendments to the articles of incorporation and bylaws.

#### TWENTY-SIXTH RESOLUTION

##### **Authorization to be given to the board of directors to distribute existing shares of the company, or shares to be issued by the company, free of charge**

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 special report of the statutory auditors, in accordance with the article L. 225-197-1 and following of the Commercial Code:

1. authorize the board of directors to make distributions of existing company shares or of company shares to be issued, free of charge, on one or more occasions, to members of salaried staff or to certain categories of such staff, and to directors, the chief executive officer and deputy executive officers of the company, of Alcatel and of companies or economic interest groups affiliated therewith, under the conditions provided by Article L. 225-17-2 of the Commercial Code;
2. resolve that the board of directors shall determine the identity of the beneficiaries of such distributions together with the conditions thereof and, if applicable, the criteria for the allocation of such shares;
3. resolve that the total number of shares distributed free of charge shall not be such that, when added to any capital increases resulting from the exercise of options granted pursuant to the twenty-seventh resolution, the increase in the capital is in excess of 6% of the capital of the company;
4. formally note that the shares shall be finally allocated to their beneficiaries at the expiration of an acquisition period and shall be retained by such beneficiaries for a minimum period. The minimum acquisition period and period of mandatory retention shall be not less than those set by the Commercial Code on the date of the decision of the board of directors;
5. resolve that the board of directors shall have the power to set the length of the acquisition period and of the mandatory retention period under the conditions provided in paragraph 4/ above;
6. authorize the board of directors, if necessary, during the acquisition period, to make adjustments to the number of shares distributed free of charge depending upon eventual transactions affecting the capital of Alcatel, in order to preserve the rights of the beneficiaries;
7. formally note that in the event of the distribution, free of charge, of shares to be issued, this authorization shall entail, at the end of the acquisition period, a capital increase by the capitalization of reserves, profits or issuance premiums in favor of the beneficiaries of the said shares and a corresponding waiver by the shareholders in favor of the persons to whom the shares are allocated, of their share of the reserves, profits and premiums so capitalized;
8. set the period of validity of this authorization at 38 months starting from the date hereof;
9. resolve that the board of directors shall have all necessary powers particularly, in the event of the distribution of shares to be issued, to set the amount and nature of the reserves, profits and premiums to be capitalized, to determine the amount of the unavailable reserve by deduction from the profits, premiums or reserves line items, to note

any capital increase effected pursuant to this delegated power, to amend the articles of incorporation and bylaws as a result and in general, to take all necessary action.

#### TWENTY-SEVENTH RESOLUTION

##### **Authorization to be given to the board of directors to grant share subscription options or share purchase options in 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 special report of the statutory auditors:

1. cancel the authorization given to the board of directors by the 13th resolution of the shareholders' meeting held on April 18, 2002, but without retroactive effect and consequently only with respect to the balance of such authorization remaining unused as of the date of this meeting;
2. authorize the board of directors, with power to sub-delegate to the chief executive officer, in the context of the provisions of Article L. 225-177 and following of the Commercial Code, to grant options to the beneficiaries indicated below, on one or more occasions, conferring a right to subscribe for new shares of the company to be issued by way of a capital increase or to buy existing shares of the company from those shares bought back by the company under the conditions provided by law;
3. resolve that the beneficiaries of these options shall be chosen among the salaried personnel or the directors of the company and the executives of the company having the power to represent the company ("mandataires sociaux") as defined by law, of Alcatel and of companies or economic interest groups affiliated directly or indirectly therewith under the conditions of Article L. 225-180 of the Commercial Code;
4. resolve that the total number of options granted in the context of this authorization may not confer a right to subscribe for a number of new shares in excess of 6% of the total number of shares comprising the capital of the company, subject to any other legal limits, it being noted that the total number of new shares allocated pursuant to the twenty-sixth resolution shall count towards this limit;
5. resolve that the issuance price or purchase price of the shares may not be less than the average opening prices quoted for the shares on the Eurolist Market of Euronext Paris during the last twenty trading sessions preceding the date of the decision to grant the options, it being noted, in addition, that in the case of purchase options, the purchase price of the share on the date the option is granted may also not be less than the average purchase price of the shares held by the company pursuant to Articles L. 225-208 or L. 225-209 of the Commercial Code;
6. set the period of validity of this authorization at 38 months starting from the date hereof;
7. resolve that the period for the exercise of the options may not exceed ten years with effect from the date of allocation of the options by the board of directors;
8. formally note, pursuant to article L. 225-178 of the Commercial Code, that this authorization shall entail the express waiver by shareholders in favor of the beneficiaries of the share subscription options, of the shareholders' preferential subscription right in respect of the shares issued as and when options are exercised;

9. delegates all necessary powers to the board of directors, with power to sub-delegate to the chief executive officer, to set the other terms and conditions of the allocation of the options and of the exercise thereof, and particularly:
- to set the conditions in which the options will be granted and to determine the list or the categories of beneficiaries of the options as provided above; if applicable, to set the conditions of seniority that beneficiaries of these options must satisfy; to decide the conditions under which the price and the number of shares may be adjusted,
  - to determine one or several periods of final vesting of the rights of the beneficiaries and any conditions attached to such vesting, as well as the period or periods during which the options thus granted may be exercised, and the term of such options,
  - to provide for the power to suspend temporarily the exercise of options for a maximum period of three months in the event of the completion of financial transactions involving the exercise of a right attached to the shares to which the options relate,
  - to carry out or arrange to be carried out any actions and formalities for the purpose of completing the capital increase or increases that may be effected pursuant to the authorization that is the subject of this resolution; to amend the articles of incorporation and bylaws accordingly, and generally to take all necessary action,
  - 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 capital of the company after each increase, the balance being available to be appropriated in any way decided by the board of directors or the ordinary shareholders' meeting.

#### TWENTY-EIGHTH RESOLUTION

##### **Powers to implement the decisions of the shareholders' meeting and to carry out the corresponding formalities**

The shareholders give all necessary powers to the bearer of an original, copy or extract of the minutes of this shareholders' meeting, to effect all filings and carry out other formalities, as necessary.



# GENERAL INFORMATION ABOUT THE COMPANY

## > THE ALCATEL SHARE

### Form of share in 2004



### Five-year summary of dividend per share

	2004*	2003	2002	2001	2000
Dividend distributed	-	-	-	0.16	0.48
Tax credit	-	-	-	0.08	0.24
Total dividend	-	-	-	0.24	0.72

\* It will be recommended to the Shareholders' Meeting of May, 20 2005 that no dividend be paid for fiscal year 2004.

### Transactions on the Paris Stock Exchange (in euros)

2004	High	Low	Closing price	Number of shares traded over the month
January	14.21	10.25	13.28	433,605,161
February	13.56	11.90	13.02	293,027,763
March	14.82	11.86	12.84	386,123,490
April	14.10	12.28	12.43	303,208,031
May	13.07	10.88	11.84	245,494,698
June	12.88	10.92	12.68	252,921,379
July	12.86	10.31	10.76	265,415,531
August	10.65	8.77	9.60	303,127,085
September	10.35	9.13	9.41	277,493,127
October	11.62	9.49	11.46	341,893,608
November	12.38	11.27	11.74	200,504,387
December	12.28	10.97	11.45	196,399,124

Source: Thomson Financial

2003	High	Low	Closing price	Number of shares traded over the month
January	7.25	4.16	6.74	568,239,000
February	7.59	5.79	6.69	367,008,000
March	7.31	5.42	6.27	296,892,000
April	8.10	6.10	7.34	342,155,000
May	7.90	6.52	7.79	247,671,000
June	8.54	7.53	7.85	345,217,000
July	8.94	7.56	8.92	283,815,000
August	10.12	8.50	9.90	185,908,000
September	11.89	9.80	10.17	372,241,000
October	11.67	9.89	11.35	307,206,000
November	11.62	10.24	10.89	204,465,000
December	11.20	9.95	10.21	181,239,000

Source: REUTERS

## Transactions on the New York Stock Exchange (ADS in U.S. dollars)

<b>2004</b>	<b>High</b>	<b>Low</b>	<b>Closing price</b>	<b>Number of shares traded over the month</b>
January	17.68	13.06	16.75	47,562,000
February	16.73	15.11	16.19	38,973,800
March	18.32	14.51	15.85	62,637,700
April	17.08	14.62	14.66	31,807,300
May	15.80	13.09	14.41	28,823,400
June	15.60	13.11	15.49	31,439,900
July	15.30	12.80	12.94	31,260,800
August	12.64	10.76	11.73	23,829,800
September	12.70	11.28	11.73	20,734,800
October	14.89	11.98	14.61	37,154,200
November	16.14	14.52	15.54	18,892,900
December	16.20	14.67	15.63	32,194,000

Source: Nasdaq

	<b>High</b>	<b>Low</b>	<b>Closing price</b>	<b>Number of shares traded over the month</b>
January	7.45	4.60	7.26	74,901,800
February	8.09	6.48	7.09	31,827,300
March	7.75	6.09	6.89	25,484,000
April	8.75	6.82	8.06	28,470,700
May	9.35	7.65	9.24	45,479,800
June	10.15	8.72	8.95	44,698,400
July	10.04	8.27	9.85	41,235,700
August	10.96	9.65	10.89	24,240,800
September	13.20	11.16	11.83	48,263,000
October	13.68	11.78	13.18	40,444,600
November	13.42	12.21	13.02	22,702,600
December	13.45	12.27	12.85	19,588,100

Source: Nasdaq

## 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.

The Alcatel share is included in the CAC 40 index of the Paris Stock Exchange Market and in the DJ Euro Stoxx 50.

## > LEGAL INFORMATION

### Identity of the company

#### Company 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

#### Company 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)

The next Shareholders' Meeting will be requested to modify the thresholds and the declaration of Bylaw thresholds (see the Report of the Board of Directors and the text of the resolutions (no. 16) at pages XXX to XXX)

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 the shares must, within fifteen days after this percentage interest is exceeded, inform the Company of the total number of the shares which it possesses, by letter, facsimile 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 ownership is exceeded, request registration of its 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 fifteen 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.

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 specified in the meeting notice.
- 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 Shareholders' 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 meeting notice and the meeting convocation.
- 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, sent 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 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-Chairmen of the Board of Directors, or by a Director designated by the Board of Directors 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 Minutes shall be validly certified either by the Chairman of the Board of Directors, the Meeting Secretary, 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 present 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 at the Annual and Special Shareholders' Meeting of April 17, 2003, which approved the elimination of special rights for Class O shares).**

The profit or loss for the year is the difference between income and expenses for the year, after provisions. Five per cent 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, 2004 was €2,610,910,922, represented by 1,305,455,461 shares with a par value of €2. The total number of voting rights as published by Alcatel in the Bulletin of Mandatory legal Notices (Bulletin des annonces légales obligatoires) of June 16, 2004 totaled 1,248,788,799.

### Financial authorizations at the close of fiscal year 2004

To date, the company has the following authorizations granted by the Shareholders' Meeting on April 18, 2002 and June 4, 2004:

<b>Capital increase authorizations positive net cash three times higher</b> (in millions of euros)	<b>Maximum amount</b>	<b>Available balance<sup>(1)</sup></b>	<b>Authorization date</b>	<b>Expiration date</b>
<b>I – Authorization with preemptive right</b>				
Shares only or any equity or security <sup>(3)</sup> giving immediate or future right to a fraction of the capital stock and capitalization of reserves <sup>(2)</sup>	750 <sup>(1)</sup>	712	06/04/2004	08/03/2006
<b>II – Authorization without preemptive right</b>				
Shares only or any equity or securities <sup>(3)</sup> giving immediate or future rights to a fraction of the capital stock (including securities tendered in an exchange offer initiated by the Company)	750 <sup>(1)</sup>	712	06/04/2004	08/03/2006
<b>III – Authorizations for employees</b>				
Issuance of shares reserved for employees participating in a company savings plan (Art L.443.1 et seq. of the Labor Code)	3% of the capital stock	3%	06/04/2004	08/03/2006
Stock options for new <sup>(4)</sup> or existing shares	15% of the total number of shares	5.9%	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.

(2) The maximum nominal amount of a capital increase by capitalization of reserves is limited to the total amount that may be capitalized.

(3) Issuance of marketable debt securities giving the right to, or attached to an equity security, up to the maximum nominal amount of €6 billion.

(4) Limit of 15% applicable to stock options for new shares.

## Five-year summary of capital stock

Date and type of operation	Number of shares		Capital	Share premiums and date and type of operation
	A Shares	O Shares <sup>(2)</sup>		
<b>CAPITAL AT 01.27.1999</b>	198,714,596		1,987,145,960	10,033,426,711.91
Stock options exercised	1,180,651			100,289,835.51
<b>CAPITAL AT 12.31.1999</b>	199,895,247		1,998,952,470	10,133,716,547.42
After five-for-one stock split <sup>(1)</sup>	999,476,235			
Stock options exercised	2,849,428			43,608,924.84
Shares issued to remunerate Genesys shareholders in connection with 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
<b>CAPITAL AT 12.31.2000</b>	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)
<b>CAPITAL AT 12.31.2001</b>	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
<b>CAPITAL AT 12.31.2002</b>	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 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
<b>Conversion of Class O shares to ordinary shares</b>	26,000,000	(26,000,000)		
<b>CAPITAL AT 12.31.2003</b>	1,284,410,224	-	2,568,820,448	21,719,088,009.11
Stock options exercised	1,508,728		3,017,456	6,856,478.00
Redemption of Coralec bonds:				
- acquisition of Astral Point Communications Inc.	300,000		600,000	4,323,000.00
- acquisition of Telera Inc.	400,000		800,000	1,304,000.00
- acquisition of iMagic TV Inc.	50,000		100,000	272,000.00
- acquisition of TiMetra Inc.	1,000,000		2,000,000	6,080,000.00
- acquisition de Spatial Communications Technologies Inc.	17,783,297		35,566,594	176,268,039.86
Redemption of Alcatel bonds / 7.917%	3,212		6,424	10,728.08
<b>CAPITAL AT 12.31.2004</b>	1,305,455,461	-	2,610,910,922	195,114,245.94

(1) The five-for-one stock split was approved by the Annual and Special Shareholders' Meeting of May 16, 2000.

(2) The shares composing the capital stock 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.

## Capital stock and voty rights vote

To the company's knowledge, the principal shareholders at December 31, 2004 were as follows:

Position in capital and voting rights	Shares		Votes	
	Number	%	Number	%
Caisse des Dépôts et Consignations	68,100,807	5.22	68,387,757	5.37
Employee Group Fund (FCP 3A)	25,442,058	1.95	42,453,834	3.34
Société Générale Group	11,672,805	0.89	18,955,310	1.49
Treasury stock	25,343,255	1.94	-	-
Shares held by subsidiaries	38,964,778	2.98	-	-
Public <sup>(1)</sup>	1,135,931,758	87.01	1,142,713,807	89.80
<b>TOTAL</b>	<b>1,305,455,461</b>	<b>100.00</b>	<b>1,272,510,708</b>	<b>100.00</b>

(1) Including 0.03% held by members of the Board of Directors and Management.

As of December 31, 2004, a total of 31,363,280 shares were entitled to double voting rights, representing 2.5% of the voting rights.

In 2004, the company received declarations that legal and statutory thresholds had been exceeded, issued by certain shareholders or intermediaries acting on behalf of their clients.

The Caisse des Dépôts et Consignations reported that over the course of fiscal year 2004 it exceeded and fell below the statutory threshold of 5.5% of the capital and the legal threshold of 5% of the capital and voting rights several times. The last report states that, as of March 2, 2005, the entity holds 5.22% of the capital and 5.37% of the voting rights.

The company has also learned that Brandes Investment Partners L.P. and certain associated companies hold 8% of the voting rights as of December 31, 2004.

In addition to the legal threshold of 5%, the declarations received by the company pertain to shareholders who exceeded thresholds between 0.5% and 3% of the capital. Based on declarations received by the company between January 1, 2004 and March 31, 2005, this applies to:

- Fidelity International Ltd and FMR Corp., that hold 4.98% of the capital as of May 31, 2004.

- Ecureuil Gestion FCP, that holds 3.30% of the capital as of March 31, 2004.
- FCP3A mutual fund, that holds 2.01% of the capital and 3.24% of the voting rights as of July 19, 2004.
- Société Générale, that holds 0.94% of the capital and 1.57% of the voting rights as of February 25, 2005.
- Atout France, that holds 1.16% of the capital as of May 28, 2004.
- Platinum Asset Management Trust, that holds over 0.5% of the capital as of July 15, 2004.
- Caisse Nationale des Caisses d'Epargne et de Prévoyance, that no longer holds any company shares since March 1, 2005.

To the company's knowledge, no shareholder other than those indicated 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 2004 implying that this estimate was inaccurate.

Three-year shareholding summary:

% Interest in capital	2004	2003	2002
Caisse des Dépôts et Consignations*	5.22	5.79	5.91
Employee Group Funds (FCP 3A)	1.95	1.94	1.36
Société Générale Group	0.89	0.91	0.90
Treasury stock	1.94	1.97	2.00
Shares held by subsidiaries	2.98	3.22	3.35
Public	87.01	86.17	86.48
<b>TOTAL</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

\*The Caisse des dépôts et consignations declared having exceeded, on September 16, 2002, the threshold of 5% of capital stock and voting rights.

## Five-year summary of dividends

Year	Share	Net dividend	Tax credit	Total return
2004 <sup>(1)</sup>	Common share	-	-	-
2003 <sup>(2)</sup>	Common share	-	-	-
2002	Class O Shares	-	-	-
	Class A shares	-	-	-
2001	Class O Shares	€0.10	€0.05	€0.15
	Class A shares	€0.16	€0.08	€0.24
2000 <sup>(2)</sup>	Class O Shares	€0.10	€0.05	€0.15
	Class A shares	€0.48	€0.24	€0.72

(1) A resolution will be submitted to the Shareholders' Meeting on May 20, 2005 not to distribute dividends for fiscal year 2004.

(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. At 31.12.04, Alcatel held 25,343,255 shares, representing 1.94 % of the capital stock. These shares were recorded at 31.12.04 as a deduction from shareholders' equity. A new authorization to purchase shares will be requested at the next Shareholders' Meeting.

The Annual and Special Shareholders' Meeting on June 4, 2004 authorized, in its seventh resolution, the Board of Directors, with a right to sub-delegate as provided by law, for a period of 18 months, to buy back Alcatel shares, up to a maximum of 10% of the capital.

This share buy back program was publicized in a memorandum, Financial Markets Authority Visa No. 04-435, dated May 14, 2004. It put an end, for the tranche not utilized, to the authorization given by the Annual and Special Shareholders' Meeting on April 17, 2003.

Pursuant to the terms of this program, the maximum share purchase price is 40 Euros per share while the minimum sale price is 2 Euros per share.

The Board of Directors, meeting on March 10, 2005, proposed to the General Shareholders' Meeting to be held on May 20, 2005, by second and last convocation, with respect to the unused tranche, canceling the existing authorization and giving the Board of Directors a new authorization to implement a buy back program in conformity with the European Regulation applying the European Directive on "Market Abuse" in connection with share buy backs, coming into law October 13, 2004.

## Securities issued giving rights to capital

### Stock options granted by Alcatel.

On March 10, 2004, the Board of Directors approved the grant of stock options to 14,810 Group employees and managers at an option price of €13.20.

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.

Between April 1, 2004 and March 30, 2005, the Chairman, exercising this delegation of authority, granted certain Group employees 1,296,400 stock options that may be exercised at fixed prices based on the value of the share during the 20 days preceding the Chairman's decision, in this case within a range of €9.80 to €13.10.

As of December 31, 2004, 118,850,969 options for new shares and 10,566,000 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 April 17 and December 10, 1997 option plans, the options still to be exercised by the beneficiaries, i.e. 7,733,500 options, became null and void as of January 1, 2005. Therefore, the total number of options outstanding as of January 1, 2005 was 111,117,469.

However, at December 31, 2004, only 25,148,698 stock options; i.e., 21.2% of the total options outstanding, had an option price lower than the market price for Alcatel shares on the Euronext Paris Exchange, based on the high recorded in December 2004 (€12.28 on December 3, 2004) and therefore offered a potential gain for the beneficiaries.

On March 10, 2005, the Board of Directors decided to grant 16,756,690 stock purchase options to 9,470 employees and executives, giving them the right to subscribe for new Alcatel shares at a price of €10 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, 2013.

720,000 options were allocated to the members composing senior management, except chairman and Chief Executive Officer.

The principal features of the options granted and outstanding at December 31, 2004 are described on the following page:

## The principal features of the options granted and outstanding at December 31, 2004

Creation of the plan	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding		Option exercise period <sup>(1)</sup>		Exercise price (in euros)	Discount	Options exercised in 2004
					held by all employees and executives	Directors <sup>(4)</sup> executives	From	To			
OPTIONS FOR EXISTING SHARES											
12.09.1998	2,025	11,602,500	0	1 480,250	10,122,250	450,000 185,000	12.09.2003	12.31.2005	20.52	0%	
09.08.1999	141	545,000	0	101,250	443,750		08.09.2004	12.31.2005	28.40	0%	
OPTIONS FOR NEW SHARES											
04.17.1997	961	8,199,500	107,000	656,000	7,436,500	585,000 150,000	05.01.2002	12.31.2004	19.27	4.97%	
12.10.1997	61	367,000	0	70,000	297,000	- 20,000	12.11.2002	12.31.2004	20.95	4.93%	
03.29.2000	3,887	15,239,250	13,000	2,160,195	13 066,055	700,000 380,000	04.01.2003 04.01.2005	12.31.2005 12.31.2007	48	0%	
03.29.2000 <sup>(3)</sup>	58,957	3,317,808	40	56,108	3,261,660	672 1,344	07.01.2003 07.01.2005	06.30.2004 06.30.2006	48	0%	
12.13.2000	478	1,235,500	0	213,650	1,021,850	- 15,000	12.13.2003 12.13.2005	12.13.2005 12.31.2007	65	0%	
12.13.2000 <sup>(2) (5)</sup>	340	306 700	0	98 959	207,741		12.13.2001 12.13.2004	12.12.2008 12.12.2008	64	0%	
03.07.2001 <sup>(2)</sup>	30,790	37,668,588	0	9,740,262	27,928,326	632,400 386,000	03.07.2002 03.07.2005	03.06.2009 03.06.2009	50	0%	
03.07.2001 <sup>(3)</sup>	2,024	275,778	0	3,558	272,220	- 300	07.01.2004 07.01.2005	06.30.2005 06.30.2006	50	0%	
04.02.2001 <sup>(2)</sup>	13	48,850	0	36,600	12,250		04.02.2002	01.04.2009	41	0%	
04.02.2001 <sup>(2) (5)</sup>	1	2,500	0	0	2,500		04.02.2002	04.01.2009	39	0%	
06.15.2001 <sup>(2)</sup>	627	977,410	0	193,789	783,621		06.15.2002 06.15.2005	06.14.2009 06.14.2009	32	0%	
09.03.2001 <sup>(2)</sup>	58	138,200	0	32,150	106 050		09.03.2002 09.03.2005	09.02.2009 09.02.2009	19	0%	
11.15.2001 <sup>(2) (5)</sup>	16	162,000	3,000	53,000	106,000		11.15.2002 11.15.2002	11.14.2009 11.14.2009	9	0%	3,000
12.19.2001 <sup>(2)</sup>	25,192	27,871,925	0	7 340 784	20,531,141		12.19.2002 12.19.2005	12.18.2009 12.18.2009	20.8	0%	
12.19.2001	45,575	935,660	0	41,030	894,630	701,800 525,000	01.01.2005 01.01.2006	12.31.2005 12.31.2006	20.8	0%	
12.19.2001 <sup>(2) (5)</sup>	521	565,800	107,018	119,276	339,506	80 200	12.19.2002 12.19.2005	12.18.2009 12.18.2009	9.3	0%	42,574

Creation of the plan	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding		Option exercise period <sup>(1)</sup>		Exercise price (in euros)	Discount	Options exercised in 2004
					held by all employees and executives	Directors <sup>(4)</sup> executive	From	To			
02.15.2002	37	123,620	0	40,253	83,367	- 15,000	02.15.2003 02.15.2006	02.14.2010 02.14.2010	17.2	0%	
04.02.2002	24	55,750	0	20,000	35,750		04.02.2003	04.01.2010	16.9	0%	
05.13.2002	23	54,300	0	9,719	44,581		05.13.2003 05.13.2006	05.12.2010 05.12.2010	14.4	0%	
06.03.2002	176	281,000	0	37,521	243,479		06.03.2003 06.03.2006	06.02.2010 06.02.2010	13.3	0%	
09.02.2002	226	1,181,050	236,329	290,331	654,390		09.02.2003 09.02.2006	09.01.2010	5.2	0%	204,147
10.07.2002	16	30,500	4,018	13,023	13,459		10.07.2003 10.07.2006	10.06.2010 10.06.2010	3.2	0%	3,165
11.14.2002	26	111,750	24,213	11,544	75,993		11.14.2003 11.14.2006	11.13.2010 11.13.2010	4.6	0%	20,838
12.02.2002	16	54,050	3,562	12,250	38,238		12.02.2003 12.02.2006	12.01.2010 12.01.2010	5.4	0%	3,562
03.07.2003	23,650	25,626,865	1,229,499	2,726,052	21,671,314	751,200 590,000	03.07.2004 03.07.2007	03.06.2011 03.06.2011	6.7	0%	1,221,749
03.07.2003 Plan AL	31,600	827,348	139	17,798	809,411	56 -	07.01.2006 07.01.2007	06.30.2007 06.30.2008	6.7	0%	111
06.18.2003	193	338,200	6,944	31,654	299,602	- 5,000	06.18.2004 06.18.2007	06.17.2011	7.6	0%	6,944
07.01.2003	19	53,950	473	23,951	29,526		07.01.2004 07.01.2007	06.30.2011	8.1	0%	473
09.01.2003	77	149,400	1,603	6,300	141,497	- 50,000	09.01.2004 09.01.2007	08.31.2011	9.3	0%	1,603
10.01.2003	37	101,350	0	29,376	71,974		10.01.2004 10.01.2007	09.30.2011	10.9	0%	
11.14.2003	9	63,600	0	2,000	61,600		11.14.2004 11.14.2007	11.13.2011	11.2	0%	
12.01.2003	64	201,850	562	37,300	163,988		12.01.2004 12.01.2007	11.30.2011	11.1	0%	562
03.10.2004	14,810	18,094,315	0	724,065	17,370,250	601,000 755,000	03.10.2005 03.10.2008	03.09.2012	13.2	0%	
04.01.2004	19	48,100	0	7,350	40,750		04.01.2005 04.01.2008	03.31.2012	13.1	0%	
05.17.2004	26	65,100	0	2,550	62,550		05.17.2005 05.17.2008	16.05.2012	12.8	0%	
07.01.2004	187	313,450	0	13,500	299,950		07.01.2005 07.01.2008	30.06.2012	11.7	0%	
09.01.2004	21	38,450	0	0	38,450		09.01.2005 09.01.2008	31.08.2012	9.9	0%	
10.01.2004	85	221,300	0	0	221,300		10.01.2005 10.01.2008	30.09.2012	9.8	0%	
11.12.2004	20	69,600	0	0	69,600		11.12.2005 11.12.2008	11.11.2012	11.2	0%	
12.01.2004	11	42,900	0	0	42,900		12.01.2005 12.01.2008	30.11.2012	11.9	0%	
<b>TOTAL</b>	<b>243,039</b>	<b>157,607,767</b>	<b>1,737,400</b>	<b>26,453,398</b>	<b>129,416,969</b>	<b>7,500,052</b>					<b>1,508,728</b>

(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, 11,142,851 options were still not exercised at December 31, 2004.

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 sets forth the U.S. and Canadian companies, the range of exercise prices, the number of outstanding and exercisable options as of December 31, 2004, the weighted average exercise price and the weighted average exercise period.

Issuing company	Exercise price	Options outstanding		Options that may be exercised		
		Number outstanding at 12/31/2004*	Weighted residual exercise period (no. of years)	Weighted average exercise price	Number of exercisable options at 12/31/2004	Weighted average exercise price
Packet Engines	USD 0.29- USD 0.86	14,372	2.89	0.50	14,372	0.50
Xylan	USD 0.05 - USD 18.14	1,897,842	3.02	8.60	1,897,842	8.60
Internet Devices Inc	USD 0.26- USD 1.17	26,480	3.83	0.89	26,480	0.89
DSC	USD 16.57- USD 44.02	110,150	1.24	30.76	110,150	30.76
Genesys	USD 0.01-USD 41.16	3,407,778	4.26	20.70	3,407,778	20.70
Newbridge	USD 11.72-USD 52.48	389,110	0.26	42.55	389,110	42.55
Astral Point	EUR 0.29-EUR 58.71	254,395	6.33	16.83	253,363	16.84
Telera	EUR 0.43-EUR 6.36	188,605	5.23	5.23	173,042	5.13
Imagic TV	EUR 2.84-EUR 64.68	130,372	2.55	15.40	95,694	17.59
TiMetra	EUR 0.53-EUR 7.97	2,172,909	5.83	5.31	1,069,286	3.80
Spatial Communications Technologies Inc.	EUR 0.24-EUR 9.1	1,563,396	8.97	4.48	408,532	2.92
<b>TOTAL NUMBER OF OPTIONS</b>		<b>10,155,409</b>			<b>7,845,649</b>	

\* 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 21,298,260 options not yet exercised at December 31, 2004. 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, TiMetra and Spatial Communications Technologies Inc.

### Bonds redeemable for shares

- Issues to finance acquisitions

During fiscal year 2004, Alcatel authorized a debt issue through its subsidiary Coralec, represented by bonds redeemable for Alcatel shares to allow the acquisition of Spatial Communications Technologies Inc. (United States).

In the acquisition of Spatial Communications Technologies, Inc., 18,988,334 bonds redeemable for Alcatel ordinary shares were issued at the unit price of €11.912 and resulted, between the date of creation and December 31, 2004, in the issue of 17,783,297 Alcatel shares with a par value of €2.

During fiscal year 2003, Alcatel authorized two debt issues through its subsidiary Coralec, represented by bonds redee-

mable for Alcatel shares to allow the acquisition of iMagic TV Inc. (Canada) and TiMetra Inc (United States).

In the acquisition of iMagic TV Inc., 3,717,254 bonds redeemable for Alcatel ordinary shares (ORA) were issued at the unit price of €7.44, and resulted in the issue of 50,000 shares with a par value of €2 between January 1 and December 31, 2004, thus bringing the number of shares issued since the date of creation as repayment for these ORAs to 3,581,332 shares of Alcatel stock.

In the acquisition of TiMetra Ltd, 17,979,738 bonds redeemable for Alcatel ordinary shares (ORA) were issued at the unit price of €8.08, and resulted in the issue of 1,000,000 shares with a par value of €2 between January 1 and December 31, 2004, thus bringing the number of shares issued since the date of creation as repayment for these ORAs to 16,534,934 shares of Alcatel stock.

In 2002, Alcatel authorized two debt issues through 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 300,000 shares with a par value of €2 between January 1 and December 31, 2004, thus bringing the number of shares issued since the date of creation as repayment for these ORAs to 9,123,396 shares of Alcatel stock.

In the acquisition of Telera Inc., 15,547,728 bonds redeemable for Alcatel ordinary shares (ORA) were issued at the unit price of €5.26, and resulted in the issue of 400,000 shares with a par value of €2 between January 1 and December 31, 2004, thus bringing the number of shares issued since the date of creation as repayment for these ORAs to 15,547,728 shares of Alcatel stock. All of these bonds had been repaid by December 31, 2004.

As of December 31, 2004, a total of 3,169,130 bonds redeemable for Alcatel shares were outstanding. These bonds are not listed on any market.

- Issues as part of financing activities
- > ORANE December 2002

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, 2004, 5,998 bonds have been redeemed and resulted in the creation of 5,040 Alcatel shares with a par value of €2.

The three-year bonds, maturing in December 2005, bear interest at an annual rate of 7.917%. The interest due was paid in full to the bondholders on January 2, 2003.

> OCEANE June 2003

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 (5.75% FRF February 2004 and 5% EUR October 2004) and 2005 (5.87% EUR September 2005). This offer resulted in the launching of an order book for institutional investors and a fixed price offer for private investors. At the

close of the offer Alcatel bought back bonds for a nominal value of €342 million.

On December 31, 2004, a total of 183,972,538 ORANE and OCEANE, listed for trading on the Premier Marché of Euronext Paris SA, were outstanding.

#### Warrants (giving rights to existing securities)

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. These warrants, due on May 21, 2004, was not exercised.

#### Securities not representing capital stock

These securities are ordinary bond issues: the balance of these issues was 3,764 million at December 31, 2004.

- Five of these issues are listed for trading on the Premier Marché of Euronext Paris:
  - 5.625% bond issued in 1997
  - zero coupon bond issued in 1998
  - 4.375 % bond issued in 1999
  - fixed rate 4.375% bond, issue 2001
  - fixed rate 5.875% bond, issue 2000 (due September 2005)
- Bonds listed on the Luxembourg Stock Exchange

Debt issue in 2001 under the Euro Medium Term Notes program established on July 27, 2001, is listed on the Luxembourg Stock Exchange.

In 2004, in accordance with the offer described herunder, Alcatel issued an ordinary bond with fixed price of 6.375%, due 2014; bonds are listed on the Luxembourg Stock Exchange.

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.

A decision made at the Annual Shareholders' Meeting of June 4, 2004 authorizes the company to issue bonds of a maximum nominal value of €10 billion over a 26 month period.

# PERSON RESPONSIBLE FOR THE REFERENCE DOCUMENT AND STATEMENTS

## > RESPONSIBILITIES

Audit Reports are prepared by the company's Statutory Auditors on the Alcatel parent company and consolidated financial statements:

	Appointment*	Renewal*	Expiration
<b>STATUTORY AUDITORS</b>			
<b>Deloitte &amp; Associates, represented by Mr. Alain Pons</b>			
185, avenue Charles de Gaulle 92203 Neuilly-sur-Seine Cedex	06/18/1998	05/16/2000	2006
<b>Barbier Frinault et Autres (Ernst &amp; Young), represented by Mr. Christian Chiarasini</b>			
41, rue Ybry 92576 Neuilly-sur-Seine Cedex	06/23/1994	05/16/2000	2006
<b>ALTERNATES</b>			
<b>Mr. Olivier Azières,</b>			
185, avenue Charles de Gaulle 92203 Neuilly-sur-Seine Cedex	06/18/1998	05/16/2000	2006
<b>Mr. Philippe Peuch-Lestrade,</b>			
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 2004

	2004				2003			
	Deloitte (Deloitte & Associates Network)		Deloitte (Deloitte & Associates Network)		Deloitte (Deloitte & Associates Network)		Barbier Frinault & Autres (Ernst & Young Network)	
	K€	%	K€	%	K€	%	K€	%
<b>1 - Audit</b>								
Statutory audits, certification, review of Company and consolidated financial statements	5,162	70.4%	3,506	58.3%	5,288	79.1%	3,959	50.1%
Other ancillary assignments and audits	1,041	14.2%	2,090	34.7%	890	13.3%	2,819	35.7%
<b>Sub-total</b>	<b>6,203</b>	<b>84.5%</b>	<b>5,597</b>	<b>93.0%</b>	<b>6,178</b>	<b>92.4%</b>	<b>6,778</b>	<b>85.8%</b>
<b>2 - Other services</b>								
Tax	967	13.2%	342	5.7%	366	5.5%	1,040	13.2%
Information technologies								
Other	167	2.3%	77	1.3%	143	2.1%	79	1.0%
<b>Sub-total</b>	<b>1,134</b>	<b>15.5%</b>	<b>419</b>	<b>7.0%</b>	<b>509</b>	<b>7.6%</b>	<b>1,119</b>	<b>14.2%</b>
<b>TOTAL</b>	<b>7,337</b>	<b>100.0%</b>	<b>6,015</b>	<b>100.0%</b>	<b>6,688</b>	<b>100.0%</b>	<b>7,897</b>	<b>100.0%</b>
Respective scopes:	54.9%		45.1%		45.9%		54.1%	

## > STATEMENTS 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

The reference document contains all the management report elements required by law.

## > REPORT OF THE STATUTORY AUDITORS ON THE REGISTRATION DOCUMENT

This is a free translation into English of the statutory auditors' report on the registration document issued in the French language and is provided solely for the convenience of English speaking readers. The statutory auditors' reports on financial statements and consolidated financial statements, referred to in this report, include information specifically required by French law in all audit reports, whether qualified or not, and this is presented after the Opinion on the financial statements. This information includes explanatory paragraph 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 and consolidated financial statements taken as a whole and not to provide separate assurance on individual account captions or on information taken outside of the annual and consolidated financial statements.

This report should be read in conjunction with, and construed in accordance with French law and professional auditing standards applicable in France.

In addition, the procedures and practices utilized by the statutory auditors in France with respect to such financial statements included in a Document de Reference, may differ from those generally accepted and applied by auditors in other countries

In our capacity as statutory auditors of Alcatel and in compliance with Article 211-5-2 of AMF General Regulation, we have verified, in accordance with French professional standards, the information in respect of the financial position and historical financial statements included in the accompanying Registration Document.

This Registration Document is the responsibility of the Chairman of the Board. Our responsibility is to issue a conclusion on the fairness of the information contained therein with respect to the financial position and financial statements.

We conducted our examination in accordance with French professional standards. This examination consisted in assessing the fairness of the information on the financial position and financial statements and to verify their consistency with the audited accounts. We also read other financial information contained in the Registration Document in order to identify any significant inconsistencies with information in respect of the financial position and financial statements and to bring to your attention any obvious misstatements we noted based on our general understanding of the company gained through our audit.

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.

We issued an unqualified opinion on the annual and consolidated accounts drawn up by the Board for the year ending December 31, 2002, 2003 and 2004 in accordance with French professional standards.

- In our Statutory Auditors' Report on the consolidated financial statements for the year ended December 31, 2004, without qualifying our opinion, we draw attention to the matter discussed in Notes 1 and 31 to the financial statements describing the changes, from January 1, 2004:

- in method, relating to the new consolidation rules of the "ad hoc" entities, introduced by the "Loi de Sécurité Financière" dated August 1, 2003, to in process Research and Development capitalisation, and to implementation of 2003

- R-01 CNC recommendation on accounting and evaluation principles on pensions and other long-term benefits,

- in presentation, done in the context of the project of the IFRS transition at January 1, 2005.

- In our Statutory Auditors' Report on the annual financial statements for the year ended December 31, 2004, without qualifying our opinion, we draw attention to the matter discussed in Note 1.i) and 12 of the notes to financial statements related to the change in method resulting from the initial implementation, beginning on January 1, 2004, of 2003 - R-01 CNC recommendation on accounting and evaluation principles on pensions and other long-term benefits.

- In the Statutory Auditors' Reports on the annual and consolidated financial statements for the year ended December 31, 2002, without qualifying our opinion, we have expressed an opinion on the change in method resulting from the first application as of starting January 1, 2002, of CRC Rule No. 2006-06 governing liabilities.

We have audited the IFRS reconciliations between the French accounting standards and International Financial Reporting Standards, as adopted in the European Union, for the year ended December 31, 2004, in accordance with the professional standards applicable in France.

In our Special Purpose Statutory Auditors' Report on the IFRS Reconciliation Tables for 2004, we issued an unqualified opinion on their preparation, in all their significant components, in accordance with the rules described in their accompanying notes and draw attention to Note No. 1 / b, which describes the reasons for which the IFRS reconciliations relating to fiscal year 2004 presented in the consolidated financial statements for fiscal year 2005 may differ from the IFRS reconciliations accompanying this report.

On the basis of our examination, we have nothing to report on the fairness of the information on the financial position and the accounts included in the Registration Document.

Neuilly-sur-Seine, March 30, 2005

The Auditors

DELOITTE & ASSOCIÉS

Alain Pons

BARBIER FRINAULT & AUTRES

ERNST & YOUNG

Christian Chiarasini

The Registration Document also includes the following reports :

- The statutory auditors' reports on the annual and consolidated accounts at December 31, 2004 (respectively shown on page 108 of the Registration Document), which includes the basis of their assessment in accordance with Article L.225-235 of French company law (Code de Commerce).
- In accordance with Article L.225-235 of French company law (Code de Commerce), the statutory auditors' report on the report prepared by the Chairman of the Board (page 32 of the Registration Document) describes the internal control procedures for the preparation and treatment of accounting and financial information.
- The Special Statutory Auditors' Report on the IFRS Reconciliation Tables for 2004 (page 140 of the Registration Document).

## > FINANCIAL INFORMATION: RELATIONS WITH SHAREHOLDERS AND THE FINANCIAL COMMUNITY

Alcatel is committed to providing all its shareholders with regular, clear, homogenous information in conformance with recommendations of the authorities of the stock exchanges where the company is listed. Alcatel's financial communication team is ready to provide information on the Group's strategy, significant developments, and objectives to retail shareholders, institutional investors, and both French and foreign financial analysts.

### A strong presence

Information meetings open to all market actors are held several times per year, coinciding with the publication of quarterly and annual results.

The Shareholders' Meeting is an important annual occasion because all shareholders have the opportunity to actively participate in the life of the Group by voting on resolutions. This is also a rare opportunity to meet Serge Tchuruk, Chairman and CEO of Alcatel. In 2004, the Shareholders' Meeting was held on June 4 in the presence of over 1,500 shareholders. It approved, through electronic voting, all of the resolutions presented by the Board of Directors. Live and recorded webcasts of the Shareholders' Meeting, were made available over the Internet.

Numerous shareholders' meetings have been held over the course of the year outside of Paris, in Nantes, Toulouse and Lyons, among others. The meetings were well attended, in particular the Marseille meeting where Philippe Germond, COO, presented the Group's strategy to over 500 shareholders. Alcatel demonstrated its commitment to retail shareholders by participating in the Actionaria Salon, where shareholders could discuss the Group's results and future with Claire Pedini, Deputy CFO. In addition, during the two-day Salon (November 19-20), the entire Financial Communication team was present to meet with you and answer your questions at the Alcatel stand. In 2005, Alcatel has already planned more events outside of Paris, specifically meetings in Lille, Tours and Bordeaux. Lastly, to help you better understand Alcatel's activities and the complexities of the telecommunications sector, Alcatel will continue hosting educational meetings at the company headquarters.

As in previous years, members of Alcatel's management met with financial analysts and portfolio managers at roadshows following the publication of quarterly results, held in the main financial centers in Europe (Paris, London, Milan, Geneva, Zurich, Frankfurt), North America (New York, Boston, Chicago, San Diego, San Francisco, Montreal), and Asia (Tokyo, Hong Kong, Shanghai). In addition, on December 2, Alcatel hosted its Analyst Day, intended for financial analysts and financial community representatives. Throughout 2004, the Group organized over 300 such meetings (about one every working day).

### Keeping you informed – More comprehensive information

The new version of the Shareholders/Investors website was made available in early 2004 at [www.alcatel.com](http://www.alcatel.com). With the addition of the Email Alerts service, Internet users can receive email reminders of events, publications, or updates to one of our documents. All website sections are kept up to date. You are invited to visit our website at your convenience.

The new format of "Shareholders Network", the financial information newsletter, offers an easy to read quarterly update of the Group's activity and now contains an explanation of a key technology for the future. A questions and answers section will address current topics. It is regularly sent out to registered shareholders and to other shareholders upon written request.

All financial documentation is available upon written request sent to the Shareholder Relations Department.

#### Financial timetable 2005

February 3: 2004 Q4 and annual earnings  
April 27: Q1 2005 earnings  
July 28: Q2 2005 earnings  
October 27: Q3 2005 earnings

#### Contacts

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# 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, 2005 under n°D.05-326.

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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