Document de référence 2005

English Version

ALCATEL

PROFILE

World leader in telecommunication services

Alcatel offers global and innovative telecommunication services, based on the excellence of its technologies and the skills of its 58 000 workforce. These solutions, which cover the entire telecommunications field, are used by telecoms operators, companies and governments to provide their customers or users fixed and mobile multimedia services (telephony, high speed Internet, video) in a high speed world. Alcatel is helping to reduce the digital divide and works within a framework of socially responsible advancement.

This high added value service offering is the result of real mastery of technical changes and their use, clear strategic choices and discipline in their implementation. It is based on Alcatel's strengths: the wealth of its technology portfolio, its capability to integrate complex projects, its leadership standing in fast developing markets such as fixed and mobile high speed access, optical transmission and IP technologies, and a long-standing presence in 130 countries.

In 2005, Alcatel earned €13.1 billion in sales with a net profit of €930 million.

AUTORITÉ DES MARCHÉS FINANCIERS
AMF

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PRESENTATION

KEY FIGURES

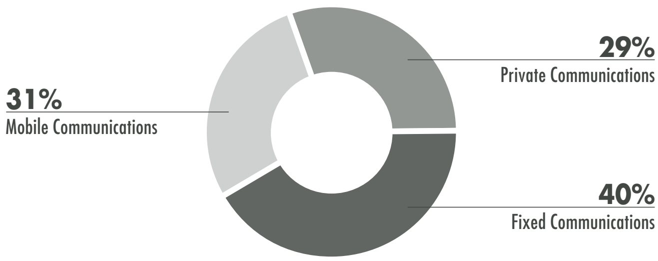
The Group's figures, published for 2005 and 2004, are produced according to IFRS standards.

SALES BY SEGMENT (in %)

Fixed communications, which strengthened its leadership positions in 2005, particularly in optical and broadband access, accounted for 40% of sales revenues.

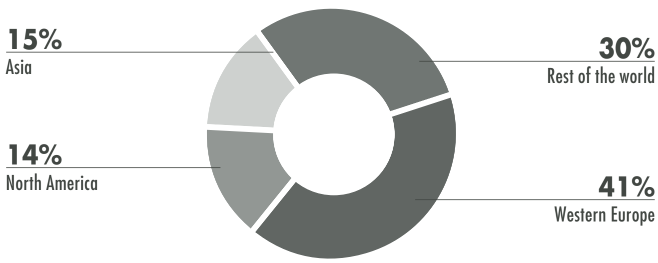
The share of sales held by mobile communications advanced strongly, pulled along by network deployments in emerging countries and accounted for 31% of sales revenues.

The private communications segment accounted for 29% of sales with Alcatel extending its customer base to include private companies and public administrations.



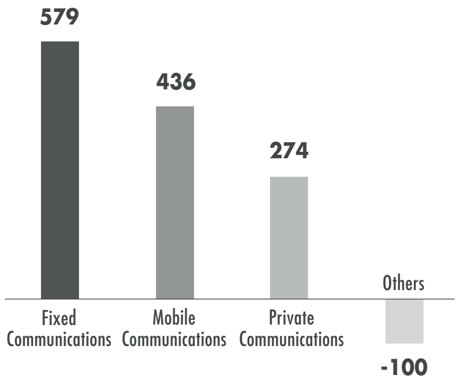
GEOGRAPHICAL BREAKDOWN OF SALES (in %)

Western Europe and North America grew in line with the average for the Group, balancing the light decline of Asian market. The geographical breakdown has not changed much from one year to the next other than for the proportion of emerging countries (Eastern Europe, Africa, Middle East, India and Latin America) which grew strongly (+15%), driven by a sharp increase in investment in 2005, particularly in the mobile communications market.



INCOME FROM OPERATIONS (in millions of euros)

Due to continuing cost optimization against a background of increasing sales, the Group's operating margin held at €1.1 billion, or 9.1% of sales. The businesses associated with telecommunications operators (fixed and mobile communications) had a margin of more than 10% of sales.



INCOME STATEMENTS SUMMARY

(in millions of euros except for earnings per share)	2005	2004
Net sales	13,135	12,244
Operating Profit	1,189	1,179
Income from operating activities	1,139	707
Net income (Group share)	930	576
EPS Diluted (in €)	0.68	0.42
E/ADS* (in $)	0.80	0.50
Number of shares (billion)	1.38	1.36

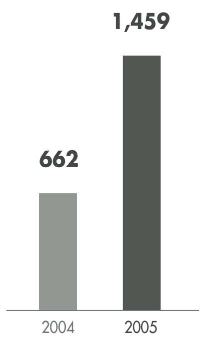
** E/ADS has been calculated using the US Federal Reserve Bank of New York noon euro/dollar buying rate of USD 1.18 as of December 30, 2005.*

CHANGE IN NET CASH

(in millions of euros)

Net cash doubled from one year to the next.

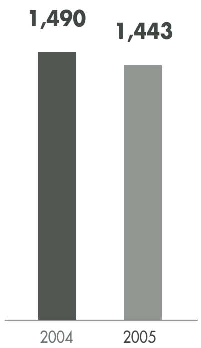
Cash generated by operations more than covered the financing of the latest restructuring plans.



CHANGE IN R&D EXPENDITURE

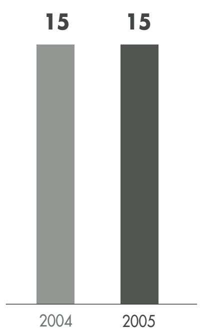
(in millions of euros)

R&D expenditure in 2005 represented close on 11% of sales revenue, compared with 12% in 2004, but the R&D effort grew due to the greater effectiveness of the Group's policy.



MARKET CAPITALIZATION (in billions of euros)

Alcatel's market capitalization remained unchanged compared with the previous year. In an extremely competitive telecommunications market, the Group succeeded in maintaining a healthy financial situation, growing its product portfolio and winning market share.



ALCATEL OVERVIEW

Fixed Communications

Activities
Design, supply and installation of fixed communications infrastructure (telephony, Internet, video) for telecommunications operators
Design, supply and installation of converged fixed/mobile networks
Supply of multimedia applications
Integration of end-to-end complex solutions

(1) Source Alcatel (2) Source RHK (3) Source Synergy (4) Source Alcatel.

Mobile Communications

Activities
Design, supply, and installation of mobile communications infrastructure (telephony, Internet, video) for telecommunications operators
Design, supply and installation of converged fixed/mobile networks
Supply of multimedia applications
Integration of end-to-end complex solutions

(5) (6) Source Alcatel.

Private Communications

Activities
Design, supply, and installation of fixed and mobile communications infrastructure (telephony, data transfer) for enterprises and public institutions
Design, supply and launch of satellite-based solutions for satellite operators
Design, supply, and installation of signaling and communication networks for operators of urban and rail transportation systems
Integration of end-to-end telecommunication networks for private companies (transport, energy)

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

Solutions	Key Figures
Wireline circuit-switched telephone networks *Seamless Voice over IP (VoIP) core 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)*	*€5.2 billion revenues in 2005* *No. 1 worldwide for ADSL: 35% worldwide market share with 21.6 million lines shipped* [(1)] *No. 1 worldwide for optical networks with 16% market share* [(2)] *Among top 3 vendors worldwide in IP routers* [(3)] *Over 380 million circuit-switched lines installed* [(4)]

Solutions	Key Figures
Wireless circuit-switched telephone networks (GSM/GPRS/EDGE/ UMTS/HSxPA and CDMA) *Seamless Voice over IP (VoIP) core networks* *Radio transmission networks* *Multimedia user services (messaging, video, music)* *Applications for mobile operators (value-based billing)* *Wireless transmission networks (WiMAX and Microwave)*	*€4.1 billion revenues in 2005* *Over 360 clients worldwide* *13% market share worldwide in GSM infrastructure* [(5)] *No. 2 worldwide with 17% market share in wireless transmission networks (microwave)* [(6)] *Video solutions enabling 20% of today's mobile video users*

Solutions	Key Figures
Voice over IP (VoIP) and voice-data convergence solutions for enterprises *Multimedia call centers* *Satellite-based systems for telecoms, navigation, meteorology, observation, and science* *Integrated signaling, communication, and management solutions for railway networks* *Professional services for operators and enterprises*	€3.9 billion revenues in 2005 No. 1 in Europe for enterprise IP communications systems with 19% market share [(7)] No. 1 worldwide in multimedia contact centers (Genesys) [(8)] No. 1 in Europe in telecommunication satellites [(9)] No. 2 position worldwide in railway management (ETCS, European Train Control System) [(10)]

FIXED COMMUNICATIONS

The fixed networks market is in a state of total transition. *Triple play* services (telephone, high speed Internet and video) are opening new horizons for operators who can use them to offset the steady fall in revenues from traditional services. The deployment of high speed access, the expansion of video services and the trend toward IP are currently the main energizing factors. All around the world, operators are becoming increasingly interested in multimedia services, a market pulled along by strong demand from new applications such as interactive television on DSL or video on demand. Similarly, the fixed/mobile convergence made possible by the universality of IP and the opening of new generation networks mean that operators can deploy new services for both consumers and enterprises.

In 2005, the supply of these new services and the conversion of operators' networks to "all-IP" allowed the fixed networks market to move forward for the first time since 2001.

Capitalizing on its investments, Alcatel took full advantage of these new market opportunities: deployment of broadband, routing and optical transport networks, software platforms and applications for television over IP, etc. In 2005, Alcatel and Microsoft signed a global collaboration agreement to speed up the large scale roll-out of television services over IP (IPTV).

Haven broken through the barrier of 2 million IPTV subscribers in 2005, the triple play market is growing rapidly. The number of IPTV subscribers should reach 70-100 million by 2010. Working on more than thirty triple play projects worldwide, Alcatel is becoming increasingly dominant as a preferred partner for operators because of its portfolio of solutions, its unrivaled experience in service integration and in end-to-end network design.

In the light of this new demand, Alcatel is in a strong position, having made the investments needed to be already up and running in these markets. Alcatel is the uncontested leader in broadband access with more than 180 customers in 75 countries. Its IP offering is ideally suited to the most dynamic applications: integrated video and communication services. By acquiring TiMetra in 2003, it was able to position itself firmly in intelligent IP routers and currently hold a strong number 3 position. Alcatel consolidated its technological lead in optical platforms and is still the world's number 1 for the fifth consecutive year. Finally, Alcatel has developed a comprehensive portfolio of business services so that it can assist operators particularly in the design, installation, maintenance and operation of their networks.

Access: toward IP and optical fiber

Access to the user is becoming increasingly crucial for operators. In 2005, the movement of the access network was clearly toward IP, with greater proximity of optical fiber in the network and rationalization of operating costs. Alcatel is the strategic partner of many operators worldwide.

At the beginning of 2006, Alcatel acquired 25% of the capital of 2Wire, a specialist in network termination equipment, and signed a cooperation agreement to handle an essential element of end-to-end triple play solutions: remote management of domestic networks and interworking of terminals. This strategic partnership makes it possible to broaden and extend the market's most comprehensive integrated triple play solution.

Alcatel retains its world lead in high speed access with more than 80 million DSL lines delivered to the end of 2005 and a broadened base of fiber customers. In 2005, Alcatel continued to enhance and improve its offering to satisfy new requirements. In particular, Alcatel launched an optical fiber access solution to supply triple play services with bit rates up to 100 Mbps or more per subscriber.

As an essential element of its high speed access portfolio, the ISAM (Intelligent Services Access Manager) product family is the first IP access services platform. Capable of covering a broad range of technologies (xDSL, FTTN, FTTU GPON and WiMAX) and network topologies (city center, long haul or rural), it enjoyed rapid success in 2005. Just 18 months after its market launch, the ISAM family already has 70 customers around the world.

Network solutions: toward interactive television and IP networks

On the conventional fixed telephone market, Alcatel has the largest installed base in the world with more than 380 million lines deployed in more than 140 countries. Alcatel maintains more than 90% of this base, with the recurrent revenues from this business partially offsetting the fall in investment in this field. This installed base is migrating toward new generation networks associated with the introduction of new communication services over IP.

At the heart of the new NGN/IMS (IP Multimedia Subsystem) standard, Alcatel is working with operators in upgrading conventional telephone services to the new architecture and introducing new communication services over IP. This move to "all-IP" requires the deployment of new generation switching systems and renewal of the application platform. This platform includes a family of multimedia applications for the rapid introduction of communication services on any type of terminal while an application server provides the operators with a simpler environment for their own developments. Alcatel's NGN/IMS solutions offering is also based on management that is common to both fixed and mobile operation so that converged services can be developed. Currently, Alcatel is working on this evolution with some sixty operators, notable among them being BT, Telstra, Telecom New Zealand, Slovak Telecom or China Telecom.

Alcatel has taken a leading position in triple play and video solutions on DSL, as can be seen in the contracts signed with Chunghwa Telecom in Taiwan, Ya.com in Spain, Swisscom, and others.

Busy with some thirty triple play projects around the world, Alcatel is currently consolidating its leadership in this field, particularly due to its experience in service integration and end-to-end network design. Alcatel also offers innovative TV over IP applications that can be used to customize the viewer's experience and share personal content with his community and friends. These user-centric applications include the distribution of content, telephony and interactivity and form an integral part of Alcatel's NGN/IMS solutions portfolio.

IP networks: success for Alcatel's platforms

In 2005, the trend in the data market continued toward the IP/MPLS and Ethernet technologies which allow operators to install new revenue-generating services in conditions of unquestionable reliability and security. The challenge for operators is to conduct this migration without affecting their current revenue streams and while offering their customers, individuals and enterprises, who are particularly demanding in this field, an unfailing quality of service. Alcatel meets this requirement in two ways.

First, the Group has upgraded its multiservices data network offering to IP/MPLS technologies and so offers operators a natural migration strategy.

Alcatel has also consolidated its remarkable progress in IP networks. At the end of 2005, more than 90 customers in 40 countries had deployed the IP services router and/or Ethernet services switch, the Alcatel 7750 and Alcatel 7450. France Telecom, BT in United Kingdom, China Telecom and China Netcom in China, KPN in the Netherlands, and Belgacom in Belgium are just some of 2005's new customers. The success of these platforms lies on their density, their performance and their flexibility which offer unrivaled protection of operators' investments. In addition, the associated network management solutions allow operators to reduce their operating costs while improving their customers' satisfaction levels. Alcatel's routing solutions are also chosen by mobile operators for routing their IP traffic.

So the Group has obtained a position as a player of reference in the IP market competing directly with the market's traditional players, thanks mainly to a technological innovation and unique operator class functionalities.

Optical networks: new solutions in a growing market

In 2005, Alcatel reaffirmed, for the fifth consecutive year, its world-leading position in the optical networks market.

Ever-increasing demand from users for applications consuming a great deal of bandwidth, such as video on demand, high definition television or the new 3G mobile applications, has generated new high speed transmission requirements. Similarly, certain business sectors, such as transportation or energy, are increasingly demanding optical solutions to improve the security and productivity of their operations and increase profitability by offering new services.

Alcatel has been able to take advantage of these growth sectors to expand its business. Of the many contracts won in 2005 we should mention Cabovisão, China Telecom, GEANT2, Golden Belt, Neptune, Telmex, UK Highways Agency, Falcon and the upgrading of the Sea-Me-We 3 submarine network.

The year was also marked by the successful launch of the new transport services switch, the Alcatel 1850. This is used to switch any type of service (TDM, Ethernet, WDM) on a single platform with unlimited traffic (from 100% TDM to 100% packet). This revolutionary concept which was very well received by the market, led to the Alcatel 1850 being elected "best new product 2005" by Light Reading.

In 2005, Alcatel acquired Native Networks, an innovative supplier of operator class Ethernet transport optical solutions. Further to this acquisition, Alcatel will be best positioned to address the growing enterprise and residential demand for faster and scalable Ethernet services.

MOBILE COMMUNICATIONS

In 2005, Alcatel continued to develop a competitive and innovative range of products and solutions that meet the requirements of mobile operators around the world. The Group mainly supplies its customers with infrastructures for radio access, core network switching and wireless transmission plus application software. In 2005, for the fifth consecutive year, Alcatel's mobile communications business grew well ahead of the world market, benefiting simultaneously from the ever-increasing penetration of GSM mobile services in developing countries and the growth of UMTS third generation networks.

GSM deployment in emerging countries: a breeding ground for growth

Due to the steady spread of the GSM and EDGE technologies in developing countries, Alcatel had a record sales year and became world leader in these countries with 18% market share in 2005.

New customers and countries, including India and Cambodia, were conquered during this period while continuing to capitalize on existing customers who continued investing. Furthermore, a technology transfer agreement between Alcatel and India's national telephone company ITI created production units for GSM radio access technology. As a result of this agreement, ITI with Alcatel's support has become one of the largest GSM technology suppliers in India. EDGE technology also grew strongly in 2005 with many deployments in Alcatel's customer base, particularly in France, Romania, Russia and Saudi Arabia.

Developing countries offer an immense reservoir of potential customers: the next billion mobile customers will be reached in the next few years in these regions, benefiting from the arrival of cheap terminals and particularly attractive subscriptions.

The deployment of UMTS third generation networks and the implementation of a high speed version (HSDPA) in Western Europe also helped Alcatel's growth in 2005.

WiMAX (high speed wireless access): Alcatel is positioning itself for the future

The future of high speed access technologies for people on the move is taking shape and Alcatel is building a strong position in it. Through its partnerships with Intel (chips) and Samsung (terminals) and its long term investments in this technology, the Group has won 30 contracts, particularly in Austria and Poland, building a benchmark customer base.

The Group supplied the world's first WiMAX commercial network in 2005 and will be the first supplier in the world to offer a "mobile" WiMAX commercial solution in 2006.

Furthermore, the Group signed a partnership development agreement with C-DOT, India's national research center, to accelerate the development of WiMAX technology, its terminals and its deployment in India as a wireless access technology in rural areas.

Mobile core network switching: a successful transition

2005 marked the beginning of the transition from conventional switches to intelligent switches (softswitches) in mobile core networks. After the acquisition of the leader in the technology, Spatial Wireless, Alcatel consolidated its progress in fixed/mobile convergence by enabling its customers to offer new services and reduce their operating costs. Parallel efforts to industrialize these new products and to train the sales forces helped the Group to make inroads with new customers, particularly in Western Europe and Asia. Commercial relations were strengthened with the United States Operator T-Mobile where the 10 billion calls barrier was broken. These successes bear out Alcatel's strategic decisions making it the benchmark in transforming mobile networks to all-IP.

Mobile applications: strong growth

Applications associated with payment systems and video and music downloading services grew solidly in 2005. The convergence of pre-pay and post-pay invigorated the payment systems replacement market in which Alcatel strengthened its share. Billing solutions for the new video and data services are becoming vital as the engine of growth for virtual mobile operators (MVNOs) in the developed countries. What is more, the Group strengthened its positions in fixed-mobile convergent payment systems.

Mobile leisure services, such as video and music, also expanded again in 2005. Some 20% of the world's users of video download services on mobiles use Alcatel's technologies. Capitalizing on its technological experience in video and its partnerships with Thomson and Thalès, Alcatel has developed a mobile television offering based on DVB-H technology. This hybrid solution, combining satellite and terrestrial relays, is the fastest solution for deploying mobile television services countrywide.

The wireless transmission business returns to profitable growth

The wireless transmission market has been buoyant in high speed transport infrastructures of mobile networks and in high speed links of optical transmission backbones, with these two fields accounting for approximately 70% of the world market. In 2005, Alcatel capitalized on its rejuvenated product line, with an attractive portfolio of IP and Ethernet solutions integrated into the PDH and SDH transport media. The Group also made progress in new market segments associated with security networks (frontier control, police and fire departments) and broadcasters of television content. The opening of an R&D and operating center in China in 2005 helped Asian sales to grow through improved competitiveness.

PRIVATE COMMUNICATIONS

In 2005, Alcatel recorded sustained growth in its businesses focusing on vertical markets. Alcatel has been involved in this field for a long time, building up an innovative offering of solutions and services for the four business sectors (transportation, energy, defense and the public sector) whose needs in communication solutions are of strategic importance.

2005 was also the year in which Alcatel and Finmeccanica formed Alcatel Alenia Space which is now Europe's number 1 for satellite solutions and occupies a prominent place in the field of orbital infrastructures.

Alcatel's market in the enterprise sector saw the implementation of its convergent IP communication solutions grow, witnessed continuing growth in applications, including call centers and unified communications, and saw the arrival worldwide of managed communication services.

Because of this dynamism and despite a sharp drop in sales in the satellite field, Alcatel's private communications business held its sales steady and improved its profitability slightly in 2005.

Integration services: demand on the increase

In 2005, orders for integrated solutions increased strongly over 2004. Alcatel offers services for multi-vendor and multi-technology and customized communication networks to meet the customer's specific needs. Alcatel can take on - locally and worldwide - some or all of network design, construction, systems integration and OSS (commissioning, services, billing and customer service), deployment, security, operation and maintenance of networks. Growth was exceptional in the vertical markets and particularly in transportation. Alcatel has a strong position in this market. Having a presence in both railway signaling systems and communication solutions allows Alcatel to take advantage of all points of convergence and synergy between the two areas so that it can offer increasingly innovative and competitive solutions to its customers.

At the same time, fixed line operators are experiencing a profound change through the migration of their networks to all-IP architectures and the introduction of triple play services. Because of its combined expertise in network integration, software integration and network operation, Alcatel has made big strides in the fixed network transformation market. Alcatel holds a position as a global integrator which, in addition to high speed network solutions and triple play applications, has a comprehensive portfolio of OSS solutions incorporating leading third party products that are suitable for the operator's information system and has a complete suite of services covering the life cycle of the whole project. Alcatel helps the operator to rationalize network operation by automating the critical activities and operational processes and helps him optimize the existing environment by providing secure introduction of new technologies. New contracts are confirming Alcatels leading position in this field.

Railway signaling: a strongly growing market

The railway signaling systems market is one of the sectors that is growing the most in the transportation industry around the world.

Whether it is main line or urban rail transportation, growth is mainly generated by the need to move more and more people and merchandise on existing rail networks. The signaling solutions optimize the traffic in maximum safety. Alcatel has won market share in this field thanks to an offering that is considered one of the most advanced in the world.

In Europe, main line passenger and freight transportation is undergoing major change with the deployment of the new European traffic regulation standard, the ETCS (European Train Control System) which allows trains to cross frontiers easily and rapidly 2005, which saw the deployment of the first ETCS lines was a propitious year for Alcatel with several lines beginning service, Vienna/Budapest, Berlin/Leipzig and Madrid/Toledo. In the longer term, Alcatel has an involvement in 15 of the 20 largest ETCS projects in progress.

Urban transportation is also growing strongly. Increased urbanization across the world is creating an urgent need to produce new lines. In addition, the operators are facing a heavy increase in traffic on the existing lines whilst needing to modernize their equipment and optimize their costs.

As a pioneer and leader in CBTC (Communications-Based Train Control) technology which increases the frequency of trains in total security while reducing operating and maintenance costs, Alcatel is extremely well positioned to satisfy the demand. Amongst the successes of 2005, winning the dollar 250 million contract for the Dubai subway is the most notable. 2005 was also marked, amongst other things, by the startup of the extension of the London City Airport line of the Dockland Light Rail and of an electronic engagement system for the Paris RATP.

Satellites: Alcatel Alenia Space at the heart of the Galileo program

Above all, 2005 will be remembered for the interweaving of the space activities of Alcatel and Finmeccanica, culminating on July 1, 2005 in the creation of Alcatel Alenia Space (67% Alcatel and 33% Finmeccanica) combining the industrial activities and Telespazio (33% Alcatel and 67% Finmeccanica) for services.

In a still difficult market, Alcatel Alenia Space achieved a large number of successes in 2005, notably:

- signing the Chinasat 6B (China), Thaicom 5 (Thailand) and Star One C2 (Brazil) communication satellite contracts;
- the success of the Huygens mission in the exploration of the universe;
- the launch of MSG2, the second of four second generation weather satellites for which Alcatel is the main contractor;
- the deployment of the EGNOS (European Geostationary Overlay System) navigation system, the precursor of Galileo;
- signing the first industrial contract to develop the Galileo European satellite navigation system;
- delivering payloads of the Colombus experimental laboratory that will be built into the international space station;
- launching the Syracuse 3A telecommunications satellite on behalf of the French Ministry of Defense.

An originator of the Galileo program, Alcatel Alenia Space is a founder member and benchmark shareholder of Galileo Industry (38%), the entity responsible for developing and deploying the 30-satellite constellation and the related ground segment. Alcatel is likewise at the heart of the future Galileo concession, the operator of the system and supplier of value added services for the transportation, security, mobile telephone and leisure sectors.

In conclusion, as the only manufacturing group in the world to be expert in terrestrial and satellite information technologies, Alcatel is in a strong position to take advantage of the expected emergence of new applications such as mobile television.

Enterprise Solutions: Focus on IP Convergence

As IP technology continues to fuel growth and innovation, today's enterprises are increasingly deploying solutions that handle voice and data on the same network.

The powerful combination of a secure IP network and innovative communications applications is driving investment by enterprises. These new converged IP solutions and applications are leading to reduced costs, improved employee productivity and increased customer satisfaction for enterprises of all sizes.

In 2005, Alcatel's enterprise business increased its focus on providing flexible deployment models of its solutions. Alcatel's Managed Communication Services (MCS) suite aims to provide a wide variety of deployment models, enabling operators and service providers to deliver innovative enterprise solutions as a service. With the emphasis on deployment and pricing flexibility, Alcatel's Managed Communication Services are fundamentally changing the way enterprises use the latest in IP communications technology, allowing them to leverage either in-house solutions or pay-per-use managed services. So Alcatel's MCS offerings enable access providers to offer their business customers the options of adding or removing services and balancing costs between capital expenditure (CAPEX) and operating expenditure (OPEX).

Alcatel's enterprise strategy in 2005 was highlighted by the following activity:

- a continued focus and investment in IP telephony and innovative applications with its unified communications;
- renewed growth for its data networking business, delivering a range of LAN, WLAN and WAN solutions that provide unmatched manageability, availability and security;
- an evolving Managed Communication Services strategy that provides a unique mix of industry-leading technology and go-to-market support that ensure service provider success and enterprise flexibility;
- developing sales of contact center offerings of Genesys in relation with the increase of the utilisation of IP technologie in Entreprises.

RESEARCH AND DEVELOPMENT

For several years, Alcatel has been maintaining a high level of investment in research and development (around 12% of revenues). In 2005, this investment represents €1.5 billions. To take maximum advantage of this, R&D activities are concentrated in fields with strong innovation potential in which the Group can gain or strengthen a leading position.

In 2005, many technologies that came out of the research laboratories enhanced Alcatel's product and solution offering:

- in broadband access fixed networks, new technologies were introduced to improve and strengthen the television and voice over IP services. A new fiber optic network architecture to the subscriber, called GPON, was launched on the market. The first field trials of the WiMAX wireless technology offering bit rates equivalent to those of the wire technologies and in which Alcatel is one of the pioneers were successfully completed;
- in the Internet and optical field, Alcatel launched in 2005, the Alcatel 1850, the first universal switch for processing, transparently and without limitation, all types of traffic whether it be in "circuit" mode (like conventional telephony) or "data" mode (for the Internet). This innovative approach received the year's best product prize awarded by Light Reading, a magazine specializing in telecoms;
- Alcatel also enhanced its offering with the creation of an IMS solution which provides operators and service providers with new opportunities to create both fixed and mobile services.

2005 was also rich in innovation thanks to the accent placed on R&D partnerships, the main one being a global collaboration agreement with Microsoft. This brought the launch of an integrated television over IP service provision solution that has already attracted more than 30 operators around the world. Alcatel also signed a global cooperation agreement with Sun Microsystems to develop a new generation of equipment for the mobile core network. Finally, Alcatel boosted its portfolio in operator class Ethernet technology by acquiring Native Networks, and in domestic network management with a stake in 2Wire.

In addition to this, Alcatel is increasing its innovation capability through a strategy of creating geographic centers of excellence where there are major concentrations of market growth potential, acknowledged scientific and technical talent and a concentrated and dynamic university and manufacturing environment.

- In France, for example, Alcatel mobilized all its R&D centers to be leading contributors to the collaborative projects launched as part of the "Centers of Competitiveness" initiative and the Industrial Innovation Agency;
- on the international front, several R&D centers were strengthened according to the dual criteria of local expertise and positioning on the most promising markets with the creation of new research centers. Alcatel opened an R&D Center in St Petersburg and 3G Reality Center (3GRC) in Moscow to promote the new generation of mobile services, IP TV and solutions for Enterprises in Russia and in the countries of the CIS (Commonwealth of Independent States). In India, Alcatel created the "C-Dot Alcatel Research" center jointly with the Indian government to develop new high speed communication solutions for developing countries or rural areas that require the most advanced technologies such as WiMAX.

Finally, major efforts were made to improve the quality, efficiency and promotion of R&D activities.

- A new R&D program called "Internal Ventures" was put in place based on the principles of how start-up companies operate and are organized.
- Initiatives in recent years to constantly improve the quality and reliability of product development and reduce its cost are bearing fruit. For example, average development project time has been cut by more than 10% per year for the last two years.
- In the field of telecommunications standards, Alcatel is one of the leading players. In 2005, more than 300 experts actively participated in about a hundred standardization working groups and have chaired several of them, thus contributing to the commercial success of innovative technologies and ensuring that they are future-proof.
- In intellectual property, Alcatel filed more than 700 patents in 2005 and now has a portfolio of more than 18 000 patents around the world. Of particular note is an increase in inventions and filed patents on service platforms and new telecommunication applications (television over IP, fixed/mobile convergence, etc). An increased effort has also been made to protect intellectual property in China, India, Russia and other emerging countries. Finally, Alcatel is developing its range of patent and technology licenses that are generating increasing revenues.

RISK MANAGEMENT

Insurance is fully integrated within the proactive risk management policy maintained by Alcatel. This policy is designed at protecting its employees and its assets, as well as the environment, while ensuring its business continuity and growth.

This commitment is formalized through Policies applicable to the entire Group, signed by the Chairman:

- the "Risk Management of Physical Assets and Operations" Policy first signed on November 30, 1999, and updated December 1, 2004 and;
- the "Environmental Policy" (last updated November 30, 1999).

The "Insurance Principles" and "Risk Engineering Principles" two documents both released November 30, 1999 and updated December 1, 2004, further define and develop the relevant applicable processes.

These processes do actively associate:

- a risk mapping which reflects an on-going risk identification and quantification process, particularly for those risks inherent to Alcatel's operations and development;
- loss prevention to reduce loss frequency and control the magnitude of those losses that materialize;

- Business Impact Analysis at each Business Organization level, to assess the potential impact of an adverse event affecting its business processes or resources;
- Business Continuity Management, defined as a holistic management process, based on the Business Impact Analysis, that provides advanced arrangements and a framework for quick recovery with the capability for an effective response after a loss;
- a coordinated approach for cost-effective risk transfer or alternative risk coverage for risks that are not retained.

A dedicated corporate team (DAGRI or Department Accountable for Global Risk and Insurance), reporting to General Administration, is responsible for defining, communicating and implementing these risk management policies, principles and processes. An executive report is issued annually and distributed to the management of Alcatel.

Risk mapping

The Group risk-map is updated regularly, and at least once a year, as a cornerstone of the risk management policy. It is based on the analysis of both past Group effective loss experience (i.e. in terms of frequency, severity, etc.) and industry catastrophic losses experience, supplemented by regular interviews with Business Divisions in order to get from the operations the knowledge of their operational risks. Risk modeling is used to forecast mean and maximum values of exposures and their uncertainties.

This allows the Group to prevent from significant risks that might affect any of its tangible and intangible assets, and to optimize the balance between risk retention/mitigation and risk financing/risk transfer when deemed necessary.

Risk mitigation/industrial risks

The Group audits and reviews its sites regularly to detect potential deficiencies and to prevent future exposure more effectively. In France, none of Alcatel industrial site is subject to the July 30, 2003 law related to technological and natural disaster prevention and loss indemnification.

A Highly Protected Risk (HPR) engineering process has been implemented for property damage. Based on international standards, it is used at major worldwide locations. This is a program of regular surveys of all industrial sites valued over €5 million, which have been conducted and continuously improved by a specialized outside consultant since 1987.

Under this program, 81 sites were audited in 2005. Highly Protected values represent now 84% of total insured values (88% when excluding the Alenia facilities integrated in the program in 2005), versus 42% in 1987.

Engineering loss prevention programs are extended to other type of risks, particularly Liability, Transport and Installation.

Business Continuity Management

In 2005 The Group has launched a formal Business Continuity Management implementation program which addresses the Business Divisions' and Regions' operations.

The customer-centred approach leaded by DAGRI is based on a Business Impact Analysis which, through an approval process, is turned into an action plan for risk mitigation or migration of critical activities.

The achievements are the identification of stress points in operations, reduction of vulnerabilities, provision of advanced arrangements for recovery, and opportunities for growth.

Environmental Risks

Using an internal engineering process introduced in the major production plants in 1992, the group got a head start on meeting the requirements of the international Standard ISO 14001 published in 1996 governing environmental management systems. By year-end 2005, 19 production plants in eight countries have been awarded third party certification under this standard.

In cases of disposal or acquisitions, environmental assessments are conducted by outside consultants.

In 2005, Alenia manufacturing operations has been reviewed as part of the Due Diligence process related to the combination of Alcatel and Finmecanica business.

Alcatel is also leaning on an environmental oversight body consisting of experts throughout the world to anticipate any environmental regulation which could affect Group's markets and equipments. In 2004, Alcatel has set up two projects aimed at, on one hand, providing Group units with necessary means to an efficient implementation of the European directive on Wastes from electric and electronic equipment as from August 13, 2005, and on the other hand, ensuring compliance of Group products to the European directive on restriction of the use of hazardous substances which will entry into force by July 1, 2006.

Expenses to prevent future environmental exposures as well as provisions and indemnities accrued for environmental litigations are not considered material.

Insurance

The coordinated implementation of risk mapping and risk mitigation allows to properly design:

- an appropriate level of risk retention, organized at Group level through Electro Re, its consolidated reinsurance subsidiary based in Luxembourg. Through various retrocession multi-year/multi-line programs, either specific or of catastrophic type, this retention is limited to €15 million per occurrence and €32 million in the annual aggregate for 2005;
- a coordinated approach for cost-effective risk transfer or alternative risk coverage for risks that are not retained and are transferred to insurance/reinsurance market.

All insurance programs are centralized through DAGRI with the exception of a few local policies necessary to comply with local legislations, mainly for Employers Liabilities, Workers Compensation, and eventually Automobile Fleet covers. They apply to all companies controlled 50% or higher. Cessions and acquisitions are carefully followed up, an the policy is to apply insurance programs to newly acquired companies as per closing date, subject to specific arrangements if necessary, pending full compliance with Group standards is achieved, and companies divested are removed from programs on the closing date.

Since January 1st, 2004 a single integrated program has been placed, for a period of 3 years, directly with a pool of a limited number of re-insurers and multi-lines insurers. Their solvency rating is continuously monitored. This program includes the following lines: Property Damage/ Business Interruption, General & Products Liability, Errors & Omissions, Transportation, Installation, Directors & Officers liability, Space Products Liability, Fiduciary Liability, Fidelity & Crime. For confidentiality reasons, a few additional covers are not herein listed.

Other covers are placed on a stand-alone basis with annual renewal and with first class rated insurers, whose rating is also closely monitored. All insurers/re-insurers involved in the risk transfer are continuously monitored using A.M. Best's Financial Strength Ratings, minimum A- (Excellent) with tolerance for B2+(Very Good). Contracts allow removal of downgraded insurers/re-insurers.

Property Damage/Business interruption cover limit was set at €1,600 million, exceeding the maximum potential loss identified for the Group. Considering our activities and geographical locations, terrorism cover is not purchased, except where mandatory by local legislation. For General and Product Liability, covers matches the worst case scenario identified through the Risk Map, i.e €500 million. Adequacy of covers is constantly monitored through the updating of the Group Risk Map and through benchmarking with competitors, and improvements are negotiated whenever necessary.

There cannot be however an absolute guarantee that actual losses will not exceed worst case scenarii, neither that they would not fall within the exclusions of policies, due to the lack or limitation of coverage available on the insurance/reinsurance market.

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, 2005 was characterized by a resumption of investment by the world's major telecommunications operators after a year of stabilization. Demand held up well for some solutions such as IP technology routers or mobile radio access solutions. Globally, the price pressure exacerbated by the competitive environment cancelled out some 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 communications 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 2005 of increasing 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 transportation industry, the energy and defense sectors, and local authorities, etc. In addition to these risks that are specific to the telecommunications sector, the markets in which the Group operates are exposed to the risks 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 in the economic and political situation of certain countries in which the Group operates, or possibly in 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. As much as 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 28 to the consolidated financial statements). Furthermore, 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 the business risks of all subsidiaries in which the Group has an interest of 50% or more. A centralized team determines, communicates and implements the Group's policy on risk engineering and insurance. In this field, its consolidated reinsurance subsidiary Electro Ré, retains the normal claims risk within the Group and transfers only the major risks to the global insurance/reinsurance market. This, and the protection of Electro Ré's retained risks take place in the context of a series of multi-annual and multi-line retrocession programs.

This policy enables the Group to spread risks between its various subsidiaries and to control the level of insurance premiums while optimizing the levels of cover.

HUMAN RESOURCES

Employees

As reported, at December 31, 2005, we employed 57,699 people worldwide, primarily in Europe. (55,718 at December 31, 2004, 60,486 at December 31, 2003 and 75,940 at December 31, 2002).

The tables below show the geographic locations in which our employees worked at December 31, 2002, 2003, 2004 and 2005 and the business segments in which our employees worked at December 31, 2002, 2003 and 2004 after taking into account the discontinuance of certain of our businesses, as follows:

- in 2002, our enterprise distribution and micro-electronic businesses;
- in 2003, our battery and optical components businesses;
- and in 2004, our optical fiber, mobile phones and electrical power systems businesses. As restated to exclude the employees of all of these discontinued businesses, we employed 56,690 people at December 31, 2003 and 66,481 people at December 31, 2002.

Total number of employees of the Group and the breakdown of this number by business segments is determined by taking into account 100% of headcounts at the end of the year of the employees of fully consolidated companies and for employees of subsidiaries consolidated using proportionate consolidation, the same percentage as the percentage of interest in such companies (see Note 36 of the Consolidated financial statements.

The breakdown by geographical areas gives the headcount of majority owned entities only (in the line before proportionate consolidation impact) and the impact of taking into account headcounts of subsidiaries consolidated using proportionate consolidation only for the percentage of interests in these entities is isolated in the "proportionate consolidation impact" line.

This impact is related to the constitution of two Joint Ventures with Finmeccanica in the Space business as explained in note 3 of the consolidated financial statements.

	Fixed Communications	Mobile Communications	Private Communications	Other	TOTAL GROUP
2002	31,342	13,966	20,467	706	**66,481**
2003	23,461	13,355	19,282	592	**56,690**
2004	18,446	15,350	21,367	555	**55,718**
2005	17,311	17,700	22,138	550	**57,699**

	France	Germany	Rest of Europe	Asia Pacific	North America	Rest of world	TOTAL GROUP
2002	20,275	7,698	16,788	8,271	9,799	3,650	**66,481**
2003	17,206	6,736	12,502	8,110	8,811	3,325	**56,690**
2004	16,161	5,951	11,918	8,338	8,783	4,567	**55,718**
2005 before proportionate consolidation impact	16,037	5,288	14,108	9,109	9,009	6,094	**59,645**
Proportionate consolidation impact	(1,362)	-	(584)	-	-	-	**(1,946)**
2005 after proportionate consolidation impact	14,675	5,288	13,524	9,109	9,009	6,094	**57,699**

The number of temporary workers at December 31, 2005 was 1,568.

Among the most significant events involving employee movement were the following:

- in France, the finalization of the reconversion of the industrial activities at the Illkirch (ABS) site towards two local companies (Asteel and Oristano) and the transfer of the site of Alcatel Alenia Space in Valence to the Saffran Group;
- at a global level, the transfer of the activities of power supply (Converters) to Ripplewood investment involving 1,300 employees distributed in 16 countries throughout the world;
- in addition the company confirmed its wish to continue its efforts in R&D by maintaining strong poles of competence in Western Europe and developing new R&D centers in Eastern Europe (Russia, Romania) and Asia (India, China).

Managing global performance

With the worldwide deployment of the Global Performance Management Program in 2005, all identified managers and professionals at Alcatel now have a common web-based, self-service tool to manage their performance and facilitate discussions on their professional development. Local Alcatel regions were key to the successful roll-out of the tool through providing communication and training to employees.

The Global Performance Management Program helps managers set clear, consistent objectives, measure employee success and promote dialogue. It provides employees with the opportunity to share a common language across the company's worldwide organization. Thanks to this improved process, Alcatel's management can better ensure that employees' development needs match those of the business.

Among all the Alcatel professionals who have had a career review with their manager during the annual performance management cycle, more than 70% have subsequently benefited from development-related opportunities such as mentoring, coaching, or formal training.

The objective is to have learning and development activities agreed upon during the annual performance review for 100% of managers and professionals by latest 2008.

Developing the next generation of leaders

The development of talent at Alcatel is managed through several processes. The most fundamental is the career development interview, resulting in a professional development plan that maps career expectations to business needs. Such a plan identifies the development enablers required to reach an employee's professional aspirations.

One tool to support talents in understanding their development needs is the 360-degree feedback process. Together with a certified coach, candidates review the results of the feedback and build a development plan.

For talents already well advanced in their careers, Alcatel offers a rigorous development centre. This is part of an integrated Leadership Development Program, where participants are assessed against a global leadership profile.

Reinforcing key learning priorities

Key learning priorities to support Alcatel's corporate strategy are in Sales and Marketing with an added emphasis on Product and Project Management. The success of the integrated development program launched in 2004 to support the Alcatel Sales population, led to its extension through 2005. To better optimize pre and post-sales support to local technical and non-technical sales teams, qualification programs remain essential to Alcatel's educational offering. A new program was set up to reinforce the qualification of product managers with state-of-the-art methodology and tools.

With its 15 branches around the globe, Alcatel University provides a variety of flexible learning solutions to employees and customers. Courses can be taken via traditional classroom, e-learning, or virtual learning, where students are linked via internet or intranet connections and a web conference tool.

Thanks to shared initiatives between the Alcatel University network and local organizations, e-learning usage rose by 70% in 2005, reaching 22% of all employee training as compared to 13% in 2004. The increase is mainly due to the inclusion of more e-learning in large scale programs such as technical certification of sales support, project management or legal compliance training.

Diversity at Alcatel

As stated in its Social Charter, "Alcatel is a global company attached to diversity, tolerance and equal opportunity for all". To make this commitment tangible, Alcatel has launched initiatives in the fields of cultural and gender diversity. By signing the French Diversity Charter in 2005, Alcatel once again reaffirmed its dedication to promoting diversity within its workforce.

Alcatel's commitment to diversity is a natural consequence of its multi-national workforce. In 2004, Alcatel formed a partnership with AIESEC, a non-profit international student platform with a global network of more than 800 universities. A pilot program, begun in 2005, allowed Alcatel to attract new talents and thus to enrich its workforce's cultural diversity. The partnership contract has been renewed for 2006 to extend the program to other Alcatel units around the world.

Increasing gender diversity is seen by the company as a business imperative and is therefore a priority. Alcatel's Chairman and CEO, Serge Tchuruk, launched the "Women in Leadership" initiative in 2005 to increase gender balance in the company's top management. Related activities include the organization of gender diversity awareness meetings for management, the creation of a dedicated discussion forum on the company's intranet, and the promotion of internal and external women's networks. Specific tools for training, mentoring and coaching have also been developed to support women in their career development.

Project Montaigne

On January 24, 2006, Alcatel announced the launch of a project to group its activities in the Paris region at two locations: Nieuport in the city of Velizy and Villarceaux in Nozay, each of which will have around 3,000 people.

The Nieuport location will be mainly dedicated to customer and support functions, while the Villarceaux center will become one of the main R&D centers of Alcatel in the world.

Employee transfers, involving around 2,500 people, will take place before the end of 2007.

EMPLOYEE DATA

The data presented below pursuant to Article L. 225-102-1 paragraph 4 of the Commercial Code cover Alcatel's French units, representing 99% of the Group's workforce in France at the end of December 2004 and 98% at the end of 2005.

Change in scope of consolidation

Between 2004 and 2005, it should be noted that Alcatel Space in Valence (onboard electronics business) and in Kourou (ground/launch stations business) were removed from the scope of consolidation, the Valence site having been bought by Sagem and that of Kourou being transferred to Telespazio (ASSO).

Furthermore, Right Vision was absorbed by Alcatel Business Systems.

The job protection plans announced during 2004 (Alcatel CIT, ABS, Alcatel Space) operated during 2004 and were completed in 2005.

All these points explain the main reported changes between 2004 and 2005.

Employment

a) Workforce

	December 31 2005	December 31 2004	December 31 2003
Total workforce	16,036	15,971	18,519
Permanent workforce	13,109	13,669	17,222
Number of employees on fixed-term employment contracts at December 31	34	51	279

b) New hires

	2005	2004	2003
Number of new hires on permanent employment contracts	1,266	409	219
Including transfers within the Group	532	260	175
Including recruitments from outside	734	149	44
Number of new hires on fixed term employment contracts	212	216	224
TOTAL	**1,478**	**625**	**443**

Most of the new hires in 2003 and 2004 consisted of transfers between the Group's entities. In 2005, there were 1,478 new hires, 86% of which were on permanent employment contracts; recruitments from outside representing 64% and Group transfers 36%.

c) Departures

	2005	2004	2003
Resignations and end of trial periods	138	106	122
End of fixed-term contracts	183	137	64
Of which fixed-term contracts converted into permanent contracts	40	12	3
Other departures, comprising disposal of businesses, transfers and redundancies	1,092	3,067	5, 521
TOTAL	**1,413**	**3,322**	**5,710**

The number of departures in France results mainly from disposing of the following businesses:

- sale of the onboard electronics business Alcatel Space - Valence (148 employees), to Sagem;
- transfer of the ground stations business, Alcatel Space - Kourou (229 employees) to Telespazio (ASSO).

Departures were also due to the restructuring plans put in place in 2004 in concertation with the personnel representatives of the units concerned and completed in 2005.

Restructuring actions affected the following units: Alcatel CIT, Alcatel Space and Alcatel Business Systems. For the latter, collective redeployments were implemented for 272 employees of the Manufacturing Department of Alcatel Business Systems in Illkirch, with Asteel Développement and Oristano.

Organization of working hours

a) 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.

	2005	2004	2003
Number of employees working part-time	1,203	1,275	1,207

b) Absenteeism

(In days)	2005	2004	2003
Absences due to illness	51,200	62,595	100,579
Absences due to work-related accidents	1,701	2,270	4,593
Absences due to travel accidents	1,046	875	1,487
Maternity leave	18,425	21,030	31,366
Absences due to strikes	806	365	1,287
Other absences	16,955	22,071	17,314
TOTAL DAYS	**90,133**	**109,206**	**156,626**

The reduction in the number of days of absenteeism is largely due to the reduction in average workforce, the absenteeism rate of 2.42% being on a par with 2004.

c) Short time working

	2005	2004	2003
Number of employees placed on short time	0	0	565
Number of days of short time compensated	0	0	10,499

Remuneration

The increase in average monthly remuneration between 2004 and 2005 results primarily from the salary policy put in place during 2005 and the effects of taking the Valence and Kourou sites out of the scope of consolidation which changes the weighting of personnel categories from one year to the other. These structural operations have had the effect of increasing executive grades to 6% while non-executive grades fell to 11%.

On the matter of recruitment and remuneration, Alcatel has a fair and reasoned policy based on employee merit without regard to sex, culture or origin, according to the commitments in the Group's Social Charter and the Charter of Diversity within the Company dating from November 2005. Alcatel makes every effort to guarantee competitive pay to its employees. Management of the remuneration policy is decentralized so as to take account of the situation in each unit. The policy is primarily designed to be sufficiently attractive to recruit high-level specialists.

(in euros)	December 31, 2005	December 31, 2004	December 31, 2003
Average monthly remuneration	4,683	4,449	3,655

Labor relations

a) The European Group committee

Put in place in 1997, Alcatel's European Group Committee for Information and Dialog (ECID) meets at least twice a year. If necessary, depending on what is happening in the Group, intermediate and special meetings are organized with the Bureau of the ECID consisting of representatives of the five European countries in which the Group has its major operations (France, Germany, Belgium, Italy, Spain). In 2005, the Bureau met on two occasions to discuss the Group's R&D policy, on June 14 and 15, 2005 and on November 30 and December 1, 2005.
In addition, in the spring of 2005, twenty or so members of the ECID went to China mainly to visit Alcatel's site in Shanghai and sites of competitive companies (TCL in Huizhou, Huawei and ZTE in Shenzen). This one-week trip also allowed the ECID delegation to meet the French economic missions in Shanghai and Canton and leaders of China's unions in Beijing.

b) The France Group Committee

Alcatel's France Group Committee was formed in 1983 and represents employees from all Alcatel's operations in France. It has 30 members and 30 alternates appointed by the unions from the elected representatives of the Works Council. Also sitting on this committee are the five central union representatives of the French central union organizations represented within the Group in France. The number of delegates from each union is proportional to the number of votes obtained in the Works Council elections in the three electoral colleges. It meets twice a year; in 2005, the plenary meetings were held on June 28 and December 16.

Health and safety

In high-technology electronics companies, worker safety is not a very big problem. In the telecommunications sector, however, certain special risks require special attention. Alcatel shares its experience with French partners like EDF, RTE, TDF and the mobile network operators in order to harmonize recommendations concerning employee exposure to electromagnetic fields. This collaboration has led to a professional recommendation guide approved by the Technical Union of Electricity and Communications (UTEC).

Training

	2005	2004	2003
Number of employees trained	9,205	10,142	11,172
Number of paid training hours	350,842	405,987	429,243

The number of employees trained and the number of paid training hours were down in absolute value. This correlates with the average staff reduction in 2005.

Disabled employees

	2005	2004	2003
Number of disabled employees	198	231	301

The reduction in the number of disabled staff is due to the sale of Alcatel Space's Valence and Kourou sites (-11 disabled employees), and the end of the job protection plan at the Illkirch site of Alcatel Business Systems (-21 disabled employees).

Scope of subcontracting

	2005	2004	2003
Average number of temporary workers per month	774	902	183
Number of trainees (training agreements)	509	517	1,193

Alcatel Space, Alcatel Submarine Networks, Alcatel CIT and Alcatel Vacuum Technology in 2005 used temporary technicians or workers to finalize satellite orders, export orders and exceptional orders for trunk cables.

SUSTAINABLE DEVELOPMENT

For more than 10 years, Alcatel has been dedicated to act as a responsible actor in the economical, social and environmental fields.

The company's strategy consists in a continuous improvement approach. It is based on a set of founding texts that define its values and ethical principles. This corpus of charters has been progressively extended and now constitute a base on which the company leans to progress even more in the key areas of sustainable development.

Alcatel also pursues its efforts to implement and promote the principles enshrined in the highest international standards in the environmental, social and ethical fields, in particular those of the United Nations Global Compact.

To make this commitment tangible, the company appointed this year a Chief Compliance Officer. He reports directly to Alcatel's Chairman and CEO and is member of the Ethics Committee. will oversee regulatory compliance according to international laws and standards, corporate governance and business practices worldwide for the Group.

In 2005, Alcatel was listed in the following main sustainable development indexes: DJSI, ASPI Eurozone and Ethibel. Its quotation in the FTSE4Good, effective sine 2002, has been renewed.

Dialogue with stakeholders

This year, Alcatel particularly focused on reinforcing dialogue with its stakeholders. Here are some examples of initiatives taken in this respect:

- by becoming member of the Global e-Sustainability Initiative (GeSI) that gathers telecom operators and manufacturers, the company reaffirmed its willingness to strengthen concertation on sustainable development issue with all actors in the sector;
- Alcatel pursued its regular meetings with the financial community and especially participated to a roadshow in London with Socially Responsible Investment funds;
- a DVD dedicated to Alcatel agents and consultants have been recorded. It notably emphasizes Alcatel's commitment to sustainable development and restates its willingness to constantly fight any form of corruption;
- following the survey completed in 2004, via dedicated assessment forms, on Alcatel's main suppliers, the company started an individualized dialogue with each of the suppliers evaluated. At the end of this process, the company decided to conduct some audits on site.

Digital inclusion

Universal access to Information has been officially recognized as one of the UN Millennium Goals to be reached by 2015, one of the imperatives to "develop a global partnership for development" (Millenium Declaration). Main partner of the Tunis Summit, Alcatel reaffirmed its commitment to bridge the digital divide in emerging countries as well as in isolated regions of developed ones:

- "Connect the world" is a global multi-stakeholder initiative launched by the International Telecommunication Union to encourage new projects to bridge the digital divide. It places strong emphasis on the importance of partnerships between the public and private sectors, UN agencies and civil society. It has 22 founding partners, including leading international companies, inter-governmental organizations, NGOs and national governments;
- the Digital Bridge Initiative consists of partnering with local players in emerging countries to develop applications and services with strong added-value and adapted to the needs of local populations;
  - in Makuleke (South Africa), Alcatel launched, in partnership with Manobi, the leading operator of Mobile and Internet services dedicated to the rural sector of developing and emerging countries and Vodacom, the main telecom operator in South Africa, a groundbreaking pilot project to connect rural farmers to real-time market information and to sell their harvest by SMS. To date, 200 farmers have been trained to use the service. The goal of this innovative project is to break out of isolation and remedy their lack of information and low competitiveness,
  - Alcatel opened two "Partnership Centers" in its premises to strengthen its proximity with the selected partners and make sure they benefit from Alcatel's resources and expertise in an optimal way. The first "Partnership center " was launched Tunis in December 2003 , the second one in Cairo in September 2005.They are enabled 4 local partners to develop more than 20 projects. In Cairo, 5 projects have been selected and will be completed by the end of the first quarter 2006.

Corporate Social responsibility in the supply chain

In 2005, Alcatel endeavored to reinforce the commitment made in previous years to further associate its suppliers and sub-contractors to its sustainable development strategy.

From the end of 2004 to the middle of 2006, Alcatel's Corporate Procurement and Sourcing conducted a survey on 130 of its suppliers worldwide, representing more than 45% of the company's total purchased volume. The goal of this evaluation, performed via dedicated assessment forms, was to improve Alcatel suppliers' understanding of the company's requirements and to get a snapshot of their performance in terms of social responsibility. Throughout this process, Alcatel endeavored to keep a constant collaboration and individualized dialogue with each supplier. Given the survey's results, 6 suppliers have been audited on site by Alcatel employees.

The objective of Alcatel's Corporate Procurement and Sourcing is to check, by 2008, the SD performance of suppliers representing 70% of Alcatel's total purchased volume, that is around 500 companies.

Environment

Alcatel's environmental policy relies on a life-cycle approach of its products. In this respect, the company is dedicated to develop solutions that are more and more environment-friendly.

Energy consumption of products: reduction by half over a 3-period

At the end of 2002, Alcatel committed to reduce the energy consumption of its new products by 20% per year during 3 years, that is a 50% decrease over the period. By the end of 2005, it had been decreased by more than 47% over the three-year period, just below the objective announced, in particular because of the increase at the same time of the products' capacities and functionalities.

Product end-of-life management has been secured

As of the date of the entering into force of the WEEE directive (Waste Electrical and Electronic Equipments), on August 13, 2005, Alcatel made operational the processes it has designed to this end. They ensure that the company fully complies with the requirements of this legislation on the European market:

- from now on, Equipment are marked in accordance with the directive requirements;
- a service provider managing the collection and treatment of end-of-life equipment has been selected and made available to all entities;
- an internal information campaign allowed to build awareness among all sites, sales teams and legal entities;
- as equipment manufacturer, Alcatel, has been registered in all appropriate Member States, in compliance with the different national legislations.

Efforts to ensure products' compliance with the RoHS directive have been pursued

On July 1, 2006, the entering into force of the RoHS directive will restrict the use of some substances, in particular lead, in most electronic products. In 2005, the company intensified its efforts to make sure it will be able to deliver on time compliant products that also present reliability and performance guarantees required from telecommunication network infrastructures equipment.

The sustainable development report can be reviewed online at www.alcatel.com or can be requested from the Investor Relations Department.

ENVIRONMENTAL DATA

Environmental indicators

	Units	2003	2004	2005	2005 Perimeter
Consumed energy and CO_2 emission					
Consumed electricity	GWh	747	740	781	100%
Consumed electricity per employee	MWh	12.3	13.3	13,5	100%
Consumed fossil energy	GWh	310	251	272	100%
Consumed fossil energy per employee	MWh	5.1	4.5	4,7	100%
Total consumed energy, including hot and chilled water	GWh	1,057	990	1,081	100%
Total consumed energy per employee	MWh	17.5	17.8	18,3	100%
Indirect emissions of CO_2, linked to consumed electricity	tCO_2 (1)	264,000	236,397	241,648	100%
Indirect emissions of CO_2 per employee	tCO_2 (1)	4.4	4.2	4,2	100%
Direct emissions of CO2, linked to consumed fosil energy	tCO_2 (1)	83,000	56,149	50,866	100%
Direct emissions of CO_2 per employee	tCO_2 (1)	1,4	1	0,9	100%
Total emissions of CO_2 (2)	tCO_2 (1)	347,000	292,546	292,514	100%
Total emissions of CO_2 per employee (2)	tCO_2 (1)	5.8	5.2	5,1	100%
Water and wastes					
Consumed water	m^3	2,356,000	2,320,382	2,334,541	100%
Consumed water per employee	m^3	39	42	40	100%
Production of hazardous waste	t	3,090	2,313	1,747	100%
Production of hazardous waste per employee	kg	51	42	30	100%
Percentage of hazardous waste recycled (3)	%	86	64	55	100%
Production of non-hazardous waste	t	24,620	24,289	21,242	100%
Production of non-hazardous waste per employee	kg	407	436	368	100%
Percentage of non-hazardous waste recycled (3)	%	65	67	66	100%
Other emissions					
Solvents		No significant quantities, indicator not relevant and not consolidated.			100%
Halogenated hydrocarbon		idem			100%
Discharge into water (heavy metals)		idem			100%
Miscellaneous					
Production sites, ISO 14001 certified	%	50	65	60	100%
New products covered by ecodeclarations	%	83	91	> 95	100%
Purchasing volume covered by ecodeclarations	%	65 (4)	85	> 85	100%

(1) tCO_2 : CO2 equivalent tons.
(2) Emissions of CO2, linked to consumed hot and chilled water are not taken into account.
(3) Recycled: not released and not burned without energy recovery.
(4) Perimeter : Europe.

Environmental indicators: definition and methodology

The 2005 environmental reporting perimeter includes all locations worldwide, owned or leased, housing Alcatel employees. Figures are consolidated at corporate level, from data reported by 52 locations (49 in 2004), each one housing more than 300 employees, representing together 81% (79% in 2004) of Alcatel employees.

Extrapolation hypotheses are used, based on ratios per employee, to cover 100% of Alcatel.

Figures are cross-checked with historical data existing since 1992.

2005/2004 Evolution

This year, for the first time, the total power consumption includes hot water vapor and chilled water purchases. This change in methodology partially explains the increase in the company's total energy consumption.

In addition, in line with the independent auditors' recommendations expressed in 2004, the gas consumption fraction of the total fossil energy consumed was measured with greater accuracy. This accuracy explains the decrease noted in the total greenhouse gas emissions.

Reported waste quantity does not include WEEE (Waste Electrical & Electronic Equipment). The latter is the subject of a specific action plan described herein.

The lower rate of ISO14001 certifications for production sites results from the integration of non-certified sites following acquisitions.

ADDITIONAL INFORMATION

Investments

Information on the main investments for 2002, 2003 and 2004 are developed in the reference document for 2004 in the Group activities section, the financial report and in note 3 to the consolidated financial statements.

The table below lists the major investments made over these last three years and, for 2006, the investments that have been agreed to date and are being made:

	2005/2006 investments
January 2006	GMK, a supplier of self-service voice solutions, an expansion of Alcatel's position in the Brazilian market and in Latin America
January 2006	A 25% stake in 2Wire, a pioneer in residential gateways making a good fit with Alcatel's end-to-end triple play offering
March 2005	Native Networks, a supplier of Ethernet optical transport solutions

	2004 investments
January 2004	Acquisition of WaterCove networks (mobile services billing solutions)
June 18, 2004	Alcatel and Finmeccanica form an alliance in the space business and create Europe's leader in satellite infrastructures and services (finalized in July 2005)
July 2004	MNC, a Swiss mobile video solutions company
September 2004	EDial for Enterprise solutions
December 2004	Spatial Wireless, a supplier of new generation mobile network solutions
December 2004	RightVision for Enterprise solutions

	2003 investments
April 2003	Acquisition of iMagic TV (service on digital TV)
July 2003	Acquisition of Timetra (IP/MPLS router)
November 2003	Acquisition of Packet video (mobile video solutions)

Property, plant and equipment

Alcatel occupies, as owner or tenant, a large number of buildings around the world. There are two types of site with different sizes and features:

- sites housing research and innovation and administrative functions have a regional remit covering all specialisms, by far the most numerous;
- the few production and assembly sites, particularly for introducing new fixed and mobile switching products, are dedicated to Alcatel's specialisms, fixed and mobile communications, and the sites for satellites and submarine cables.

On December 31, 2005, the total capacity of the production sites was approximately equivalent to 298,000 square meters divided between the various divisions and regions as shown in the table below.

Alcatel estimates that these properties are in good condition and meet the needs and requirements of the Group's current and future activities and that they do not present an exposure to major environmental risks that would have an impact on the Group's results. The environment-related issues that may influence their use are described in the Risk Management section of the present reference document for 2005.

Divisions	Europe	North America	Rest of world	Total
Fixed communications	141,000	5,000	24,000	170,000
Mobile communications	37,000	34,000	31,000	102,000
Private communications	124,000	2,000	0	126,000
Total	302,000	41,000	55,000	398,000

Alcatel has largely pulled out of production of many telecommunications products with the objective of achieving better flexibility in order to adapt to economic and market changes.

In 2005, the process continued and made it possible to rationalize the Group's property base which was also boosted by the acquisition of satellite assembly plants in Italy as part of the agreements made in July 2005 between Alcatel and Finmeccanica.

Alcatel has operations in approximately 450 sites in 130 countries, the main ones being:

	Research and innovation and support functions center	
Country	**Site**	**Owned/leased**
Germany	STUTTGART	Leased
Belgium	ANTWERP	Fully owned
Brazil	SAO PAULO	Fully owned
Canada	OTTAWA	Tenancy
China	SHANGHAI PUDONG	Fully owned
France	MARCOUSSIS	Fully owned
France	VILLARCEAUX	Fully owned
France	VELIZY	Tenancy
France	MASSY	Leased
France	PARIS LA BOÉTIE	Tenancy
France	ORVAULT	Fully owned
Mexico	CUAUTITLAN IZCALLI	Fully owned
India	CHENNAI	Tenancy
Italy	VIMERCATE	Leased
Austria	VIENNA	Fully owned
Spain	MADRID	Tenancy
United stated	DALLAS PLANO	Fully owned

			Production/Assembly sites
Country	**Site**	**Owned/leased**	**Trades**
Belgium	GEEL	Fully owned	Fixed and mobile communications
China	SHANGHAI	Fully owned	Fixed and mobile communications
France	CALAIS	Fully owned	Submarine cables
France	CANNES	Fully owned	Satellites
France	EU	Fully owned	Fixed and mobile communications
France	TOULOUSE	Fully owned	Satellites

HISTORY

May 31, 1898	French engineer Pierre Azaria sets up the Compagnie Générale d'Electricité (CGE) with the aim of taking on the likes of AEG, Siemens and General Electric.
1925	Absorption by CGE of Compagnie Générale des Câbles de Lyon.
1928	Setting up of Alsthom by Société Alsacienne de Constructions Mécaniques and Compagnie Française Thomson-Houston.
1946	Setting up of Compagnie Industrielle des Téléphones (CIT).
1966	Absorption by CGE of the Société Alsacienne de Constructions Atomiques, de Télécommunications et d'Electronique (Alcatel).
1970	Ambroise Roux becomes CGE's chairman. At the end of his term (1982), he remains honorary chairman until his death in 1999.
1982	Jean-Pierre Brunet becomes CGE's chairman.
1984	Georges Pebereau becomes CGE's chairman. Thomson CSF's public telecommunication and business communication operations are merged into a holding company Thomson Télécommunications, which is taken over by the CGE group.
1985	Alsthom Atlantique changes its name to Alsthom. Merger between CIT-Alcatel and Thomson Télécommunications. The new entity adopts the name Alcatel.
1986	Setting up of Alcatel NV following an agreement with ITT Corporation, which sells its European telecommunications activities to CGE. Pierre Suard becomes CGE's chairman. CGE buys into Framatome (40%). Câbles de Lyon becomes a subsidiary of Alcatel NV.
1987	Privatization of CGE. Alsthom wins an order to supply equipment for the TGV Atlantique network and leads the consortium of French, Belgian and British companies involved in the building of the northern TGV network.
1988	Link-up of Alsthom and General Electric Company (UK) Merger of Alsthom's activities and GEC's Power Systems division into a joint company.
1989	Agreement between CGE and General Electric Company and setting up of GEC Alsthom. CGEE-Alsthom changes its name to Cegelec.
1990	CGE-Fiat agreement. Alcatel takes over Telettra and Fiat acquires a majority stake in CEAC. Acquisition by Câbles de Lyon of Câbleries de Dour (Belgium) and Ericsson's US cable operations. Agreement on Framatome's capital structure, with CGE holding a 44.12% stake.
1991	Compagnie Générale d'Electricité changes its name to Alcatel Alsthom. Purchase of the transmission systems division of the American group Rockwell Technologies. Câbles de Lyon becomes Alcatel Cable and takes over AEG Kabel.
1993	Acquisition of STC Submarine Systems, a division of Northern Telecom Europe (today Nortel Networks).
1995	Serge Tchuruk becomes chairman and CEO of Alcatel Alsthom. He restructures the company focusing on telecommunications.
1998	Alcatel Alsthom is renamed Alcatel. Acquisition of the American DSC which has a solid position in the US access market. Initial public offering of GEC ALSTHOM which becomes Alstom. Alcatel retains 24% in the newly-formed company. Alcatel sells Cegelec to Alstom.
1999	Acquisition of the American companies Xylan, Packet Engines, Assured Access and Internet Devices, specialised in Internet network and solutions. Alcatel raises its participation in Thomson CSF (now Thales) to 25,3% and reduces its participation in Framatome to 8,6 %.
2000	Acquisition of the Canadian Newbridge, worldwide leader in ATM technology networks. Acquisition of the American company Genesys, worldwide leader in contact centers. The Cable activities are subsidized and renamed Nexans.
2001	Sale of its 24% share in Alstom. IPO of a significant part of Cables & Components business (Nexans activity). Alcatel keeps 20% of Nexans shares. Acquisition of the remaining 48.83% stake held in Alcatel Space by Thales, bringing Alcatel's ownership of Alcatel Space to 100%. After this transaction, Alcatel's stake in Thales decreased to 20%. Sale of DSL modems activity to Thomson Multimedia.

2002	Sale of its remaining share in Thomson. Alcatel acquires control of Alcatel Shanghai Bell. Sale of 10.3 million Thales shares (Alcatel's shareholding in Thales from 15.83% to 9.7%).
2003	Acquisition of TiMetra Inc., a privately held, Silicon Valley-based company that produces routers (devices that interconnect computer networks and move information from one network to another). Sale of Alcatel's optical components business to Avanex. Sale of SAFT Batteries subsidiary to Doughty Hanson.
2004	Alcatel and TCL Communication Technology Holdings Limited formed a joint venture mobile handset company. The joint venture company is 55% owned by TCL and 45% owned by Alcatel. Alcatel and Draka Holding N.V. ("Draka") combined their respective global optical fiber and communication cable businesses. Draka owns 50.1% and Alcatel owns 49.9% of the new company, Draka Comteq B.V. Alcatel acquired privately held, U.S.-based eDial Inc., a leading provider of conferencing and collaboration services for businesses and telephone companies. 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.

SUBSEQUENT EVENTS

In January 2006, Alcatel finalised the acquisition of a 25 percent stake in 2Wire, a pioneer in home broadband network solutions. This strategic investment, Alcatel will complete and deploy triple play solution services and successfully address this fast growing market opportunity.

On March 10, 2006, Standard and Poor's revised its outlook on Alcatel debt to positive from stable.

On March 24, 2006, Alcatel and Lucent confirmed that they were engaged in discussions about a potential merger of equals that is intended to be priced at market. At the date of filing this document, there could be no assurances that any agreement will be reached or that a transaction will be consummated.

There were no significant changes, financial or commercial, that occurred after the balance sheet date.

CORPORATE GOVERNANCE

MANAGEMENT AND CONTROL

MEMBERS OF THE BOARD

Serge Tchuruk
Chairman and Chief Executive Officer
Daniel Bernard
Independent Director
Philippe Bissara
Independent Director
Honorary General Representative of the Association nationale des sociétés par actions
W. Frank Blount
Independent Director
Chairman and Chief Executive 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 Institut français des administrateurs (IFA)
Pierre-Louis Lions
Independent Director
Professor of the Collège de France
Thierry de Loppinot
Director
Legal Counsel at Alcatel head office
Peter Mihatsch
Independent Director
Chairman of the Supervisory Board of Giesecke und Devrient (Germany)
Bruno Vaillant
Director
Engineer at Alcatel Space
Marc Viénot
Independent Director
Honorary Chairman and Director of Société Générale
Pascal Durand-Barthez
Secretary of the Board

Outgoing members in 2005

Philippe Germond occupied the posts of Director and Deputy Chief Executive until April 19, 2005.
Thomas Edig was a member of the Executive Committee until December 31, 2005.
Ron Spithill was a member of the Executive Committee until October 2005.
Niel Ransom was a member of the Executive Committee until April 2005.

Nomination since 2006

Claire Pedini became a member of the Executive Committee in January 2006.

MEMBERS OF THE STRATEGIC COMMITTEE

Serge Tchuruk, Chairman
Pierre-Louis Lions
Peter Mihatsch

MEMBERS OF THE APPOINTMENTS AND REMUNERATIONS COMMITTEE

Daniel Bernard, Chairman
Philippe Bissara
W. Frank Blount

MEMBERS OF THE AUDIT COMMITTEE

Daniel Lebègue, Chairman
Daniel Bernard
Marc Viénot

MEMBERS OF THE EXECUTIVE COMMITTEE

Serge Tchuruk
Chairman and Chief Executive Officer
Michael Quigley
Deputy Chief Executive
Jean-Pascal Beaufret
Financial Director
Jacques Dunogué
President, Europe and South
Étienne Fouques
President, Mobile Communications
Olivier Houssin
President, Private Communications
Claire Pedini
Human Resources Director
Christian Reinaudo
President, Asia-Pacific

STATUTORY AUDITORS

Deloitte & Associés
Represented by Alain Pons
Barbier Frinault et Autres (Ernst & Young)
Represented by Christian Chiarasini

BOARD OF DIRECTORS

Alcatel complies with the recommendations of the AFEP-MEDEF working party's recommendations which specify the principles of corporate governance of listed companies arising from the Viénot report (1995 and 1999) and Bouton report (2002) on the improvement of corporate governance.

These principles mainly govern the way in which the Board and its committees operate as described in the Board's internal rules. In addition, because the Company is listed on the New York Stock Exchange, it is subject to the terms of the "Sarbanes-Oxley Act" which took effect in 2002.

Structure of the Board of Directors

The Board has thirteen members, the majority of whom were re-elected during the General Meeting of May 20, 2005. The directorships of Philippe Bissara, W. Frank Blount, Jean-Pierre Halbron, David Johnston, Pierre-Louis Lions, Thierry de Loppinot, Peter Mihatsch and Bruno Vaillant were renewed for periods of one to four years, in accordance with the company's bylaws concerning regular renewal of Board members.

The maximum period of office for a director was in fact reduced to four years instead of the six years specified by law, following a decision of the General Meeting of May 16, 2000.

Of the thirteen Board members, four are of non-French nationality and two are Group employees put forward by the Alcatel Fonds Commun de Placement (employee investment fund).

During the Meeting of April 19, 2005, the Board accepted Philippe Germond's resignation of his company directorship and his relinquishing of his duties as Deputy Chief Executive.

The average age of the directors is 63.

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 high-tech businesses, sufficient financial expertise to make independent, well-informed decisions on the Group's financial statements and on its compliance with accounting standards, and they must be unquestionably independent of the company's management, based on the criteria listed below.

The independence criteria 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 his period in office, is independent if he has no direct or indirect relationship with the company or Group or the management thereof that could compromise his freedom of judgment.

According to these criteria, the Board of Directors, at its March 8, 2006 Meeting, confirmed the independence of eight of its members, that is, over half the Board as of January 1, 2006: Daniel Bernard, Philippe Bissara, W. Frank Blount, David Johnston, Daniel Lebègue, Pierre-Louis Lions, Peter Mihatsch and Marc Viénot.

The Board also noted that de facto, Serge Tchuruk, a current corporate officer, and Jean-Pierre Halbron and Jozef Cornu, having held management posts within the Group, cannot be considered independent directors until five years have elapsed after the end of their respective management terms.

Without recognizing them as independent directors according to corporate governance criteria, the Board of Directors nevertheless considers Thierry de Loppinot and Bruno Vaillant, employee directors and members of the Alcatel Employee Investment Fund "FCP 3A", enjoy total freedom of opinion due to the manner of their election and their status.

Responsibilities of the Board of Directors

The internal rules adopted by the February 3, 2003 board 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 Board of Directors' responsibilities and powers are based on three major principles: its duties in terms of administration, review and prudence.

Extracts 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 seven times during 2005 and the average attendance rate at these Meetings was 88%.

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.

Depending on the agenda of these Meetings and the nature of the subjects to be discussed, the Chairman of the Board may request that any of the three official Board committees meet beforehand.

Extract 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 3 to 5 directors, shall be chaired by one of them appointed by the Board of Directors."

Unless justified by urgency, the 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.

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.

The file submitted to the Board Meeting contains information that is as complete as possible on 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 Board resolution. The file also contains a draft press release by the Board that is generally published the day after the Board Meeting and before the opening of the Paris Bourse, in accordance with the recommendations of the French Financial Markets Regulator (Autorité des marchés financiers, AMF).

The file also contains a list of the principal contracts and agreements signed since the last Meeting as well as data on changes in Alcatel's 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 option is expressly prohibited by law. A proposal will be made to the General Meeting of 2006 to change the bylaws to allow directors to attend by other telecommunication means, as permitted by the law modified in 2005, to improve the efficiency of the Board's work.

The average length of Board Meetings is three hours, usually preceded by an informal Meeting with the members of the Group Executive Committee.

The members of the Board of Directors are invited to meet regularly with the Group's principal senior operating executives in order to familiarize themselves with the company's strategies 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.

In addition, Board members receive all relevant information concerning the company, particularly press articles and financial analysis reports.

Deliberations of the Board of Directors in 2005

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 has approved the parent company and consolidated financial statements at December 31, 2004, and the budget for the current year and proposed the appropriation of earnings. It has also reviewed the quarterly and mid-year consolidated financial statements and the consolidated financial statements for 2005. At each of these Meetings, the financial statements were reviewed in the presence of the Statutory Auditors and the Audit Committee presented a report.

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

The Group's business

The Board regularly examined Alcatel's position on the market, discussed the Group's strategy in depth and issued statements on certain structural operations.

In this way, it approved the plan to take a 25% stake in the Californian company 2Wire to form a strategic partnership to broaden and extend the most comprehensive integrated "triple play" solution on the market.

The Board approved in principle the disposal of all its holding in Nexans, 15.02% of the capital and 28.2% of the voting rights. This was finalized in March 2005 as a private placement achieved by setting up an accelerated order book.

Furthermore, it approved the sale of the Europe*Star assets to Panamsat thus completing Alcatel's retreat from the satellite operator business and approved the terms for "closing" the operations to merge Alcatel's space activities with those of Italy's Finmeccanica by setting up two joint venture companies on July 1, 2005.

The Board also reviewed various divestments and acquisitions still in the planning stage.

Financial situation and transactions

The Board monitored developments in the Group's income and financial structure and continued restructuring and cost-reduction plans.

In particular, it formally noted the renegotiation of the €1.3 billion line of credit that Alcatel has.

Powers of the Chairman

During its Meeting of April 17, 2003, according to the bylaws, the Board confirmed the appointment of Serge Tchuruk as Chairman of the Board of Directors and Chief Executive Officer of the company for a term due to expire at the end of the general Meeting in 2006 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 by law, the bylaws and 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.

Remuneration policy

The Board examined the Appointments and Remunerations Committee's proposals to allocate options to subscribe for shares for 2005 and decided on an options plan for employees on the usual terms. It also renewed the Chairman and Chief Executive Officer's delegation of powers to grant options to new employees or to certain employees in exceptional circumstances.

The Board decided on the variable portion of the remuneration to be paid to the Chairman and Chief Executive Officer and to the Deputy Chief Executive. As proposed by the Appointments and Remunerations Committee, it defined the criteria for calculating the variable portion for 2005.

Furthermore, the Board, having taken advice from the Appointments and Remunerations Committee, adopted the convention between Alcatel and Philippe Germond and formally noted the termination of his service as Deputy Chief Executive and member of the Board. It also approved the Chairman's decision to appoint Michael Quigley as Deputy Chief Executive.

Corporate governance

The Board proposed a change to the regulations of the Audit Committee to satisfy the requirements arising from Rule L. 10A-3 of the Securities and Exchange Commission, taken in execution of the Sarbanes-Oxley Act, while complying with the terms relating to the treatment of information by an outsider and the use of electronic files defined by the Commission nationale informatique et libertés (CNIL), France's national commission on data and civil liberties.

The Board also formally noted the new regulation applicable to directors' declarations of their dealings in Alcatel shares.

Ethics

The Board took note of the report produced by Jean-Pierre Halbron, Director and Chairman of the Ethics Committee, on that committee's activities in 2004. Following the allegations made in 2004 against the Group's companies in Costa Rica and Taiwan concerning commercial practises, the Board monitored and examined the progress of the ongoing enquiries and legal proceedings.

The Board took note of the report and conclusions of Ron Spithill, who was the Director Marketing and member of the Group's Executive Committee, on Alcatel's relationships with the agents and consultants and approved the recommendations arising therefrom, and particularly the improvement in training on tackling corruption and tightening up the process of selecting agents and intermediaries in countries in which Alcatel operates.

Shareholders' Meetings

The Board convened the General Joint Meeting of Shareholders and approved the documents to be submitted to the Meeting and particularly the agenda. It also convened a Meeting of the holders of bonds redeemable for new and existing Alcatel shares in order to submit to them certain resolutions put to the Shareholders' Meeting.

It gave its decisions on the questions raised by certain Shareholders in writing or during the Shareholders' Meeting. The Board also discussed the lessons to be drawn from the Shareholders' Meeting following the refusal of the majority of Shareholders to adopt certain resolutions relating to the delegation of powers to the Board to issue shares without preferential subscription rights.

Evaluation of the Board of Directors

The report evaluating the functioning of the Board was prepared at the end of 2005 by an independent Corporate Governance Consultant, M. Edoardo De Martino, as had already been done in 2000 and 2002. According to the firm's findings reported to the directors during the Board Meeting of February 1, 2006, the Board has the necessary independence from Senior Management and the Directors make good quality contributions to the discussions.

Pursuant to the Board's internal rules, the directors met to discuss the functioning of the Board. The Meeting continued without the presence of those directors serving as executives or employees of the company in order to assess the performance of Serge Tchuruk and Philippe Germond.

The Board also discussed the independence of its members.

BOARD COMMITTEES

For several years, there have been three committees: the Audit Committee, the Appointments and Remunerations Committee and the Strategic Committee.

At its Meeting of February 3, 2003, the Board redefined the composition and responsibilities of each committee and approved regulations determining their respective duties and operating procedures.

Strategic Committee

This committee is made up of three members who are appointed or reappointed by the Board on the recommendation of the Appointments and Remunerations Committee. As at January 1, 2006, the members are Serge Tchuruk, Chairman of the committee, Pierre-Louis Lions and Peter Mihatsch, both independent directors. The Strategic Committee defines the Group's growth policies, the selection of investments and the management of the Group's performance.

The committee met in March 2005 to analyze the issues and examine the strategic options facing Alcatel due to the changes in the market. All its members were present.

Appointments and Remunerations Committee

The committee is made up of three members appointed or reappointed by the Board. As at January 1, 2006, the members are Daniel Bernard, Chairman of the committee, Philippe Bissara and W. Frank Blount. They are all independent.

The Chairman of the Board may be involved in the discussions and work of the committee but naturally not in questions concerning him.

This committee has three major responsibilities. The first is to study all issues relating to the composition, organization and operation of the Board of Directors and its committees (establishing a procedure for appointing new members, evaluating the independence of directors, etc.)

It is also responsible for making recommendations to the Board regarding the remuneration of senior executives and corporate officers, including that of the Chairman.

The committee discusses the policy of granting options to subscribe for or purchase shares and capital increases reserved for employees.

The committee met four times in 2005 with an average attendance rate of 83%.

It proposed to reappoint Philippe Bissara, W. Frank Blount, Jean-Pierre Halbron, David Johnston, Pierre-Louis Lions, Thierry de Loppinot, Peter Mihatsch and Bruno Vaillant as directors for terms staggered over time to ensure regular renewal of the Board in accordance with Article 13 of the bylaws.

It studied possible ways of keeping employees loyal and examined the company's stock option plans of March 2005.

It also studied the method of determining the remuneration of the Chairman and Chief Executive Officer and of the Deputy Chief Executive and the variable portion of their remuneration for 2005. It approved the terms of Philippe Germond's departure.

The committee examined the situation of each director against the criteria defined by the Board and resulting from the corporate governance recommendations. It prepared the Board's decisions concerning the evaluation of the Board and the performance of the Chairman and Chief Executive Officer.

Finally it considered the Chairman's succession plan and the employee loyalty policy.

The Chairman of the committee reported on its work to the Board of Directors which gave it due consideration.

Audit Committee

The Audit Committee consists of three members, who are appointed or reappointed by the Board of Directors on the recommendation of the Appointments and Remunerations Committee. As of January 1, 2006, the members were Daniel Lebègue, Chairman of the committee, Marc Viénot and Daniel Bernard.

The committee has four areas of responsibility: accounting principles, internal control, financial statements and financial situation and the Statutory Auditors.

The committee monitors the relevance and consistency of the principles used. It examines the scope consolidation, the applicable accounting standards and the parent company and consolidated financial statements in IFRS and American (US GAAP) reporting standards. 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. A new version of the Audit Committee's rules was adopted in 2005 to supplement the existing procedures by setting up a procedure specific to the confidential handling of complaints and whistleblowing in the accounts and financial audit field.

In addition, the Audit Committee handles the procedures for appointing the Statutory Auditors and checks their independence by setting, as applicable, any rule governing work assigned to them. It also gives an opinion on the level of their fees.

The members of the committee met six times in 2005. At these meetings, their attendance rate was 88%.

The committee reports on its work to the Board on a regular basis, in particular on the following points for 2005:

Accounting principles

The committee was informed of the principles applied in preparing the reconciliations with the American accounting standards (US GAAP) and the differences in accounting treatment compared with the financial statements prepared to IFRS standards.

The committee studied the impacts of the transition to IFRS for preparing the consolidated financial statements and approved the options adopted by the Group.

Internal control

The committee received the annual internal audit report for 2005 and the internal audit plan for 2006. During the review of internal audits, it consulted with the Internal Audit Department and reviewed its resources.

In particular, the committee reviewed the procedures put in place to ensure the reliability of the contracts of commercial consultants and agents and to protect against fraud within the Group. It was kept informed of progress in the proceedings concerning the accusations of corruption in Costa Rica. The committee also took an interest in the progress made in the certification required by section 404 of the Sarbanes-Oxley Act.

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. The committee reports to the Audit Committee.

Finally, as indicated above, the committee set up in 2005 a financial whistleblowing procedure as required by the Sarbanes-Oxley act while observing the requirements set by the CNIL.

Financial statements and financial position

During 2005, the committee performed a preliminary review of the financial statements for the past fiscal year and the mid-year financial statements, drawn up to IFRS and American standards and of the quarterly financial statements to IFRS standards and the parent company annual financial statements to French accounting standards. At each of these Meetings, the committee interviewed the Chief Financial Officer and the Statutory Auditors and reviewed in their presence the principal points discussed with the Chief Financial Officer when the financial statements were prepared.

Early in the year, the budget and financial forecasts for 2005 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 way in which hedging instruments for commercial bids and the Group's tax policy and how deferred taxes are reported.

Auditors

For the purpose of preserving auditor independence, in compliance with the new SEC regulations and french regulation LSF, in 2003 the committee introduced a procedure that requires prior approval of audit assignments. It also set the thresholds that are based on total fees paid to the auditors for the statutory audit, beyond which any assignment must be authorized by the Audit Committee. In line with this procedure, any tasks the auditors were assigned in addition to statutory audits were subject to prior approval by the Audit Committee.

After hearing the Chief Financial Officer's and Statutory Auditors' reports, the committee also expressed an opinion on the auditors' fees for 2005.

DIRECTORS' REMUNERATIONS

Chairman and Chief Executive Officer

The Chairman and Chief Executive Officer's annual remuneration, like that paid to all the Group's managers and senior executives, consists of a fixed portion and a variable portion. It is decided by the Board on the recommendation of the Appointments and Remuneration Committee.

The variable remuneration determined every year by the Board is based on the outlook and expected Group results for the following year according to stable criteria as defined below. It is paid in the year following the year to which it relates, after the shareholders' meeting has approved the financial statements for the year just ended.

The overall gross annual remuneration paid in 2005 to the Chairman and Chief Executive Officer was €2,839,363 (compared with €2,303,610 in 2004).

The fixed remuneration remains unchanged since 2000, standing at €1,524,490. The gross amount of variable remuneration paid in 2005 for 2004 was €1,314,873, fixed in consideration of the net income before amortization of goodwill and after deduction of minority interests.

Mr Tchuruk did not wish to take any options as part of the March 2005 and 2006 plans. He reinvested the net amount of his variable remuneration in Alcatel shares, buying 130,700 Alcatel shares on the market in June 2005 for €1,201,050. The AMF was notified of this transaction pursuant to Articles 222-14 and 222-15 of the general regulation of the AMF, available on the AMF and Alcatel web sites.

According to the Board's decision when it met on March 10, 2005, the variable remuneration to be paid in 2006 in respect of 2005 will be based on the same calculation criteria as for 2004, with reference to net income before amortization of goodwill and after deduction of minority interests.

The Board Meeting of March 30, 2006 therefore set the gross amount of the variable portion at €1,105,255 for 2005, representing 72.5% of the fixed portion, compared with 86.25% for 2004.

Concerning the Chairman and Chief Executive Officer's variable remuneration for 2006, to be paid in 2007, the Board decided that the applicable criteria will be those applied to all Alcatel Senior Executives, that is 30% of consolidated income, 40% of net income after minority interests and 30% of net operating cash flow after tangible and intangible investments ("free cash flow") calculated on a prorata temporis basis.

Finally, pursuant to the commitments made on his appointment, Mr Tchuruk will be entitled, when he leaves his post as Chairman and Chief Executive Officer, to an allowance equal to twice the average of the highest two annual remunerations paid to him during the five years preceding his leaving office. These commitments, reviewed and approved by the Appointments and Remuneration Committee, are the result of the decisions made by the Board on May 30, and December 13, 1995, revised at the meetings of October 30, 2001 and December 11, 2002.

He will also receive the supplementary pension granted to some 80 Group Senior Executives as specified in the section below entitled "Commitments and other benefits". Because of the entitlements he has acquired under this supplementary pension scheme, and the entitlements acquired prior to joining the Group, it will not be necessary to apply the guarantee granted him by the Board, that is a pension of 40% of the average of the highest two annual remunerations paid to him during the five years preceding his leaving office as Chairman and Chief Executive Officer.

In addition, Mr Tchuruk does not receive any directors' attendance fees for any of the directorships he holds in the Group's companies or for those he holds 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 in 2005.

Directors

Attendance fees

The total annual attendance fees allocated to directors is set at €600,000 as decided by the combined Shareholders' Meeting of May 16, 2000. The fees, as approved by the Board and set forth in the internal rules, are allocated as follows:

- the attendance fees are divided into two equal parts, a fixed portion and a variable portion, as follows:
  - the fixed portion is distributed equally between all the directors,
  - the variable portion is distributed between the members of the Board based on their attendance at Board Meetings and Meetings of the committees on which they serve;
- payments are made in two installments: the first one after the annual general Meeting and the second one at the end of the year;
- a total of €600,000 in attendance fees was paid out for 2005;
- the Chairman and the directors exercising power within the company's management do not receive attendance fees: this rule applies to Mr Tchuruk, Chairman and Chief Executive Officer of Alcatel, and applied to Mr Germond, Deputy Chief Executive up to April 19, 2005.

Gross remuneration and benefits in kind

(In euros)					2005				2004
Board members	Fixed	Variable	Exceptional	Attendance fees	Benefits in kind	Fixed	Variable	Attendance fees	Benefits in kind
Serge Tchuruk	1,524,490	1,314,873			9,120	1,524,490	770,000		9,120
Daniel Bernard				66,604				61,807	
Philippe Bissara				40,884				48,060	
W. Frank Blount				49,524				43,625	
Jozef Cornu				44,606		316,305	38,000	45,621	
Jean-Pierre Halbron				44,606				41,186	
David Johnston				44,606				43,182	
Daniel Lebègue				60,489				70,676	
Pierre-Louis Lions								45,621	
Thierry de Loppinot	89,747	12,600		50,720		86,500	12,522	45,621	
Peter Mihatsch				45,802				43,182	
Bruno Vaillant	78,626	5,799		44,605		72,084	5,881	45,621	
Marc Viénot				62,948				65,798	
Philippe Germond*	414,584	1,543,750	3,105,017		2,855	750,000	750,000		5,496

** Resigned his directorship of the company on April 19, 2005.*

To the company's knowledge, no service contract binding the members of the Board to the company or to its subsidiaries provides for benefits or allowances linked to or resulting from leaving a post in the Company or its subsidiaries.

Commitments and other benefits

The officers of the company (including former salaried directors of the Group and Philippe Germond) have the same supplementary pension scheme as approximately 80 senior executives of the Group, who are employees of Alcatel and the French subsidiaries in which Alcatel has more than a 50% stake.

This scheme, set up in 1976, is based on a contract with an insurance company and is a defined benefit scheme. For each beneficiary, this scheme supplements the supplementary AGIRC scheme for the remuneration portion above the ceiling specified by the latter and according to an arrangement and calculation method that are similar to the AGIRC scheme.

The insurance company dedicates a specific collective fund to this scheme that is fed by company contributions beginning when each beneficiary draws from the fund (usually on reaching the age of 65) and up to the pension commitments.

The company has no further commitments to the officers of the company corresponding to remuneration, allowances and benefits due or likely to be due on leaving or changing position subsequent to the latter, except the contractual commitment relating to the Chairman and Chief Executive Officer's severance mentioned in the paragraph above entitled "Chairman and Chief Executive Officer".

The total commitments provisioned by the issuer at December 31, 2005 in application of the IFRS standard for the purposes of paying pensions or other benefits to Alcatel officers (including the Group's three former salaried directors and Philippe Germond) stood at €30.6 million.

This amount is distinct from the information relating to "Benefits after leaving the company" in Note 32 to the consolidated financial statements, which, according to IAS 24, is the amount booked in the income statement for 2005 irrespective of whether or not these amounts are paid, for all directors and members of the Executive Committee present between January 1 and December 31, 2005 (€5 million with respect to 2005 compared with €4 million with respect to 2004).

Senior executives

In 2005, excluding exceptional items, the total gross remunerations and advantages paid by Alcatel or by the companies that it controls to the 11 members of the Executive Committee who were or had been in post during 2005, was €14 million (compared with a total of €11.6 million in 2004).

The exceptional items (severance payments resulting from contractual commitments and pensions paid or falling due during the year) for senior executives totaled €5.3 million for 2005.

Senior executives' remunerations comprise a fixed portion and a variable portion based on the company's performance and their individual performance, according to criteria reviewed by the Appointments and Remunerations Committee.

Within the total remunerations paid in 2005, the fixed portion (also including benefits in kind, expatriate allowances and accommodation allowances), was €7.2 million (unchanged from 2004), and the variable portion, linked to sales, net income and cash flow for 2004, was €6.8 million or 48.6% of the total (compared with a total of €4.4 million in 2004).

The variable portion paid in 2006 with respect to 2005 is linked to net income and cash flow in 2005.

In addition, attendance fees paid to senior executives for their participation in the Board Meetings of companies within the Group are deducted from the amount of the salaries paid.

Senior executives' interests

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 good corporate governance, the Directors' Charter recommends that the number of shares held be significant, and that if a director does not own the shares on entering office, he must invest at least one year of attendance fees to buy additional shares.

As of December 31, 2005, the members of the Board together held 489,537 Alcatel shares (including ADS) and 18,631 units held in the FCP 3A, representing 0.03% of Alcatel's equity capital and voting rights (see the details of their holdings under "Information on the directors").

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 insider information. 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, since January 1, 2006 each director reports to the company all transactions carried out on securities issued by Alcatel. In this respect, a report was filed with the French Financial Markets Regulator (AMF).

During the year, three directors declared their Alcatel share transactions that were passed on to the AMF:

Alcatel share transactions	Date	Transaction	Number of shares	Weighted average price	Total transaction value
Serge Tchuruk	June 2005	Buy	130,700	€9.189	€1,201,050.00
David Johnston	June 2005	Buy	1,256	€9.49	€11,990.96
Jean-Pierre Halbron	August 2005	Sell	2,350	€10.03	€23,570.50

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 insider information (annual, mid-year and quarterly financial statements, acquisition and divestment plans, sales or financial agreements, strategic plan or budget) and more generally any information likely to influence the stock price of the security or securities concerned".

The members of the Executive Committee, like the directors and employees of the Group having, as a result of their employment, information that is not yet public, must comply with the same rules preventing insider trading.

As of December 31, 2005, the members of the Executive Committee together owned 242,144 Alcatel shares (including ADS) and 3,836 units held in the FCP 3A, representing 0.02% of Alcatel's equity capital and voting rights.

Options

No options were granted to the Chairman and Chief Executive Officer and other members of the Board in 2005, with the exception of one salaried director representing the FCP 3A.

The options plan approved by the Board on March 10, 2005 related to an overall total of 16.7 million options, providing entitlement to subscribe for Alcatel shares at €10, being the average stock market price of Alcatel's shares during the twenty stock market trading days preceding the Board's decision.

No options were exercised by Board members in 2005.

Options granted to members of the Board and still outstanding on January 1, 2006:

	Option plan	Exercise price range	Options granted	Options available*	Number of options with an exercise price < €15	Number of options with an exercise price < €21
Chairman	2000 to 2004	€6.7 to €50	2,300,000	61%	900,000	1,400,000
Jean-Pierre Halbron	2000 and 2001	€20.8 to €50	600,188	100%	NA	200,020
Jozef Cornu	2000 and 2001	€20.8 to €50	30,188	100%	NA	20
Thierry de Loppinot	2000 to 2005	€6.7 to €50	5,416	44%	3,028	4,048
Bruno Vaillant	2000 to 2003	€6.7 to €50	2,416	91%	228	1,048
Philippe Germond	2003 and 2004	€6.7 to €13.2	450,000	0%	450,000	450,000

** Exercise period open on January 1, 2006.*

The members of the Executive Committee in post or having been in post during 2005 benefited from options to subscribe for shares giving entitlement to 720,000 shares, representing 4.3% of the total number of options granted by the Board on March 10, 2005. These options satisfy the general terms of the annual plan and can be exercised at a price of €10.

A total 37,186 options to subscribe for Alcatel shares were exercised in 2005 at a weighted average price of €6.77 with respect to the plans of March 7, 2003 and June 18, 2003.

The options granted to directors in 2006 are described on page 181.

REGULATED AGREEMENTS

A new agreement was made between Alcatel and a director during 2005. Two other agreements authorized during earlier years continued in 2005. They relate to the agreements made between Alcatel and Thales and Alcatel and the Group companies.

New agreement between Alcatel and a director

The Board Meeting of April 19, 2005, after receiving a favorable recommendation from the Appointments and Remunerations Committee, authorized an agreement between Alcatel and Philippe Germond, noting and arranging the cessation of his duties as the Group's Deputy Chief Executive.

The main terms of this agreement, aimed at adjusting the contractual commitments due to a departure during the first half-year, relate to Mr Germond's severance pay of €3 million pursuant to the contract terms agreed when he entered the post, reducing the notice period to three months, setting his 2005 bonus, on a *prorata temporis* basis, or €250,000, the resignation from his directorship within the Group and the retention of rights to options to subscribe for Alcatel shares that he had under the terms and procedures of the option plans agreed by the Board.

Agreements continued

Agreements with Thales

The agreements made in 1998 and reinforced in 1999, when Alcatel raised its stake in Thales (formerly Thomson-CSF) in December 1999, relate primarily to the terms and conditions of 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 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 2005, income recorded by Alcatel amounted to €730,592,920.69. The expense owed by Alcatel to the subsidiaries amounted to €752,473,965.64.

EMPLOYEE PROFIT-SHARING SCHEMES

In addition to the stock option plans described above, Group companies have set up profit-sharing plans and employee savings plans, in accordance with the recommendations of Senior Management. Foreign subsidiaries are establishing profit-sharing schemes for their employees within the framework of local legislation and when the law allows.

Capital increases reserved for employees

During the past five years, the company made capital increases in favor of 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 Meeting of March 7, 2001, a total of 91,926 shares were issued on June 29, 2001. Every share subscribed for 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 vesting period (four-year period in France).

Since then, it has not been decided to make further capital increases reserved for employees, the Board making this announcement by delegation received from the Shareholders' Meeting in accordance with Article L. 225-129-6 of the Commercial Code.

Policy for granting stock options

The main guidelines for granting options to subscribe for shares or purchase shares were set by the Board Meetings of 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 grant of stock options is approved by the Board on the recommendation of the Appointments and Remunerations 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 with its competitors. Under the policy described above, the number of beneficiaries for each annual plan increased noticeably (from 1,000 in 1996 to 9,470 in 2005). 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 practises of each country and on the levels of responsibility of the beneficiaries.

Since 1998, the option exercise price has not included a discount or reduction from the average trading price in the twenty days preceding the date of grant. 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 1/48 of the same number after each subsequent month.

Moreover, to ensure that the Group's activities and staff most crucial to the Group's development remains stable in all circumstances, the Board 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 the beneficiaries of the options, with the exception of corporate officers holding office on the date the options were granted or the decision was taken, should be table to exercise their options without delay, notwithstanding the vesting period, if any.

The options granted to corporate officers, senior executives and the Chairman are strictly on the same terms as those governing options granted to all beneficiaries.

Alcatel's stock subscription and stock purchase option plans are explained on page 181.

INFORMATION ON THE DIRECTORS

To the Company's knowledge, there are no potential conflicts of interest between the Directors' duties and their private interests. In accordance with the Director's charter, "The Director is obliged to notify the Board of any conflict of interest, even potential...".

There is no family link between the members of the Board and the other Senior Executives of the Company.

To the Company's knowledge, no member of the Board nor any corporate officer has been convicted of fraud during the last five years. None has been a Director involved in a bankruptcy, sequestration or liquidation in the last five years and none has received a conviction and/or an official public sanction pronounced by a statutory or regulatory authority.

None has been barred by a court from acting as a member of an administrative, management or supervisory body of an issuer nor from being involved in the management or conduct of the affairs of an issuer in the last five years.

Offices and duties held

Name and business address	Appointed/ expiry of term*	Offices and duties held
SERGE TCHURUK Nationality: French, Age: 68 Alcatel 54, rue La Boétie – 75008 Paris – France owns 236,150 shares and 209 units in FCP 3A	1995/2007	In France: Director of Total and Thales. Member of the Board of the École polytechnique. Abroad: Chairman of the Board of Alcatel USA Holdings Corp. (formerly Alcatel NA, Inc.). Member of the Board of Alcatel Deutschland GmbH.
DANIEL BERNARD Independent Director, Nationality: French, Age: 60 Provestis – 22, rue de la Trémoille – 75008 Paris – France owns 141,125 shares	1997/2007	In France: Chairman of Provestis. Director of Saint-Gobain and Cap Gemini.
PHILIPPE BISSARA Independent Director, Nationality: French, Age: 64 Alcatel 54, rue La Boétie – 75008 Paris – France owns 53,645 shares and 4,469 units in FCP 3A	1997/2008	In France: Honorary legal advisor to the Conseil d'État, member of the Board of the French branch of the International Tax Association, member of the Académie de comptabilité, honorary general representative of the ANSA (National Association of Joint Stock Companies).
W. FRANK BLOUNT Independent Director, Nationality: American, Age: 67 1040 Stovall Boulevard N.E. – Atlanta, Georgia, 30319 – United States owns 1,000 American Depositary Shares (ADS)	1999/2008	Abroad: Chairman of JI Ventures Inc., TTS Management Corp., Director of Entergy Corporation USA, Caterpillar Inc. USA, Adtran Inc., Hanson Plc. UK.
JOZEF CORNU Director, Nationality: Belgian, Age: 61 Grouwesteenstraat 13 – 9170 Sint-Gillis-Waas – Belgium owns 20,500 shares and 1,734 units in FCP 3A	2000/2008	In France: Director of Alcatel CIT. Abroad: Chairman of the Board of Alcatel Bell NV, member of the Supervisory Board of Alcatel SEL AG, Director of Taiwan International Standard Electronics Ltd, of Barco (Belgium), of KBC (Belgium), of Agfa Gevaert (Belgium) and of Arinso International (Belgium), Chairman of Information Society Technologies Group of the European Commission.
JEAN-PIERRE HALBRON Director, Nationality: French, Age: 69 Alcatel 54, rue La Boétie – 75008 Paris – France owns 18,670 shares and 1,969 units in FCP 3A	1999/2008	In France: Director of Electro Banque, Chairman of Alcatel's Ethics Committee.
DAVID JOHNSTON Independent Director, Nationality: Canadian, Age: 64 President's office University of Waterloo 200 University Avenue West – Waterloo, Ontario N2L3J1 – Canada owns 3,336 shares	2001/2009	Abroad: President of the University of Waterloo (Canada), Director of CGI, MASCO, and the Sustainable Development Technology Foundation.
DANIEL LEBÈGUE Independent Director, Nationality: French, Age: 62 IFA (Institut Français des Administrateurs) 27, avenue de Friedland – 75008 Paris – France owns 500 shares	2003/2007	In France: Director of Scor, Technip, Crédit Agricole SA, member of the Supervisory Board of Areva, President of the Institut français des administrateurs "IFA"(Association), President of Transparency International (France) (Association) and of the IEP of Lyon.
PIERRE-LOUIS LIONS Independent Director, Nationality: French, Age: 49 Alcatel 54, rue de la Boétie – 75008 Paris – France owns 520 shares	1996/2009	In France: Professor at the Collège de France and the École polytechnique, President of the Scientific Board of EDF, and of the CEA-DAM and France Telecom, member of the Academy of Technologies, the Academy of Sciences*, the Mathematical Society of France. Consultant to EADS – Launch Vehicles, BNP Paribas and CALYON. Abroad: Director of Sark Fund, member of the American Mathematical Society and of the European Mathematical Society, the International Association in Mathematical Physics, the Istituto Lombardo, the Academia Europea and the Acad. Naz. Lincei.
THIERRY DE LOPPINOT Employee director, National: French, Age: 62 Alcatel 54, rue La Boétie – 75008 Paris – France owns 6,091 shares and 4,901 units in FCP 3A	1997/2006	In France: Legal council at Alcatel's head office, Chairman of the Supervisory Board of the Alcatel employee investment fund (FCP 3A), Chairman of Formalec.
PETER MIHATSCH, Independent Director, Nationality: German, Age: 65 Beethovenstrasse 5 - D – 71069 Sindelfingen – Germany owns 1,200 shares	2002/2008	Abroad: Chairman and member of the Supervisory Board of Giesecke and Devrient Munich, member of the Supervisory Board of Vodafone GmbH, Vodafone-Mobilfunk, ARCOR- Vodafone and Rheinmetal AG and non-executive Director of 3i p.l.c. London UK.

Name and business address	Appointed/ expiry of term*	Offices and duties held
BRUNO VAILLANT Employee director, Nationality: French, Age: 62 Alcatel Alenia Space - 26, avenue Champollion – BP 1187 31037 Toulouse – France owns 1,850 shares, 5,349 units in FCP 3A	1997/2006	In France: Engineer at Alcatel Alenia Space (Information Systems Department), member of the Supervisory Board of the Alcatel employee investment fund (FCP 3A), expert with the Toulouse Court of Appeals, Vice President of the Compagnie des experts-judiciaires with the Court of Appeal and the Toulouse Administrative Tribunal.
MARC VIÉNOT Independent Director, Nationality: French, Age: 77 Société Générale – Tour Société Générale – 92972 Paris La Défense Cedex – France owns 4,950 shares	1987/2007	In France: Honorary Chairman and Director of Société Générale, Director of Ciments Français, member of the Advisory Board of Aventis and Groupe Barrière, member of the Board of the Association française des entreprises privées. Abroad: Director of Société Générale Marocaine de Banque.

** Date of the General Meeting called to vote on reappointment.*

Expertise and experience of Members of the Board

SERGE TCHURUK	Graduate of the École polytechnique of Paris and the École nationale supérieure de l'armement, he began his career in the Mobil Group where he held several positions before took management positions in France and the USA (1964-1979). In 1979 he was Chairman of Mobil in Benelux. He worked in the international chemical and pharmaceuticals Group, Rhône Poulenc (1980-1986) and held several positions in the basic chemicals division before becoming Chief Executive of the company in 1983. He was involved in special chemical and petroleum activities (1986-1990). He was Chairman and Chief Executive Officer of Total, one of the world's leading petroleum companies (1990-1995). Since June 1995, he has been Chairman and Chief Executive Officer of Alcatel. Area of expertise: Industrial sector.
DANIEL BERNARD	A graduate of the École des Hautes Études Commerciales, he worked for Delcev industries (1969-1971), Socam Miniprix (1971-1975) and Ruche Picarde (1975-1980) and was Chief Executive of the Groupe Metro France (1981-1989), member of the Board and responsible for managing the commercial activities of Metro International AG (1989-1992), Chairman of the Board (1992-1998) and then Chairman and Chief Executive Officer (1998-2005) of Carrefour. Area of expertise: Industrial sector.
PHILIPPE BISSARA	Bachelor of law, a graduate of the Institut d'Études Politiques de Paris, former student at the École nationale des langues orientales vivantes and of the École nationale d'administration, (Jean-Jaurès promotion 1967-1969), he was a public prosecutor, second class (1969), first class (1970), legal advisor (1976) to the Conseil d'État, Deputy General Secretary of the Conseil d'État (1973-1976), financial and economic director of the Office national des forêts (1976), government commissioner with the litigation section of the Conseil d'État (1982-1985), Director of legal and fiscal services (1986-1994), then Secretary General (1995-1997) of Alcatel Alsthom Compagnie générale d'électricité, Chairman of the legal commission of the Conseil national du patronat français (CNPF) (1994-1997), Secretary general (1993) and then general representative of ANSA (National Association of Joint Stock Companies). Area of expertise: Law - Industrial sector.
W. FRANK BLOUNT	Master of science in Management at the Massachusetts Institute of Technology (MIT) and the Sloan School, management MBA at the University of Georgia and Bachelor of Science in Electrical Engineering at the Georgia Institute of Technology. Between 1986 and 1992, he was Chairman of AT&T Corp., in charge of the Group's network operations and communications products. He then became Chief Executive from 1992 to 1999 of Telstra Corporation in Australia. Director of FOXTEL Corp. (Australia) (1995-1999), of IBM-GSA Inc. (Australia) (1996-1999), of the Australian Coalition of Service Industries (1993-1999) and the Australian Business Higher Education Roundtable (1993-1999); he was also Chairman and Chief Executive Officer of Cypress Communications Inc. (2000-2002). Since 1991 he has been Chief Executive of the New American Schools Development Corporation at the request of President George Bush. Member of the first Advisory Board of China Telecom. Area of expertise: Industrial sector.
JOZEF CORNU	A doctor of electrical and mechanical engineering at the University of Louvain (Belgium) and a Ph.D at Carleton University (Canada), he was an engineer at the Brown Boveri research center in Baden (Switzerland) (1970-1973), Design Center Manager of Bell Telephone in Antwerp (Belgium) (1973-1983), Chief Executive of Mietec (Bell Telephone Group) (1983-1984), member of the Board and Chief Executive of Bell Telephone (1984-1987), Vice-President of the Public Networks Group (1987), member of the Board responsible for technical and industrial questions of Alcatel NV (1988-1995), Chairman of Alcatel Networks Systems (1990-1995), Director responsible for technical affairs of Groupe Alcatel Alsthom (1992), Chief Executive of Alcatel Telecom and a member of the Executive Committee of Alcatel Alsthom (1995) and then of the Alcatel Group. He then became advisor to the Chairman of Alcatel (1999-2004). Area of expertise: Industrial sector.
JEAN-PIERRE HALBRON	A former student at the École polytechnique, an engineer of the Corps des mines, graduate of the Institut français du pétrole, he was a non-executive engineer of the Corps des Mines (1963). Chief Executive (1968) then Chairman of the Board (1974-1982) of Compagnie Financière. Chairman and Chief Executive of the Compagnie générale du jouet (1969), Financial Director (1982-1985) and then Deputy Chief Executive (1986) of Groupe Rhône-Poulenc, Deputy Director and then Chief Executive (1987-1990) of CdF Chimie later to become Orkem, Chairman of La Grande Paroisse (1987-1990) and of Lorilleux International (1987-1990), Financial Director of the Total Group (1990-1991), Chairman of the financial investments holding company OFP (1990) and of the bank Wasserstein Perella France (1991-1995), Director of strategy and finance (1995-1997) and then Deputy Chief Executive (1997-1999), Chief Financial Officer (1997-2001) and Chief Executive (2000-2002) of Alcatel. Area of expertise: Industrial sector.
DAVID JOHNSTON	Professor of law, a graduate of the Universities of Harvard, Cambridge and Queen's, his specialities are stock market law, corporate law and information technology law. Author or co-author of many legal publications. Area of expertise: Universities.

DANIEL LEBÈGUE	Bachelor of law, a graduate of the Institut d'Études Politiques de Lyon and of the École Nationale d'Administration, (Jean-Jaurès promotion 1967-1969), he worked at the Ministry of Economy and Finance, as a civil administrator in the Treasury Department (1969-1973), financial attaché to the French Embassy in Japan (1974-1976), bureau chief of the balance of payments and foreign exchange in the Treasury Department (1976-1979), bureau chief of the Treasury (1979-1980), under-manager of the savings and Financial Markets Department (1980-1981), technical advisor responsible for economic and financial affairs in the cabinet of Pierre Mauroy (Prime Minister) (1981-1983), deputy director of central administration of the Ministry of Economy and Finance (1983-1984), Director of the Treasury (1984-1987), Chief Executive (1987-1996) then Vice-Chairman and advisor to the Chairman of the Banque Nationale de Paris (1996-1997), Chief Executive of the Caisse des dépôts et consignations (1997-2002), Chairman of the Institut du développement durable et des relations internationales (IDRI) (2002), Chairman of the Institut français des Administrateurs (2003). Chevalier in the Ordre National de la Légion d'Honneur and in the Ordre National du Mérite. Area of expertise: Banking, finance and insurance sector.
PIERRE-LOUIS LIONS	A graduate of the École Normale Supérieure and of the Pierre-et-Marie-Curie University and professor at the University Paris-Dauphine (1981-2002). Since 2002 he has been professor at the Collège de France and also since 1984, professor at the French École Polytechnique Mathématicien having received the Fields medal (Zurich 1994), he has also received many other prizes including those mentioned below. Prizes: Foundation Doistau-Blutet, Academy of science – Paris (1986), IBM – Paris (1987), Philip Morris for science– Paris, Prix Ampère, Academy of science, Prix Institut Europlace de Finance. Area of expertise: Applied mathematics and Science of Information.
THIERRY DE LOPPINOT	A doctor of law (1970) he was responsible for fixed asset questions in the Legal Department of La Compagnie Française de Raffinage (Total) (1972-1973), Head of the Rights Department of the Port Autonome de Rouen (1974-1975), member of the Legal Department of SEITA (1976-1984). Since November 1984, he has been legal counsel at the Alcatel head office. Area of expertise: Law - Industrial sector.
PETER MIHATSCH	A telecommunications engineer, he made his career in different groups including ITT in Germany before being taken on by Alcatel. In 1988, he joined Mannesman where he became a Board Director in 1994. He was Chairman of Mannesman Mobilfunk and held various positions on Supervisory Boards. In 1997, he was a member of the Supervisory Board of Giesecke und Devrient where he became Chairman in 1998. Area of expertise: Industrial sector.
BRUNO VAILLANT	A graduate of the École Nationale Supérieure d'Électronique, d'Informatique et d'Hydraulique of Toulouse, the holder of a university degree in management (1973) and a certificate of aptitude in company administration (1974). He was an engineer at Synelec (1970-1971), Manager of the Scientific IT Department of Valeo (1971-1984), engineer responsible for the Testing Department of Bendix Electronics (1984-1986), the engineer responsible for the Scientific Software Department (1986-2002) and then the engineer responsible for the Software Products and IT Legal Support Department of Alcatel Alenia Space (since 2002). Area of expertise: industrial sector.
MARC VIÉNOT	A graduate of the Institut d'Études Politiques de Paris and of École Nationale d'Administration (ENA) (Paul-Cambon promotion 1951-1953), he was Deputy Inspector of Finance (1953), Inspector of Finance (1956). Chargé de mission in the cabinet of Paul Ramadier (Minister of Economic and Financial Affairs, cabinet of Guy Mollet) (1957), then in the cabinet of Félix Gaillard (Ministry of Finance, cabinet of Bourgès-Maunoury) (1957). President of the council (1957-1958), Chargé de mission in the Treasury Department (1958), Chairman of the Economic Situations and Development Problems Examination Committee of the OECD (1961-1966), Secretary of the Board of the economic and social development fund (1962-1965), Deputy Director (1965) and then head (1967-1970) of the Treasury Department, Director of Snecma (1968-1970), of EDF (1968-1970), Minister plenipotentiary, financial advisor to the French Embassy in the United States and Canada (1970-1973), Director of the International Monetary Fund and World Bank (1970-1973), Chairman of Société Générale de banque in Spain, Director and Chairman of European Banks International Co., Director of Schneider Electric (1975-1994), of TF1 (1989-1995) and Vice-Chairman of the bureau of the French Banks Association, Deputy Chief Executive (1974), Chief Executive (1977-1986), Chairman and Chief Executive (1986-1997) and then honorary Chairman of Société Générale. Area of expertise: Banking - Finance sector.

Other directorships held by the members of the Board in the last five years

SERGE TCHURUK	Director of Alstom, Vivendi Universal, Société Générale and the Institut Pasteur*.
DANIEL BERNARD	Chairman and Chief Executive of Carrefour*, Director of Comptoirs Modernes, of Erteco, Managing Director of SISP*. Abroad: Director of Carrefour Commercio e Industria (Brazil) *, of Grandes Superficies de Colombia, of Carrefour Argentina*, of Centros Comerciales Carrefour (Spain)*, Vice Chairman of DIA SA* (Spain), of Finiper (Italy)*, of GS (Italy)*, of Presicarre (Taiwan)*, Director of Vicour (Hong Kong)*.
PHILIPPE BISSARA	General representative of ANSA, Deputy Secretary General of EALIC (European Association for Listed Companies). Director of Societé d'Oxygène et d'Acétylène d'Extrême Orient
W. FRANK BLOUNT	Chairman and Chief Executive of Cypress Communications Inc., Director of Alcatel USA Inc., of Global Light Communications – Canada, management consultant of AT Kearney Inc. – USA.
JOZEF CORNU	Chairman of the Board of Tijd NV*, Advisor to the Chairman of Alcatel, Chief Executive of the Alcatel Telecom sector. Abroad: Director of Keyware Technologies NV (Belgium), Xeikon (Belgium).
JEAN-PIERRE HALBRON	Director of Alstom, Chairman and Chief Executive Officer of Electro Banque. Abroad: Chairman of the Board of Alcatel USA Inc., of Alcatel Finance Inc., Director of Alcatel USA LP Inc., of Alcatel Finance Australia Ltd, of Alcatel USA Holdings Corp. (formerly Alcatel NA Inc.), Member of the Supervisory Board of Alcatel Deutschland GmbH.
DAVID JOHNSTON	Director of Open Text, of EMCO and of Lifestyle Furnishings.
DANIEL LEBÈGUE	Chairman of the Board of Compagnie financière Eulia, Director of Thales, of C3D, of Gaz de France, Chief Executive of Caisse des dépôts et consignations, Chairman of the Supervisory Board of CDC Ixis, member of the Supervisory Board of CNP and Caisse nationale des Caisses d'Epargne, of CDC Ixis Capital Market, Chairman of the Institut Théseus, Professor of the IEP of Paris and of the Institut Technique de Banque.
PIERRE-LOUIS LIONS	Professor at the University of Paris-Dauphine, Chairman of the INRIA Evaluation Committee*.
THIERRY DE LOPPINOT	Director of Société Immobilière Kléber-Lauriston (SIKL).
PETER MIHATSCH	Chairman of the Supervisory Board of Infineon – Germany. Member of the Supervisory Board of Daimler Chrysler Services, Director of Taurus Holding – Germany, of BT & T and of Ascom.
BRUNO VAILLANT	Treasurer of the Compagnie des experts-judiciaires at the Court of Appeal and of the Administrative Tribunal of Toulouse.
MARC VIÉNOT	Chairman of the Association Paris Europlace, Director of Vivendi Universal.

** Term of office expiring during 2005 and 2006.*

INTERNAL CONTROL

As required under Article L. 225-37 of the Commercial Code, the internal control procedures introduced by the company at Group level to meet the objectives it has set, the Group responsibilities and the standards followed are discussed in a report by the Chairman, which is outlined below.

The Chairman has tasked the Group's Financial Department and Internal Audit Department with preparing the two sections of this report, drafted in collaboration with the relevant departments. The Disclosure Committee and the Audit Committee received this report during their meeting of March 24, 2006.

The conditions for the preparation and organization of the Board's work are described in the section entitled "Corporate governance".

I - Overall internal control system

Objectives

Alcatel has an internal control system aimed at optimizing controls within the Group, while primarily ensuring that there are no significant items likely to call into question the reliability of the parent company and consolidated financial statements. One of the objects is to prevent and control any risks resulting from the company's operations and 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, Alcatel is organized into three business groups defined by market type. The Group owes its unity to coordination and control by Senior Management and Head Office functions, 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 has been applied by the Board, senior executives and employees, is designed to provide a reasonable assurance that the following objectives will be achieved:

- operations are completed in an optimal manner;
- financial data is reliable;
- the applicable laws and regulations are obeyed.

The system is based on three guiding principles:

- shared responsibility: internal control is based on the resources of every constituent unit and on the sense of responsibility of every employee, backed by a system of delegated responsibility, through which the Group's policies can be implemented in a consistent fashion. Each manager is responsible for efficiently overseeing the operations under his 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 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 ensures that there are 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 board members, all of whom are independent, checks in the presence of the Chief Financial Officer and Statutory Auditors, that internal procedures have been defined for collecting and controlling financial data to ensure that it is reliable. It regularly reviews the operation and organization of the Audit Department, the plan of its tasks and its main reports. This committee also reviews the risks to which the Group may be exposed and checks that these risks are monitored.

The Executive Committee

The composition of the Executive Committee reflects the grid structure of the Group. As at January 1, 2006, it consists of the Chairman and Chief Executive Officer and seven Executive Directors, the Deputy Chief Executive, the Chief Financial Officer, the President Europe and South, the President Mobile Communications, the President Private Communications, the Director of Human Resources and the President Asia-Pacific. The Committee is responsible for carrying out the strategic decisions taken by the Board, and defining and coordinating the Group's management policies. It checks on the achievement of the objectives reflecting its decisions on matters of operation and financial resource assignment. The Executive Committee meets regularly and at least one a month.

Ethics Committee and Director of Compliance and Ethics

The Ethics Committee has been set up to ensure that the code of conduct is observed, check that it is kept up-to-date and propose the action to be taken if a clear breach is brought to its attention. It consists of members of Senior Management and is chaired by a Board member. The Ethics Committee reports directly to the Chairman and Chief Executive Officer and may call in the Internal Audit Department.

A director of Compliance and Ethics, who is a member of the Ethics Committee and reports to the Chairman and Chief Executive Officer, was appointed on January 1, 2006. His job is to ensure that the Group's practises comply with international laws and regulations and with the rules of conduct in the matter of corporate governance and business ethics. He is setting up a world network of correspondents in the Group, developing training programs and advising directors on the specific questions that may arise.

The Internal Audit Department

The responsibilities of the Internal Audit Department are to assist Senior Management in assessing the efficiency of the risk management, auditing and corporate governance systems. The department has a staff of 50 auditors, and is centralized at Group level and reports directly to the Chairman and Chief Executive Officer. The internal audit 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 the ISO 9001:2000 certification obtained in 2001 and renewed in 2004 and by the "Commitment to Quality Improvement" prize awarded three times, in 1999, 2002 and 2005, by the Institute of Internal Auditors (IAA). In 2005, the Internal Audit Department also successfully ran an audit on compliance with the professional internal audit standards. This review attests to the fact that the management delivers its services in accordance with internationally recognized standards (IIA).

The Finance Department

Within the Finance Department, the Financial Control and Consolidation and Accounting Procedures Departments play an active role in the internal control system.

The Financial Control Department is in charge of preparing the budget, the monthly, quarterly and annual consolidated financial statements, and for the interim accounts. Working with the Operating and Financial Departments of the business divisions and 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 applicable accounting laws and standards 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 Legal Counsel, the Corporate Controller and the Director of Project Finance under the chairmanship of the Chief of Projects and Contracts. Its job 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, an Information Systems Department, responsible for application development and maintenance, an Operations Department, in charge of system and network operation, and three regional departments responsible for defining needs and ensuring that the Group's IT standards are being maintained.

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

Cutting-edge intrusion detection and protection technologies are used to maintain the security of the 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 Groups financial position. It also assists them in forming an opinion on the effectiveness of the internal control system and on its suitability to the organization of the Group.

The members of this committee include representatives of corporate functions, the Chief Financial Officer, the Legal Counsel, the Corporate Controller, the Director of Consolidation and Accounting Procedures, the Director of Financial Communications, the Tax Director who is also the secretary of the Audit Committee, the Head of Research and Technology and the Chief Internal Auditor who chairs the Meetings.

Charters and good business practice

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 Group's intranet.

Code of conduct

Published for the first time in 1997, this code 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 conflict 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 initiatives to strengthen the internal control procedures applicable to the selection of and relations with commercial representatives and agents and to further develop anti-corruption legislation training. The particular form that this action took was a specific "e-learning" module and a series of targeted presentations to sales executives.

The code of conduct, which applies to all Group employees, has been strongly communicated to all 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 conduct specifically designed for Group executives was introduced in early 2004. This code, which has been approved by the Audit Committee and submitted to the Board, defines the rules of good conduct for persons responsible for preparing and releasing 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 line 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 a manual of good practice for both internal auditors and operational management. It defines, for each of the company's business processes, the stakeholders, the data flows, the principal risks and the best practices for monitoring and controlling such risks.

II – Financial reporting system

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 are prepared under the responsibility of the Chief Financial Officer, and 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 standards became mandatory for annual financial statements published from January 1, 2005 since the Group's shares are listed in a country of the European Union. Alcatel, which publishes its financial statements on a quarterly basis, presented its consolidated financial statements for the first three quarters of 2005 according to the accounting and valuation principles of the IFRS standards.

In 2004, the Group took a number of actions to better prepare readers and preparers of the Group's financial statements for the impacts resulting from the changeover to IFRS. Internally, the Group implemented a large-scale training plan during 2004 for all people affected by this change in accounting standards. The financial reporting system used by the Group was also modified to adapt it to the specific IFRS requirements, and to ensure that the available information meets the disclosure requirements, particularly in the area of notes to the consolidated financial statements. In addition, the accounting procedures available on the Group's intranet site were updated to include the changes caused by the transition to the IFRS standards. The main impacts on the Group expected from applying the new standards have been addressed and are available in the 2004 reference document and on the Group's Internet web site.

In addition to updating the descriptive summary of the main impacts expected from the changeover to the new accounting standards, a special report was issued on March 29, 2005 giving the market the first IFRS-based figures.

A detailed report of the impacts of the transition to IFRS on the 2004 financial statements was published in the interim financial statements of the first three quarters 2005 and provided an update of the changes in terms of regulations and additional information obtained particularly from associate companies also making the change to IFRS.

The report describing the definitive impacts of the change of reporting standards on the 2004 financial statements is included in the notes to the consolidated financial statements as at December 31, 2005 (Note 38).

A particular effort has been made to explain the options adopted, where appropriate, in terms of interpretation or application of IFRS both internally (through the accounting procedures available on the Group's intranet site) and externally (through the appended notes), so that these new reporting standards are applied consistently within the Group and are transparent to the outside.

The existing system

The Finance Department is responsible for preparing the parent company and consolidated financial statements. These statements are used internally to monitor and analyze how the Group's businesses are performing. 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 Meetings, the principal financial data are reviewed and all sensitive subjects are openly examined. This process is set down in summary notes on the significant points; it is 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 parent company and consolidated financial statements and the compliance thereof with the Group's rules and procedures. This department is responsible for publishing the parent company and consolidated financial statements and for ensuring, at each period-end, that the statements comply with the standards applicable to listed companies.

The Finance Department is responsible for normal business transactions (sales, purchases, capital employed, cash flow, etc), preparing accounting estimates (goodwill impairment tests, etc) and processing specific transactions (finance transactions, changes in scope of consolidation, etc). The analysis carried out by the Financial Control 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), which are compared with the previous audit findings.

Internal audit tasks, directly or indirectly associated with financial reporting, are a significant part of the internal audit plan. The purpose of these tasks is to ensure that relevant controls exist and that they are working. 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 the Chairman and Chief Executive Officer and the Chief Financial Officer to make an annual assessment of the effectiveness of the internal controls and procedures pertaining to the preparation of financial and accounting data. These executives are required to attest to 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 the 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) chosen 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.

Since 2004, Alcatel has been dedicating the necessary resources to comply with Section 404 of the Sarbanes-Oxley Act. The approach was based on the 34 units considered to contribute the most to the preparation of financial and accounting information.

In response to the new requirements of the Financial Security Act, the procedure for describing controls concerning the preparation of financial and accounting data has been in place since 2003. This procedure is based on a self-assessment process that covers 89 units.

The self-assessment questionnaire includes 76 checkpoints, based on the five COSO guidelines:

- control environment: the control culture within the company;
- risk assessment: evaluation of the internal and external factors likely to affect the company's performance;
- control operations: the rules and procedures under which risk management actions established by senior management are applied;
- information and communication: the process whereby relevant data is identified and communicated in real time;
- management: a process designed to make certain that internal controls are adequately designed, effectively applied and relevant to the organization.

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

During every audit in the units concerned, the internal auditors assess the quality of the self-assessment process and 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 concerning the reliability of financial data are appropriate.

Backed by a strong internal audit culture, Alcatel plans to expand its procedures in response to the requirements of the new 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 the Group.

STATUTORY AUDITORS' REPORT

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 of the French Company Law (*Code de Commerce*) for the year ended December 31, 2005.

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 of the French Company Law (*Code de Commerce*).

Neuilly-sur-Seine, March 30, 2006

The Auditors

DELOITTE & ASSOCIES	BARBIER FRINAULT & AUTRES
	ERNST & YOUNG
Alain Pons Antoine de Riedmatten	Christian Chiarasini

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.

CONSOLIDATED FINANCIAL STATEMENTS

FINANCIAL REPORT

In application of article 28 of EC regulation N° 809/2004 dated April 29, 2004, the following information is included by reference in this reference document:

- the consolidated financial statements for the year ending December 31, 2004, the financial report and the report of the Statutory Auditors relating thereto from page 43 to 107 of the reference document filed with the AMF on April 1, 2005 under N° D.05-326 and on page 3-3 of the update filed on May 2, 2005 under N° D.05-326-A-01;
- the consolidated financial statements for the year ending December 31, 2003, the financial report and the report of the Statutory Auditors relating thereto appearing from page 21 to 79 and on page 80 of the reference document filed with the AMF on April 1, 2004 under N° D.04-379.

Because the Alcatel consolidated financial statements have been drawn up according to International Financial Reporting Standards (IFRS) in 2005 and to provide comparability of the financial statements, the income statements for 2004 have been restated according to the new reporting standards.

Introduction

After a turnaround year in 2004, 2005 confirmed the return to growth in the markets for communication equipment and solutions. So the Group's sales grew, based on identical IFRS international accounting standards and the same scope of consolidation, from €12,244 million in 2004 to €13,135 million in 2005, a 7% improvement slightly marred by a continuing weakness of the American dollar versus the euro. At a constant exchange rate, sales growth would have been 8%. The Group was able to maintain or increase its market shares in most of its lines of business. The operating margin was €1,189 million, or 9.1% of income. So Alcatel consolidated the benefits of the competitive measures taken on most of its product lines because the Group was successful in maintaining its operating margin in a highly competitive environment. Alcatel was profitable in all business segments in which it operates: fixed communications, mobile communications and private communications. The Group's net profit in 2005 of €930 million is 61% better than the previous year, or a net diluted income per share of €0.68 which includes gains on operating and financial assets of €0.17 per share. The €1.5 billion net cash position is stronger due to a free cash flow of more than €200 million generated during the year.

Consolidation and principal changes in structure

The principal changes that occurred during 2005 in the scope of consolidation are the result of the following events:

- on March 2, 2005, Alcatel announced the acquisition for USD 55 million of 100% of the capital of Native Networks, a supplier of operator class Ethernet optical transport solutions. The attribution of the purchase price has led to recognizing USD20 million of intangible fixed assets that can be amortized and USD38 million of goodwill, the net assets of this company being a negative USD3 million on the date of acquisition (of which USD0.3 million was cash and cash equivalents). The company's contribution to income for the year is insignificant;
- on May 17, 2005, Alcatel and TCL Corp. announced the end of their partnership in mobile telephones. Alcatel decided to swap its 45% stake in the joint venture for 4.8% of TCL Communication Holdings Ltd shares (shares listed on the Hong Kong stock market);
- On July 1, 2005, Alcatel and Finmeccanica announced the formation of the two jointly owned companies named when the memorendum of understanding was signed on June 18, 2004: Alcatel Alenia Space (67% owned by Alcatel and 33% by Finmeccanica) and Telespazio (67% owned by Finmeccanica and 33% owned by Alcatel). These two companies are proportionately consolidated from July 1, 2005. This transaction was analyzed by Alcatel as being the sale to Finmecanica of 33% of the manufacturing business and 67% of the services business of Alcatel Space and the purchase of 67% of Alenia Spazio (Finmeccanica's space manufacturing business) and 33% of Telespazio (Finmeccanica's space systems services business);
- The valuations used for this transaction are €1,530 million for Alenia Space and €215 million for Telespazio, causing Alcatel to book in 2005 a pre-tax disposal income of €129 million before tax and goodwill, not yet allocated, of €143 million. Alcatel received a net equalization payment of €109 million from Finmeccanica. The net cash from the incoming and outgoing businesses is €15 million on the transaction date. Proportionately consolidating the combined space activities of the two partners did not have a significant effect on Alcatel's revenues, operating margin and total balance sheet. It has the effect of booking a deferred tax charge of €38 million due to the removal from the French tax consolidation of the companies contributed to the joint ventures as part of the abovementioned grouping.

Accounting principles

Because it is listed in a European Union country and in line with CE regulation N° 1606/2002 of July 19, 2002, the Group's consolidated financial statements published for 2005 have been drawn up in line with IFRSs as adopted in the European Union. It includes the standards approved by the International Accounting Standards Board (IASB), that is the IFRS standards, the International Accounting Standards (IAS) and the interpretations emanating from the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Group's consolidated financial statements published before 2005 were drawn up according to French accounting standards, that is since January 1, 1999, in line with the accounting rules and methods for consolidated financial statements approved by the order of June 22, 1999 providing homologation of regulation 99-02 of France's *Comité de la Réglementation Comptable*.

Revenues

The Group's revenues were €13,135 million in 2005, an increase of 7% compared with €12,244 million in 2004.

By segment, revenues grew by 1.7% in fixed communications (€5,213 million in 2005 compared with €5,125 million in 2004), by 24% in mobile communications (€4,096 million in 2005 compared with €3,313 million in 2004) and revenues fell by 1% in private communications (€3,918 million in 2005 compared with €3,946 million in 2004). Other activities and inter-segment eliminations amounted to €92 million (€140 million in 2004).

In 2005, Western Europe accounted for 41% of revenues (42% in 2004), the rest of Europe 7% (7% in 2004), North America 14% (15% in 2004), Asia Pacific 15% (15% in 2004) and the rest of the world 23% (21% in 2004).

Operating margin

The Group's gross margin fell in 2005 relative to 2004, declining from 37.7% in 2004 to 35.3%. Research and development expenses amounted to €1,443 million in 2005 (€1,490 million in 2004), or 11% of income in 2005 (12% in 2004) reflecting the size of the financial effort being put into preparing for the Group's future. Administrative and sales expenses remained stable at €2,000 million in 2005 compared with €1,944 million in 2004. Combined with the improvement in gross margin, this effort helped to generate a positive Group operating margin of €1,189 million compared with €1,179 million in 2004.

The operating margins of each of the Group's business segments were positive: €579 million in fixed communications (€576 million in 2004), €436 million in mobile communications (€418 million in 2004) and €274 million in private communications (€267 million in 2004). Losses of the non-operating businesses rose to €100 million (a loss of €82 million in 2004).

Financial income (loss)

Net financial income (loss) was a charge of €50 million compared with a charge of €107 million in 2004. The change from one year to the next is partially due to the gains made in 2005 on the disposal of the Nexans and Mobilrom shares (for €69 and €45 million respectively) and a net negative impact of €22 million in 2005 for financial provisions compared with a positive impact of €32 million in 2004. This change is also due to the fall in the cost of finance (€96 million compared with €121 million in 2004) due to the reduction in the Group's gross financial debt, which fell from €4,606 million at December 31, 2004 to €3,798 million at December 31, 2005.

Net income from continuing operations

Net income from continuing operations showed a profit of €984 million (against a profit of €503 million in 2004) taking account mainly, in addition to the net financial charge described above, of the restructuring expenses of €110 million (€324 million in 2004), a net gain on disposal of consolidated shares of €129 million (€0 in 2004), a net tax expense of €91 million in 2005 (€36 million net expense in 2004), payments in shares of €69 million (€60 million in 2004) and expenses associated with the shares in the net income of companies accounted for by the equity method of €14 million in 2005 (€61 million in 2004).

Net income attributable to the equity holders of the parent

Net income attribuable to the equity holders of the parent was €930 million (against a profit of €576 million in 2004) after a net expense of discontinued operations of €13 million (compared with a net profit of €142 million in 2004).

Net income attributable to the equity holders of the parent per share

Diluted earnings per share were €0.68 (€0.42 in 2004).

Analysis by business segment

See the presentation of the business segments.

Cash flow

Funds generated from operations were positive at €984 million in 2005 (against €650 million in 2004) and consisted mainly of cash outflows associated with the major restructuring operations pursued by the Group.

The increase in working capital had a negative impact on the net cash flow from operations which stood at a negative €849 million (versus a positive €58 million in 2004). The net cash flow posted for investment activities was a negative €181 million in 2005 (a negative €114 million in 2004). This was marked in 2005 by a program of tangible asset disposals (€165 million was received in 2005 compared with €217 million in 2004), and also by a decrease in the amount of loans granted of €108 million in 2005 (€569 million in 2004). Finally, the cash flow from financing activities was a negative €887 million, due primarily to an €879 million repayment of gross debt (compared with a negative €1,251 million in 2004). Thus, cash and cash equivalents for the Group stood at €4,510 million at December 31, 2005 compared with €4,611 million at December 31, 2004.

Balance sheet

Total shareholders' equity amounted to €6,711 million at December 31, 2005 before appropriation of net income, compared with €5,293 million at December 31, 2004. Net operating working capital increased from €431 million at December 31, 2004 to €862 million at December 31, 2005. Net cash for the Group, the total of cash, cash equivalents and marketable securities less financial debt, gross, rose from €662 million in 2004 to €1,459 million at December 31, 2005.

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 and intellectual property expenditure;
- granting guarantees to 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 by the equity method are as follows:

• Thales (9.5%)

The Thales holding did not change during 2005. Alcatel retained its position as the largest private shareholder in Thales, with three directors on the Board.

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

• Draka Comteq BV (49.9%)

Following the agreement signed by Alcatel on July 2, 2004 with Draka Holding BV concerning the grouping of the two groups' optical fiber and communication cable activities, Draka Comteq BV was formed. Alcatel has a 49.9% stake in the company and it has been consolidated by the equity method since July 1, 2004.

Contractual and off-balance sheet commitments

Contractual off-balance sheet commitments relate to future payment obligations including simple lease agreements, firm orders to purchase fixed assets, interest on loans and other firm purchase orders. Minimum future payments for the coming years in respect of these commitments totaled €1,678 million, €423 million of which will fall due in less than one year.

In the context of its ongoing operations, the Group may make commitments guaranteeing the completion of contracts. The potential maximum amount of these commitments (excluding intra-group commitments, i.e. commitments made by the Group's holding companies in respect of their subsidiaries' contracts) amounted to €2,034 million at December 31, 2005. 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 €639 million at December 31, 2005.

In addition, Alcatel has specific commitments relating 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.

Customer concentration

No Alcatel customer accounted for more than 10% of sales in 2005. The biggest customer accounted for 6% of sales, the top five customers accounted for 18% and the top ten for 28% of Alcatel sales in 2005. 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 and Siemens. A very large number of other smaller companies also compete with Alcatel in one area or another.

In a situation of more solid growth of investment by operators and companies, 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 technology field and particularly in the migration of the operators' networks toward IP technology, new players can benefit from a technological breakthrough and rapidly gain market share.

Outlook

Alcatel anticipates that the carrier market will continue to grow in the mid single digit range for the full year 2006. The wireline market should accelerate with the deployment of IPTV services and the transformation of carrier networks towards IP. The wireless market growth rate will most probably slow down compared to last year, and will be focused on emerging market needs and new applications across all geographical regions. Rate of growth going into the year will depend on the regulatory outcome for fiber deployments, 3G deployments in China, and the take-up rate of IP carrier network transformation. Enterprise IP Telephony and vertical markets should also continue to present opportunities particularly in the Transport, Energy and Defence sectors.

Concerning Alcatel's business, the Group expects to see the good dynamics of year end 2005 to continue into the first quarter of 2006, with year over year revenue growth above 10%. Overall, with the currently limited visibility beyond mid-year, we expect a lower growth rate for the second half compared to the first half, but feel confident that our revenues should outpace the carrier market growth for the full year 2006.

In terms of full year operating profitability, Alcatel anticipates a slight improvement in the operating margin for full year 2006, taking into account continuing competitive pressure in some markets. We also expect to improve free cash flow for the full year.

Principal differences between the IFRS and American accounting principles

Because Alcatel lists its shares in the United States, the Group prepares its financial statements in accordance with United States Generally Accepted Accounting Principles (GAAP) and files a "Form-20F" with the Securities and Exchange Commission (SEC) showing the IFRS financial statements published in France and a statement reconciling net income and shareholders' equity prepared in accordance with IFRS reporting principles and the equivalent figures according to US accounting principles. 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 are the following:

Accounting for business combinations

Some acquisitions made by the Group (DSC, Genesys, Newbridge, Kymata, Telera, TiMetra) have been initially recorded at book value in the French financial statements in accordance with the pooling of interests method (Article 215 of regulation 99-02) and have not been restated as part of the transition to IFRSs in accordance with the first-time adoption rules defined in IFRS 1. Under US GAAP, these same transactions resulted in accounting for goodwill and goodwill impairment, whereas these items are charged to shareholders' equity under IFRSs.

Accounting for restructuring provisions

The American rules, and particularly the SFAS 146 standard applicable to restructuring plans initiated in 2003, result in new differences with IFRS principles. First, early retirement plans can be accrued under American accounting principles when the rights are granted to the employees, whereas in IFRS accounting principles they are accrued when announced. Secondly, for restructuring plans announced in 2004 and 2005, some may be accounted for under SFAS 146 only in 2005 and 2006 because the criteria for recognizing liabilities are more restrictive under American principles than under IFRS principles.

Capitalization of development expenses

The application of the principles specified by IAS 38 (Intangible assets) leads to capitalizing in IFRS financial statements all the development expenses satisfying certain criteria (clearly identified projects, individualized costs relating thereto and reliably monitored, technical feasibility, etc), whereas only development costs relating to software are capitalized in the American financial statements.

Hybrid financial instruments (Oceane and Orane)

Loans that are convertible (OCEANE) and repayable (ORANE) in shares issued by the Group in 2003 and 2002 respectively are called hybrid financial instruments comprising, according to IFRS principles, a debt component and a shareholders' equity component valued at the date on which the instruments are issued.

The ORANE is booked at its par issue value in other shareholders' equity according to American accounting principles and appears in shareholders' equity under IFRSs. The OCEANE is booked in borrowings according to American accounting principles and appears in the IFRS balance sheet partly as bonded debt and partly as shareholders' equity.

Provisions for pensions and retirement allowances

Provisions for retirement have different amounts in the IFRS and American financial statements. The main differences between the two standards are as follows: (i) the cumulative actuarial gains and losses at the date of the transition to IFRSs are charged to shareholders' equity, according to the option specified in IFRS 1, this charge being cancelled out in the American financial statements; (ii) a "minimum liability adjustment" is booked in the American financial statements where appropriate and (iii) application of specific IFRS rules of limitation of the booking of dedicated assets when the latter exceed the commitments.

Other principal restatements

Application of IFRS accounting principles leads to recording personnel expenses relating to the grant to employees of shares, options to subscribe or options to buy shares of the company for amounts different from those booked in the American financial statements.

Certain sale and leaseback transactions which took place during 2003 have been recorded under US 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 IFRS accounting principles, if the lease is an operating lease established under market conditions.

Changeover to IFRS

The impacts on the 2004 financial statements of the transition from French accounting principles to IFRS principles are detailed in Note 38 to the consolidated financial statements for 2005.

The main impacts are as follows:

Capitalization of development expenses

Research and development expenses were usually recorded as a charge in the Alcatel Group under French accounting principles except for certain software development expenses. The application of the principles specified by IAS 38 (Intangible assets) has led the Group to capitalize a portion of the development expenses, previously booked as a charge when they were committed. This adjustment has resulted in increasing the Group's intangible fixed assets and shareholders' equity in the opening IFRS balance sheet (at January 1, 2004) by a significant amount. Alcatel has put in place information systems by which to validate the eligibility of capitalizing development expenses. It has not however been possible to apply the IAS 38 standard totally retrospectively, because of a lack of comprehensive and reliable information. At a constant research effort, the application of the IAS 38 standard will have a positive but diminishing impact on net income due to an average residual amortization period of two to three years. The capitalization effect is shown on a separate line in the income statement in order to better isolate this effect of the build-up of capitalization of development expenses.

Bonds convertible and repayable in shares

The bonds that can be converted (OCEANE) and repaid (ORANE) in shares issued by the Group in 2002 and 2003 respectively are called hybrid financial instruments according to the IAS 32 and IAS 39 standards) containing a debt component and an equity component. The first-time adoption of IFRSs has had the effect of booking some or all of the book value of the loans at January 1, 2004 as equity. It will be remembered that ORANEs were booked, according to French accounting principles, as other shareholders' equity and OCEANEs as loans (bonded debt).

Goodwill and business combinations

Because the Group has decided to adopt the option offered by IFRS 1 not to restate business combinations that do not comply with the requirements of IFRS 3 prior to January 1 2004, the first-time adoption of IFRSs has not compromised the accounting methods used according to French accounting principles. On the other hand, application of IFRSs has resulted in no more amortization of goodwill which will in future be the subject of an annual impairment test.

Financial assets and hedging transactions

With respect to **financial assets** available for sale (according to the definition given in IAS 39), adopting IFRSs has had the effect of valuing these shares at their fair value in the balance sheet. Since these are listed shares, the restatement has involved booking as equity (with no impact on the income statement) the differential between the net book value and the market value in the event of an unrealized gain. Derivatives used for **hedging transactions** are now, according to the requirements of the IAS 39 standard on financial instruments, recorded at their fair value on the balance sheet. Interest rate derivatives are mostly fair value hedges and the variations in value with respect to these positions are to a large extent offset in income by the revaluation of the underlying debt. Exchange rate derivatives are also mostly used for cash flow or fair value hedges related to commercial bids whose changes in fair value are recognized diectly in the income statement.

Share-based payments (stock option plans)

The application of the IFRS 2 standard (Share-based payments) has the effect of changing the method of booking options to subscribe to or buy shares that the Group allocates to its employees. Only plans put out after November 2002 in which the rights were not acquired as at December 31, 2004 are restated. This therefore involves the 2003 and 2004 plans and those relating to business combinations that took place after November 2002 and for which there are subscription options where the rights were not acquired as at December 31, 2004. The impact on 2004 income restated according to IFRSs corresponds to the distribution of the fair value of the allocated options entering the scope of the IFRS 2 standard over the period of acquisition of the rights. This impact is isolated on a special line of the income statement.

Other impacts

The other main impacts relate to different methods of presenting the financial statements (balance sheet, income statement, variation of shareholders' equity and cash flow statement) according to the two standards. The main reclassifications caused by applying the IFRSs are: (i) presentation of the balance sheet according to a logic of maturity (current and noncurrent) that differs from the presentation according to the French accounting principles by nature and/or liquidity of the assets and liabilities; (ii) the disappearance in IFRSs standards of the concept of extraordinary income has the effect of reclassifying as operating income and/or financial income the income and expenses that were, under French principles, booked as other income and expenses (after operating income) and (iii) interest paid and received and taxes paid are isolated on separate lines of the cash flow statement and the cash flow variations relating to discontinued activities are not shown in the net variation of investment cash flow but on separate lines.

CONSOLIDATED INCOME STATEMENTS

(In millions of euros)	Notes	Q4 2005*	Q4 2004*	2005	2004
Revenues	(4) & (5)	4,094	3,806	13,135	12,244
Cost of sales		(2,668)	(2,445)	(8,503)	(7,631)
Gross profit		**1,426**	**1,361**	**4,632**	**4,613**
Administrative and selling expenses		(489)	(496)	(2,000)	(1,944)
Research and development expenses before capitalization of development expenses		*(417)*	*(428)*	*(1,544)*	*(1,620)*
Impact of capitalization of development expenses		*21*	*29*	*101*	*130*
Research and development costs	(6)	(396)	(399)	(1,443)	(1,490)
Operating profit (loss)	**(4)**	**541**	**466**	**1,189**	**1,179**
Share-based payments (stock option plans)	(23)	(14)	(18)	(69)	(60)
Restructuring costs	(27)	(63)	(173)	(110)	(324)
Impairment of capitalized development costs	(7)	-	(88)	-	(88)
Gain/(loss) on disposal of consolidated shares		-	-	129	-
Income (loss) from operating activities		**464**	**187**	**1,139**	**707**
Financial interest on gross financial debt		*(50)*	*(55)*	*(218)*	*(226)*
Financial interest on cash and cash equivalents		*30*	*28*	*122*	*105*
Finance costs	**(8)**	**(20)**	**(27)**	**(96)**	**(121)**
Other financial income (loss)	(8)	17	(26)	46	14
Share in net income (losses) of equity affiliates	(16)	-	(30)	(14)	(61)
Income (loss) before tax and discontinued operations		**461**	**104**	**1,075**	**539**
Income tax expense	(9)	(115)	(71)	(91)	(36)
Income (loss) from continuing operations		**346**	**33**	**984**	**503**
Income (loss) from discontinued operations	(10)	9	(6)	(13)	142
NET INCOME (LOSS)		**355**	**27**	**971**	**645**
attributable to:					
– equity holders of the parent		**344**	**7**	**930**	**576**
– minority interests		11	20	41	69
Net income (loss) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share	(11)	0.25	0.01	0.68	0.43
– diluted earnings per share	(11)	0.25	0.00	0.68	0.42
Net income (loss) (before discontinued operations) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share		0.25	0.01	0.69	0.32
– diluted earnings per share		0.25	0.00	0.69	0.31
Net income (loss) of discontinued operations per share (in euros)					
– basic earnings per share		0.00	0.00	(0.01)	0.11
– diluted earnings per share		0.00	0.00	(0.01)	0.11

** Unaudited.*

CONSOLIDATED BALANCE SHEETS

ASSETS

(In millions of euros)	Notes	December 31, 2005	December 31, 2004
Goodwill	(12)	3,772	3,774
Intangible assets, net	(13)	819	705
Goodwill and intangible assets, net		**4,591**	**4,479**
Property, plant and equipment, gross	(14)	4,557	4,674
Depreciation	(14)	(3,446)	(3,579)
Property, plant and equipment, net		**1,111**	**1,095**
Share in net assets of equity affiliates	(16)	606	604
Other non-current financial assets, net	(17)	306	554
Deferred tax assets	(9)	1,768	1,638
Prepaid pension costs	(25)	294	287
Other non-current assets	(21)	468	332
TOTAL NON-CURRENT ASSETS		**9,144**	**8,989**
Inventories and work in progress, net	(18) & (19)	1,438	1,273
Amounts due from customers on construction contracts	(18)	917	729
Trade receivables and related accounts, net	(18) & (20)	3,420	2,693
Advances and progress payments	(18)	124	90
Other current assets	(21)	827	1,418
Assets held for sale	(10)	50	196
Current income taxes		45	78
Marketable securities, net	(17) & (26)	640	552
Cash and cash equivalents	(26)	4,510	4,611
TOTAL CURRENT ASSETS		**11,971**	**11,640**
TOTAL ASSETS		**21,115**	**20,629**

LIABILITIES AND SHAREHOLDERS' EQUITY

(In millions of euros)	Notes	December 31, 2005	December 31, 2004
Capital stock (€2 nominal value: 1,428,541,640 ordinary shares issued at December 31, 2005 and 1,305,455,461 ordinary shares issued and 120,780,519 shares to be issued related to ORANE at December 31, 2004)	(23)	2,857	2,852
Additional paid-in capital		8,308	8,226
Less treasury stock at cost		(1,575)	(1,607)
Retained earnings, fair value and other reserves		(4,460)	(4,944)
Cumulative translation adjustments		174	(183)
Net income (loss) – attributable to the equity holders of the parent	(11) & (22)	930	576
Shareholders' equity – attributable to the equity holders of the parent	**(23)**	**6,234**	**4,920**
Minority interests	(23)	477	373
Total shareholders' equity	**(23) & (24)**	**6,711**	**5,293**
Pensions, retirement indemnities and other post-retirement benefits	(25)	1,461	1,459
Bonds and notes issued, long-term	(26)	2,393	3,089
Other long-term debt	(26)	359	402
Deferred tax liabilities	(9)	162	132
Other non-current liabilities	(21)	295	201
TOTAL NON-CURRENT LIABILITIES		**4,670**	**5,283**
Provisions	(27)	1,621	2,049
Current portion of long-term debt	(26)	1,046	1,115
Customers' deposits and advances	(18) & (29)	1,144	973
Amounts due to customers on construction contracts	(18)	138	133
Trade payables and related accounts	(18)	3,755	3,350
Liabilities related to disposal groups held for sale	(10)	-	97
Current income tax liabilities		99	179
Other current liabilities	(21)	1,931	2,157
TOTAL CURRENT LIABILITIES		**9,734**	**10,053**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**21,115**	**20,629**

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions of euros)	Notes	Q4 2005	2005	2004
Cash flows from operating activities				
Net income (loss) – attributable to the equity holders of the parent		344	930	576
Minority interests		11	41	69
Adjustments	(30)	165	13	5
Net cash provided (used) by operating activities before changes in working capital, interest and taxes	**(30)**	**520**	**984**	**650**
Net change in current assets and liabilities (excluding financing):				
– decrease (increase) in inventories and work in progress	(18)	357	(7)	(154)
– decrease (increase) in trade receivables and related accounts	(18)	(210)	(497)	(231)
– decrease (increase) in advances and progress payments	(18)	(14)	(31)	8
– increase (decrease) in trade payables and related accounts	(18)	241	180	90
– increase (decrease) in customers' deposits and advances	(18)	138	157	(127)
– other current assets and liabilities (excluding financing)		125	103	(139)
Cash provided (used) by operating activities before interest and taxes		**1,157**	**889**	**97**
– interest received		30	116	113
– interest paid		(47)	(143)	(175)
– taxes (paid)/received		(1)	(13)	23
Net cash provided (used) by operating activities		**1,139**	**849**	**58**
Cash flows from investing activities				
Proceeds from disposal of tangible and intangible assets		66	165	217
Capital expenditures	(13) & (14)	(200)	(638)	(579)
of which impact of capitalization of development costs	*(13)*	*(86)*	*(349)*	*(326)*
Decrease (increase) in loans and other non-current financial assets		(2)	108	569
Cash expenditures for acquisition of consolidated and non-consolidated companies		(7)	(68)	(120)
Cash proceeds from sale of previously consolidated and non-consolidated companies		47	282	64
(Increase) in marketable securities		(323)	(30)	(265)
Net cash provided (used) by investing activities		**(419)**	**(181)**	**(114)**
Cash flows from financing activities				
Issuance/(repayment) of short-term debt		43	(74)	(733)
Issuance of long-term debt	(26)	-	-	462
Repayment/repurchase of long-term debt	(26)	(20)	(805)	(983)
Proceeds from issuance of shares		3	13	12
Proceeds from disposal/(acquisition) of treasury stock		-	5	-
Dividends paid		(5)	(26)	(9)
Net cash provided (used) by financing activities		**21**	**(887)**	**(1,251)**
Cash provided (used) by operating activities of discontinued operations	(10)	(12)	(19)	(247)
Cash provided (used) by investing activities of discontinued operations	(10)	-	14	210
Cash provided (used) by financing activities of discontinued operations	(10)	-	-	(30)
Net effect of exchange rate changes		5	123	(50)
Net increase (decrease) in cash and cash equivalents		**734**	**(101)**	**(1,424)**
Cash and cash equivalents at beginning of period / year		**3,776**	**4,611**	**6,035**
Cash and cash equivalents at end of year		**4,510***	**4,510***	**4,611**

** This amount includes €337 million of cash and cash equivalents held in countries subject to exchange control restrictions. Such restrictions can limit the use of such cash and cash equivalents by other group subsidiaries.*

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In millions of euros)	Number of shares	Capital stock	Additional paid-in capital	Retained earnings	Fair value and other reserves	Treasury stock	Cumulative translation adjustments	Net income (loss)	Total attributable to the equity holders of the parent	Minority interests	Total
BALANCE AT JANUARY 1, 2004	**1,342,622,184**	**2,810**	**7,966**	**(4,951)**	**50**	**(1,730)**	**-**	**-**	**4,145**	**388**	**4,533**
Financial assets available for sale					32				32		32
Cumulative translation adjustments							(183)		(183)	(34)	(217)
Cash flow hedging									-		-
Other adjustments									-		-
Net income (loss) changes directly recognized in equity					**32**		**(183)**		**(151)**	**(34)**	**(185)**
Net income (loss)								576	576	69	645
Total of accounted expenses and revenues					**32**		**(183)**	**576**	**425**	**35**	**460**
Acquisition of Spatial Wireless	17,783,297	36	176						212		212
Other capital increases	3,258,280	6	20						26		26
Deferred share-based payments			60						60		60
Net change in treasury stock of shares owned by consolidated subsidiaries	2,310,066			(88)		123			35		35
Other adjustments			4	13					17	(50)	(33)
BALANCE AT DECEMBER 31, 2004 BEFORE APPROPRIATION	**1,365,973,827**	**2,852**	**8,226**	**(5,026)**	**82**	**(1,607)**	**(183)**	**576**	**4,920**	**373**	**5,293**
Appropriation of net income (loss)				576				(576)	-	-	-
BALANCE AT DECEMBER 31, 2004 AFTER APPROPRIATION		**2,852**	**8,226**	**(4,450)**	**82**	**(1,607)**	**(183)**	**-**	**4,920**	**373**	**5,293**
Financial assets available for sale					(69)				(69)		(69)
Cumulative translation adjustments							357		357	72	429
Cash flow hedging					2				2		2
Other adjustments				18					18	-	18
Net income (loss) changes directly recognized in equity				**18**	**(67)**		**357**		**308**	**72**	**380**
Net income (loss)								930	930	41	971
Total of accounted expenses and revenues				**18**	**(67)**		**357**	**930**	**1,238**	**113**	**1,351**
Other capital increases	2,305,660	5	13						18		18
Deferred share-based payments			69						69		69
Net change in treasury stock of shares owned by consolidated subsidiaries	1,341,444			(37)		32			(5)		(5)
Other adjustments				(6)					(6)	(9)	(15)
BALANCE AT DECEMBER 31, 2005 BEFORE APPROPRIATION	**1,369,620,931**	**2,857**	**8,308**	**(4,475)**	**15**	**(1,575)**	**174**	**930**	**6,234**	**477**	**6,711**
Proposed appropriation of net income (loss)				701				(930)	(229)		(229)
BALANCE AT DECEMBER 31, 2005 AFTER APPROPRIATION		**2,857**	**8,308**	**(3,774)**	**15**	**(1,575)**	**174**	**-**	**6,005**	**477**	**6,482**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Alcatel is a French public limited liability company that is subject to the French Commercial Code and to all the legal requirements governing commercial companies in France. Alcatel was incorporated on June 18, 1898 and will be dissolved on June 30, 2086, except if dissolved earlier or except if its life is prolonged. Alcatel's headquarters are situated at 54, rue la Boétie, 75008 Paris, France. Alcatel is listed principally on the Paris and New York stock exchanges.

The consolidated financial statements reflect the results and financial position of Alcatel and its subsidiaries (the "Group") as well as its investments in associates ("equity affiliates") and joint ventures. They are presented in Euros rounded to the nearest million.

The Group develops and integrates technologies, applications and services to offer innovative global communications solutions.

On February 1, 2006, the Board of Directors authorized for issue the consolidated financial statements at December 31, 2005. The consolidated financial statements will only be final once approved by the Annual Shareholders' Meeting.

Note 1

Summary of accounting policies

Due to the listing of Alcatel's securities on the Euronext Paris and in accordance with the European Union's regulation No. 1606/2002 of July 19, 2002, the 2005 consolidated financial statements of the Group are prepared in accordance with IFRSs (International Financial Reporting Standards), as adopted by the European Union. They include the standards approved by the International Accounting Standards Board ("IASB"), that is, IFRSs, International Accounting Standards ("IASs") and the accounting interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") or the former Standing Interpretations Committee ("SIC").

Between 1999 and 2004, the consolidated financial statements of the Group were prepared in accordance with French generally accepted accounting principles ("French GAAP") 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.

As a first-time adopter, Alcatel has followed IFRS 1 regulations governing the first-time adoption of IFRSs by companies. At the transition date (January 1, 2004), the following options were selected:

- business combinations that were completed before the transition date have not been restated;
- the accumulated total of translation adjustments at the transition date has been deemed to be zero;
- the accumulated unrecognized actuarial gains and losses at the transition date relating to pension and retirement obligations and other employee and post-employment benefit obligations have been recorded in shareholders' equity;
- property, plant and equipment has not been revalued;
- only stock options issued after November 7, 2002 and not fully vested at January 1, 2005 are accounted for in accordance with IFRS 2;
- all the Group's subsidiaries, equity affiliates and joint ventures adopted IFRSs at the same date as the parent company;
- all the requirements of IAS 32 "Financial Instruments: Disclosure and Presentation", IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" have been applied since January 1, 2004;
- early application, as from January 1, 2004, of interpretations IFRIC 4 "Determining whether an Arrangement contains a Lease" and IFRIC 6 "Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment".

Reconciliation schedules of the 2004 consolidated net income, consolidated statement of cash flows and consolidated shareholders' equity at both January 1, 2004 and December 31, 2004 between IFRSs and those prepared previously in accordance with French GAAP are presented in note 38. Accounting standards or amendments to accounting standards existing at December 31, 2005, whose effective date is on or after January 1, 2006, have not been applied.

All standards and interpretations applied by Alcatel in these consolidated financial statements are in compliance with both the European directives and the IFRSs adopted by the European Union.

As IFRSs evolved during 2005 and as certain restatements of the 2004 financial statements to IFRSs were only completed at the end of 2005, the audited opening balance sheet at January 1, 2004, from which the 2005 consolidated financial statements have been prepared, the quarterly, half-yearly and annual 2004 IFRS results and the balance sheet at December 31, 2004, presented hereafter, have been changed during 2005. The definitive figures relating to the 2004 quarters are given in note 37.

The nature of the changes made to the previously published figures for 2004 are described in the introduction to the reconciliation schedules between French GAAP and IFRSs (note 38). The changes made, both individually and in total, have only a marginal impact on the figures previously published.

a) Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention, with the exception of certain categories of assets and liabilities, in accordance with IFRSs. The categories concerned are detailed in the following notes.

b) 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 (investments in "associates" or equity affiliates) 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 that were completed before January 1, 2004, the transition date to IFRSs, have not been restated, as permitted by the optional exemption included in IFRS 1. Goodwill has therefore not been accounted for business combinations occurring prior to January 1, 2004, which were previously accounted for in accordance with article 215 of Regulation No. 99-02 of the "Comité de la Réglementation Comptable". According to this regulation, 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 policies, and the difference between this value and the acquisition cost of the shares is adjusted directly against shareholders' equity.

Business combinations after January 1, 2004: These business combinations are accounted for in accordance with the purchase method. Once control is obtained over a company, its assets, liabilities and contingent liabilities are measured at their fair value at the acquisition date in accordance with IFRS requirements. Any difference between the fair value and the carrying value is accounted for in the respective underlying asset or liability, including both the Group interest and minority interests. Any excess between the purchase price and the Group's share in the fair value of such net assets is recognized as goodwill (see intangible and tangible assets).

The accounting treatment of stock options of companies acquired in the context of a business combination is described in note 1w below.

d) Translation of financial statements denominated in foreign currencies

The balance sheets of consolidated subsidiaries having a functional currency different from the euro are translated into euros at the closing exchange rate (spot exchange rate at the balance sheet date), and their income statements and cash flow statements are translated at the average exchange rate. The resulting translation adjustments are included in shareholders' equity under the caption "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 closing exchange rate.

Regulations governing first-time adoption: In accordance with the option available under IFRS 1, the accumulated total of translation adjustments at the transition date has been deemed to be zero. This amount has been reversed against consolidated reserves, leaving the amount of shareholders' equity unchanged. Translation adjustments that predate the IFRS transition will therefore not be included when calculating gains or losses arising from the future disposal of consolidated subsidiaries or equity affiliates.

e) Translation of foreign currency transactions

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

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 caption "Cumulative translation adjustments" until the disposal of the investment. Refer to Note 1d above for information on the recognition of translation adjustments at the transition date.

In order for a currency derivative to be eligible for hedge accounting treatment (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 exposure to changes in fair value of their assets, liabilities or firm commitments. Cash flow hedges allow companies to protect themselves against exposure to changes in future cash flows (for example, 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 as follows:

- for derivatives treated as cash flow hedges, changes in their fair value are accounted for in shareholders' equity and then reclassified to income (cost of sales) when the hedged revenue is accounted for. The ineffective portion is recorded in other financial income (loss).
- For derivatives treated as fair value hedges, changes in their fair value are recorded in the income statement where they offset the changes in fair value of the hedged assets, liabilities and firm commitments.

In addition to derivatives used to hedge firm commitments documented as fair value hedges, from April 1, 2005 onwards, the Group has designated and documented highly probable future streams of revenue with respect to which the Group has entered into hedge transactions. The corresponding derivatives are accounted for in accordance with the requirements governing cash flow hedge accounting.

Derivatives related to commercial bids are not considered eligible for hedge accounting treatment and are accounted for as trading financial instruments. Changes in fair values of such instruments are included in the income statement in cost of sales (in the business segment "other").

Once a commercial contract is effective, the corresponding firm commitment is hedged with a derivative treated as a fair value hedge. Revenues made pursuant to such a contract are then accounted for, throughout the duration of the contract, using the spot rate prevailing on the date on which the contract was effective, 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 as an intangible asset when they strictly comply with the following criteria:

– the project is clearly defined, and the costs are separately identified and reliably measured;

– the technical feasibility of the project 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 their usefulness, in case of internal use, is demonstrated; and

– adequate resources are available to complete the project.

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

Specifically for software, useful life is determined as follows:

– in case of internal use: over its probable service lifetime,

– in case of external use: according to prospects for sale, rental or other forms of distribution.

The amortization of capitalized development costs begins as soon as the product in question is released.

Capitalized software development costs are those incurred during the programming, codification and testing phases. Costs incurred during the design and planning, product definition and product specification stages are accounted for as expenses.

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

With regard to business combinations, Alcatel allocates a portion of the purchase price to in-process research and development projects that may be significant. 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 consider 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 combinations 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, and 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 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.

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

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

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

g) Goodwill, intangible assets and property, plant and equipment

In accordance with IAS 16 "Property, Plant and Equipment" and with IAS 38 "Intangible Assets", only items whose cost can be reliably measured and for which future economic benefits are likely to flow to the Group are recognized as assets.

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 greater 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 is lower than the net carrying value, the difference between the two amounts is recorded as an impairment loss. Impairment losses for property, plant and equipment or intangible assets with finite useful lives can be reversed if the recoverable value becomes higher than the net carrying value (but not exceeding the loss initially recorded).

Goodwill

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

Each goodwill item is tested for impairment at least annually during the second quarter of the year. The impairment test methodology is based on a comparison between the recoverable amounts 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 was the Group's weighted average cost of capital of 10.8% for 2004 and 9.5% for 2005. These discount rates are after-tax rates applied to after-tax cash flows. The use of such rates results in recoverable values that are identical to those that would be obtained by using, as required by IAS 36, before-tax rates applied to before-tax cash flows. A single discount rate has been used on the basis that risks specific to certain products or markets have been reflected in determining the cash flows. 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 if events occur indicating a potential impairment. Goodwill impairment losses cannot be reversed.

Equity affiliate goodwill is included with the related investment in "share in net assets of equity affiliates". The requirements of IAS 39 are applied to determine whether any impairment loss must be recognized with respect to the net investment in equity affiliates. The impairment loss is calculated according to IAS 36 requirements.

Intangible assets

Intangible assets mainly include capitalized development costs and those assets acquired in business combinations, primarily software-related costs. Intangible assets are generally amortized on a straight-line basis over a 3 to 7 year period. However, software amortization methods can be adjusted to take into account how the product is marketed. Amortization and impairment losses are accounted for in the income statement under cost of sales, research and development 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 less accumulated depreciation expenses and any impairment losses. Depreciation expense 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 ownership of the asset to the Group (tenant) are capitalized.

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

Depreciation and impairment losses are accounted for in the income statement under cost of sales, research and development costs or administrative and selling expenses, depending on the nature of the asset.

h) Non-consolidated investments and other non-current financial assets

In accordance with IAS 39 "Financial Instruments: Recognition and Measurement", 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. Fair value changes are accounted for directly in shareholders' equity. When objective evidence of impairment of a financial asset exists (for instance, a significant or prolonged decline in the value of an asset), an irreversible impairment loss is recorded. This loss can only be released upon the sale of the securities concerned.

Loans are measured at amortized cost. Loans may suffer impairment losses if there is objective evidence of a loss in value. The impairment represented by the difference between net carrying amount and recoverable value is recognized in 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 quarter-end to detect any objective evidence of impairment. When this is the case, an impairment loss is recorded. Impairment losses on securities accounted for at quarter-ends are considered definitive and are not reversed before disposal of the securities.

i) Inventories and work in progress

Inventories and work in progress 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 expected selling costs.

j) Treasury stock

Treasury shares owned by Alcatel or its subsidiaries are valued at their cost price and are deducted from shareholders' equity. Proceeds from the sale of such shares are included directly in 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.

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 is made. Provisions for defined benefit plans and other long-term employee benefits are determined as follows:

- using the Projected Unit Credit Method (with projected final salary), each period of service gives rise to an additional unit of benefit entitlement and each unit is measured separately to calculate the final obligation. Actuarial assumptions such as mortality rates, rates of employee turnover and projection of future salary levels are used to calculate the obligation;
- using the "corridor" method, only actuarial gains and losses in excess of either 10% of the present value of the defined benefit obligation or 10% of the fair value of any plan assets, whichever is greater, are recognized over the expected average remaining working lives of the employees participating in the plan.

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

Regulations governing first-time adoption

In accordance with the option available under IFRS 1, the accumulated unrecognized actuarial gains and losses at the transition date have been recorded in shareholders' equity. The corridor method has been applied starting January 1, 2004.

Certain other post-employment benefits such as life insurance and health insurance (particularly in the United States) or long-service medals (bonuses awarded to employees for long service particularly in French and German companies), are also recognized as provisions, which are determined by means of an actuarial calculation similar to the one used for retirement provisions.

The accounting treatment used for employee stock options is detailed in note 1w below.

l) Provisions for restructuring and restructuring costs

Provisions for restructuring costs are made when restructuring programs have been finalized and approved by Group management and have been announced before the balance sheet date (December 31) 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, costs for notice periods not worked, training costs of terminated employees, and other costs linked to the closure of facilities. Other costs (removal costs, training costs of transferred employees, etc.) and write-offs of fixed assets, inventories and work in progress and other assets, directly linked to restructuring measures, are also accounted for in restructuring costs.

The amounts reserved for anticipated 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 on the present value of the payments is included in other financial income (loss).

m) Financial debt – compound financial instruments

Some financial instruments contain both a liability and an 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", bonds that can be converted into or exchanged for new or existing shares) and in 2002 ("ORANE – Obligation Remboursable en Actions Nouvelles ou Existantes", notes mandatorily redeemable for new or existing shares). The different 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 on the issuance date at present value (taking into account the credit risk at issuance date) of the future cash flows (including interest and repayment of the nominal value) of a bond with the same characteristics (maturity, cash flows) but without any equity component. The portion included in shareholders' equity results from the difference between the debt issue amount and the financial liability component.

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 in tax rates are recorded in shareholder's equity or in net income (loss) for 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 deferred tax assets, the following factors are taken into account:

- forecasts of future tax results;
- the impact of non-recurring costs included in income or loss in recent years that are not expected to be repeated in the future;
- historical data concerning recent years' tax results; and
- if required, tax planning strategy, such as the planned disposal of undervalued assets.

o) Revenues

Revenues include net sales and service revenues from the Group's principal business activities, net of value added taxes (VAT), income due from licensing fees and from income grants, net of VAT.

Revenue is recognized when the company has transferred the significant risks and rewards of ownership of a product to the buyer.

Revenue is measured at the fair value of the consideration received or to be received. Where a deferred payment has a significant impact on the calculation of fair value, it is accounted for by discounting future payments. Product rebates or quantity discounts are deducted from revenues with the exception of promotional activities giving rise to free products, which are accounted for in cost of sales and provided for in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", or IAS 11 "Construction Contracts".

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. For arrangements where the customer specifies formal 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 network build-outs 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 in cost of sales. If uncertainty exists regarding 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. Under IAS 11, changes in provisions for penalties for delayed delivery or poor contract execution are reported in revenues and not in cost of sales.

Advance payments received on construction contracts, before corresponding work has been carried out, are recorded in customers' deposits and advances. Costs incurred to date plus recognized profits less the sum of recognized losses (in the case of provisions for contract losses) and progress billings, are determined on a contract-by-contract basis. If the amount is positive, it is included as an asset under "amount due from customers on construction contracts". If the amount is negative, it is included as a liability under "amount due to customers on 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 above. 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 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 and research and development costs (see note 1f) and, in particular, pension costs (except for the financial component, see note 1k), employee profit sharing, fair value changes of derivative instruments related to commercial bids and capital gains (losses) from the disposal of intangible assets and property, plant and equipment. Income (loss) from operating activities includes operating profit (loss), restructuring costs (see note 1l), share-based payments (stock option plans and stock purchase plans), capital gains (losses) from the disposal of shares in consolidated or proportionately consolidated subsidiaries (not eligible to be accounted for as a discontinued operation under IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations") and all other elements of operating activity whose inclusion in the operating profit (loss) would hamper an understanding of the Group's operating performance (notably for the case of impairment of development costs capitalized in 2004). Income (loss) from operating activities is calculated before financial income (loss), which includes the financial component of retirement expenses, financing costs and capital gains (losses) from disposal of financial assets (shares in a non-consolidated company or company consolidated under the equity method and other non-current financial assets, net), and before income tax, share in net income (losses) of equity affiliates and income (loss) from discontinued operations.

q) Finance costs

This item includes interest charges and interest income relating to net consolidated debt, which consists of bonds, the liability component of compound financial instruments such as OCEANE, other long-term debt (including lease-financing liabilities), and all cash assimilated items (cash, cash equivalents and marketable securities).

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset are capitalized as part of the cost of that asset.

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 trade receivables and related accounts) and current liabilities (provisions, customers' deposits and advances, trade payables and related accounts) without distinction between the amounts due within one year and those due after one year.

s) Financial instruments and derecognition 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 measured 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 are offset by equivalent changes in the interest rate swaps for the effective part of the hedge.

Derecognition of financial assets

A financial asset as defined under IAS 32 "Financial Instruments: Disclosure and Presentation" is either totally or partially derecognized (removed from the balance sheet) 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 payment default by the debtor is regarded as a transfer of substantially all risks and rewards of ownership, thus making such receivables eligible for derecognition, on the basis that risk of late payment is considered marginal. A more restrictive interpretation of the concept of "substantial transfer of risks and rewards" could put into question the accounting treatment that has been adopted.

The amount of receivables sold without recourse is given in note 18.

t) Cash and cash equivalents

In accordance with IAS 7 "Cash Flow Statements", cash and cash equivalents in the consolidated statements of cash flows includes cash (cash funds and term deposits) and cash equivalents (short-term investments that are very liquid and readily convertible to known amounts of cash and are only subject to negligible changes of value). Cash and cash equivalents in the statement of cash flows does not include investments in listed securities, investments with an initial maturity date exceeding three months and 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 are considered as financing and are also excluded from cash and cash equivalents.

Cash and cash equivalents in the balance sheet correspond to the cash and cash equivalents defined above.

u) Marketable securities

In accordance with IAS 39 "Financial Instruments: Recognition and Measurement", marketable securities are valued at their fair value. No securities are classified as "held-to-maturity". For securities classified as financial assets at fair value through profit or loss, changes in fair value are recorded in the income statement (in other financial income (loss)). For available-for-sale securities, changes in fair value are recorded in shareholders' equity, or in the income statement (other financial income (loss)), if there is objective evidence of a more than temporary decline in the fair value, or in connection with a disposal of such 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 statement of cash flows.

The second category of financing is accounted for in other non-current financial assets, net. Changes in net loans receivable are included in cash flows from investing activities (decrease/increase in loans and other non-current financial assets) in the consolidated statement 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 grant date. It is accounted for in additional paid-in capital (credit) at grant date, with a counterpart in deferred compensation (debit) (also included in additional paid-in capital). During the vesting period, deferred compensation is amortized in the income statement (in the caption "share-based payments").

Stock option fair value is calculated using the Cox-Ross-Rubinstein binomial model. This model 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 interest rate on risk-free securities, 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 according to IFRS 2.

The impact of applying IFRS 2 on net income (loss) is accounted for in share-based payments (stock option plans) in the income statement.

Outstanding stock options at the acquisition date of a company acquired in a business combination are usually converted into options to purchase Alcatel shares using the same exchange ratio as for the acquired shares of the target company. In accordance with IFRS 3 "Business Combinations" and IFRS 2 "Share-based Payment" requirements, the fair value of stock options acquired at the time of acquisition is accounted for in the caption "additional paid-in capital". Unvested options at the acquisition date are accounted for at their fair value as deferred compensation in shareholders' equity (included in additional paid-in capital). The counter value of these two amounts, 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 acquisition date are accounted for as described above.

x) Assets held for sale and discontinued operations

A non-current asset or disposal group (group of assets or a cash generating unit) is considered as held for sale if its carrying amount will be recovered through a sale transaction rather than through continuing use. For this to be the case, the asset must be available for sale and its sale must be highly probable. These assets or disposal groups classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

A discontinued operation is a separate major line of business or geographical area of operations for the Group that is either being sold or is being held for sale. The net income (loss), balance sheet and statement of cash flow elements relating to such discontinued operations are presented in specific captions in the consolidated financial statements for all periods presented.

y) Accounting standards and interpretations that have been published but are not yet effective

The IFRS accounting standards and interpretations that have been issued and are not yet effective, but which have been applied earlier than the effective date, are detailed in the introductory paragraph to this note 1 – Accounting policies.

Other IFRS accounting standards and interpretations have been issued by the approval date of these financial statements that are not yet effective and for which the Group has not elected early application. Those standards and interpretations that are likely to affect the Group are as follows:

- amendment to IAS 19 "Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures", effective for annual periods beginning on or after January 1, 2006;
- amendment to IAS 39 "Financial Instruments: Recognition and Measurement – The Fair Value Option", effective for annual periods beginning on or after January 1, 2006;
- IFRS 7 "Financial Instruments – Disclosures", effective for annual periods beginning on or after January 1, 2007; and
- IFRIC 8 "Scope of IFRS 2", effective for annual periods beginning on or after May 1, 2006.

The Group is currently assessing the potential impacts that application of these standards and interpretations will have on consolidated net income (loss), financial position, changes in cash and cash equivalents and notes to the consolidated financial statements. At this stage, we do not currently anticipate any significant impact for the Group.

Note 2

Principal uncertainties regarding the use of estimates

The preparation of consolidated financial statements in accordance with IFRSs (International Financial Reporting Standards) implies that the Group makes a certain number of estimates and assumptions that are considered realistic and reasonable. However, subsequent facts and circumstances could lead to changes in these estimates or assumptions, which would affect the value of the Group's assets, liabilities, shareholders' equity and net income (loss).

a) Valuation allowance for inventories and work in progress

Inventories and work in progress are measured at the lower of cost or net realizable value. Valuation allowances for inventories and work in progress are calculated based on an analysis of foreseeable changes in demand, technology or the market, in order to determine obsolete or excess inventories and work in progress.

The valuation allowances are accounted for in cost of sales or in restructuring costs depending on the nature of the amounts concerned.

Significant provisions for write-down of inventories and work in progress were accounted for in the past because of difficult market conditions and the abandonment of certain product lines. The impact of these provisions on our income before tax is a net charge of €18 million in 2005 (a net gain of €20 million in 2004).

Because of the revival in the telecommunications market, our future results could continue to be positively impacted by the reversal of provisions previously made.

b) Impairment of customer receivables and loans

An impairment loss is recorded for customer receivables and loans if the present value of the future receipts is below the nominal value. The amount of the impairment loss reflects both the customers' ability to honor their debts and the age of the debts in question. A higher default rate than estimated or the deterioration of our major customers' creditworthiness could have an adverse impact on our future results. Impairment losses on customer receivables were €228 million at December 31, 2005 (€284 million at December 31, 2004). The impact of impairment losses for customer receivables and loans on income before tax is a net gain of €19 million in 2005 (a net gain of €43 million in 2004).

Impairment losses on customer loans and other financial assets (assets essentially relating to customer financing arrangements) were €897 million at December 31, 2005 (€908 million at December 31, 2004). The impact of these impairment losses on income before tax is a net gain of €25 million in 2005 (a net gain of €77 million in 2004).

c) Capitalized development costs, goodwill and other intangible assets

The criteria for capitalizing development costs are set out in note 1f. Once capitalized, these costs are amortized over the estimated lives of the products concerned.

The Group must therefore evaluate the commercial and technical feasibility of these projects and estimate the useful lives of the products resulting from the projects. Should a product fail to substantiate these assumptions, the Group may be required to impair or write off some of the capitalized development costs in the future.

The Group also has intangible assets acquired for cash or through business combinations and the goodwill resulting from such combinations.

As indicated in note 1g, in addition to the annual goodwill impairment tests, timely impairment tests are carried out in the event of indications of reduction in value of intangible assets held. Possible impairments are based on discounted future cash flows and/or fair values of the assets concerned. A change in the market conditions or the cash flows initially estimated can therefore lead to a review and a change in the impairment loss previously recorded.

Net goodwill is €3,772 million at December 31, 2005 (€3,774 million at December 31, 2004). Other intangible assets, net were €819 million at December 31, 2005 (€705 million at December 31, 2004).

d) Impairment of property, plant and equipment

In accordance with IAS 36 "Impairment of Assets", when events or changes in market conditions indicate that tangible or intangible assets may be impaired, such assets are reviewed in detail to determine whether their carrying value is lower than their recoverable value, which could lead to recording an impairment loss (recoverable value is the higher of its value in use and its fair value less costs to sell) (see note 1 g). Value in use is estimated by calculating the present value of the future cash flows expected to be derived from the asset. Fair value less costs to sell is based on the most reliable information available (market statistics, recent transactions, etc.).

The planned closing of certain facilities, additional reductions in personnel and reductions in market outlooks have been considered impairment triggering events in prior years. No significant impairment losses were recorded in 2005 and 2004.

When determining recoverable value of property, plant and equipment, assumptions and estimates are made, based primarily on market outlooks, obsolescence and sale or liquidation disposal values. Any change in these assumptions can have a significant effect on the recoverable amount and could lead to a revision of recorded impairment losses.

e) Provision for warranty costs and other contractual obligations

Provisions are recorded for warranties given to customers on our products or for expected losses and for penalties incurred in the event of failure to meet contractual obligations on construction contracts. These provisions are calculated based on historical return rates and warranty costs expensed as well as on estimates. These provisions and subsequent changes to the provisions are recorded in cost of sales either when revenue is recognized (provision for customer warranties) or, for construction contracts, when revenue and expenses are recognized by reference to the stage of completion of the contract activity. Costs and penalties that will be effectively paid can differ considerably from the amounts initially reserved and could therefore have a significant impact on future results.

Provisions for contractual obligations represent €753 million at December 31, 2005, of which €173 million relate to construction contracts (see note 18) (€933 million and €271 million respectively at December 31, 2004). For further information on the impact on net income (loss) of the change in these provisions, see notes 18 and 27.

f) Deferred taxes

Deferred tax assets relate primarily to tax loss carry forwards and to deductible temporary differences between reported amounts and the taxes bases of assets and liabilities. The assets relating to the tax loss carry forwards are recognized if it is probable that the Group will dispose of future taxable profits against which these tax losses can be set off.

At December 31, 2005, deferred tax assets were €1,606 million (of which €850 million relate to the United States and €369 million to France). Evaluation of the Group's capacity to utilize tax loss carry forwards relies on significant judgment. The Group analyzes the positive and negative elements to conclude as to the probability of utilization in the future of these tax loss carry forwards, which also consider the factors indicated in note 1 n. This analysis is carried out regularly in each tax jurisdiction where significant deferred tax assets are recorded.

If future taxable results are considerably different from those forecast that support recording deferred tax assets, the Group will be obliged to revise downwards or upwards the amount of the deferred tax assets, which would have a significant impact on our balance sheet and net income (loss).

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

As indicated in note 1k, the Group participates in defined contribution and defined benefit plans for employees. Furthermore, certain other post-employment benefits, such as life insurance and health insurance (mainly in the United States), are also reserved. All these obligations are measured based on actuarial calculations relying upon assumptions, such as the discount rate, return on plan assets, future salary increases, employee turnover and mortality tables.

These assumptions are generally updated annually. The assumptions adopted for 2005 and how they have been determined are detailed in note 25. Using the "corridor" method, 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 are recognized over the expected average remaining working lives of the employees participating in the plan. In accordance with the option available under IFRS 1, cumulative actuarial gains and losses at the transition date have been recognized in shareholders' equity. The corridor method is therefore only applied as from January 1, 2004.

The Group considers that the actuarial assumptions used are appropriate and supportable but changes that will be made to them in the future could however have a significant impact on the amount of such obligations and the Group's net income (loss). An increase of 0.5% in the discount rate at December 31, 2004 (or a reduction of 0.5%) has a positive impact on 2005 net income of €8 million (or a negative impact of €8 million on net income). An increase of 0.5% in the assumed rate of return on plan assets for 2005 (or a reduction of 0.5%) has a positive impact on 2005 net income of €11 million (or a negative impact of €11 million on net income).

h) Revenue recognition

As indicated in note 1 o, revenue is measured at the fair value of the consideration received or to be received when the company has transferred the significant risks and rewards of ownership of a product to the buyer.

For revenues and expenses generated from construction contracts, the Group applies the percentage of completion method of accounting, provided certain specified conditions are met, based either on the achievement of contractually defined milestones or on costs incurred compared with total estimated costs. The determination of the stage of completion and the revenues to be recognized rely on numerous estimations based on costs incurred and acquired experience. Adjustments of initial estimates can however occur throughout the life of the contract, which can have significant impacts on future net income (loss).

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 to determine the fair value of the various elements of the arrangement. Determination of the fair value of the various elements of the arrangement relies also on estimates, which if they would have to be corrected, would have an impact on revenues and net income (loss).

For product sales made through distributors, product returns that are estimated according to contractual obligations and past sales statistics are recognized as a reduction of sales. Again, if the actual product returns were considerably different from those estimated, the resulting impact on the income statement could be significant.

In the context of the present telecommunications market, it can be difficult to evaluate the Group's capacity to recover receivables. Such evaluation is based on the customers' credit worthiness and on the Group's capacity to sell such receivables without recourse. If, subsequent to revenue recognition, the recoverability of a receivable that had been initially considered as likely becomes doubtful, a provision for an impairment loss is then recorded (see note 2b above).

Note 3

Changes in consolidated companies

The main changes in consolidated companies for 2005 were as follows:

- On March 2, 2005, Alcatel announced the acquisition of 100% of Native Networks, a provider of carrier-class optical Ethernet transport solutions, for a purchase price of USD 55 million. The purchase price was allocated USD 20 million to depreciable intangible assets and USD 38 million to goodwill (the net assets of this company being negative USD 3 million at the acquisition date). The contribution from this company had no impact on Alcatel's 2005 income.
- On May 17, 2005, TCL Corp. and Alcatel announced the end of their handset partnership. Alcatel agreed to swap its 45% stake in the joint venture for TCL Communication Holdings Ltd shares (these shares are listed on the Hong Kong market).
- On July 1, 2005, Alcatel and Finmeccanica announced the successful creation of two joint ventures that had been described in a memorandum of understanding signed by the parties on June 18, 2004: Alcatel Alenia Space (Alcatel holds 67% and Finmeccanica 33%) and Telespazio Holding (Finmeccanica holds 67% and Alcatel 33%). These joint ventures are consolidated using the proportionate consolidation method starting July 1, 2005.

  Alcatel analyzes this transaction as a sale to Finmeccanica of 33% of Alcatel Space's satellite industrial activity and 67% of its service activity and as an acquisition of 67% of Alenia Spazio (the industrial space systems of Finmeccanica) and of 33% of Telespazio (service activities for Finmeccanica's space systems).

  The values assigned to this transaction are €1,530 million for Alenia Space and €215 million for Telespazio, resulting in a gain to Alcatel on the sale before tax of €129 million in 2005 and in goodwill not yet allocated of €143 million. Alcatel received from Finmeccanica an equalization payment of €109 million. Net cash resulting from the activities acquired and disposed of is €15 million at the transaction date.

  Proportionately consolidating the combined space activities of the two partners did not have a significant impact on Alcatel's revenues, operating margin and total balance sheet. However, this consolidation method resulted in recognizing a deferred tax charge of €38 million due to the removal from the French tax consolidation of the companies transferred to the joint ventures in the context of the transaction described above.

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 gain on disposal amounted to €256 million and was recorded in 2004 under the caption "income (loss) from discontinued operations" (see note 10).
- 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 was 55% owned by TCL and 45% owned by Alcatel. It was consolidated under the equity method in Alcatel's accounts from September 1, 2004. The mobile phone business has been accounted for as a discontinued operation as from January 1, 2004 (see note 10). The gain on disposal was recorded in 2004 under the caption "income (loss) from discontinued operations" (see note 10).
- 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 discontinued operation as of and after January 1, 2004 (see note 10). 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 the sale and an estimated share in the net result of Draka Comteq BV were taken into account in the income statement at December 31, 2004. The definitive financial statements of Draka Comteq BV were received during the second quarter of 2005 and the gain/loss was adjusted accordingly.
- 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 required approvals from the regulatory authorities, which were obtained in 2005.
- 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 purchase 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 in €3.4 million of cash. The goodwill acquired in this business combination is €16 million, after recognizing €8 million of depreciable intangible assets and €2 million of other net acquired liabilities (including approximately €1 million of cash). The contribution from this company had no impact on Alcatel's 2004 income.
- 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 took place on January 25, 2005. The results of this business were recorded as a discontinued operation in 2004 (see note 10). The gain/loss on disposal of the shares was recorded in discontinued operations in the first six months 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 sale of its investment 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 in other non-current financial assets and no longer in share in net assets of equity affiliates.
- 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 of Spatial Wireless shares were acquired for 17.4 million Alcatel's ADSs, representing a purchase price of €207 million. The total cost of this acquisition is €223 million, after recognizing costs of acquisition and the fair value of equity instruments granted to Spatial Wireless employees in return for services rendered. The goodwill acquired in this business combination is €175 million, after recognizing €62 million of depreciable intangible assets and €14 million of other net acquired liabilities (including approximately €2 million of cash). The contribution from this company had no impact on Alcatel's 2004 income.

The financial impacts of other business combinations not referred to above are insignificant, either individually or in the aggregate.

Note 4
Information by business segment and by geographical segment

The tables below present information for the business segments described hereunder.

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.

All inter-segment commercial relations are conducted on an arm's length basis on terms and conditions identical to those prevailing for the supply of goods and services to third parties.

The performance measure of each business segment is based on the "operating profit (loss)".

The business segments presented are identical to those appearing in the information given to the Board of Directors. At December 31, 2005, no individual business division making up the business segments represents more than 10% of Alcatel's revenues, operating profit (loss) and total assets.

a) Information by business segment

(In millions of euros)

2005	Fixed Communications	Mobile Communications	Private Communications	Other	Eliminations	Total Group
Revenues:						
– segments	5,213	4,096	3,918	3	(95)	13,135
– between segments	(15)	(7)	(73)	-	95	-
TOTAL - REVENUES	**5,198**	**4,089**	**3,845**	**3**	**-**	**13,135**
Operating profit (loss)	579	436	274	(100)	-	1,189
Depreciation and amortization (tangible and intangible assets)	137	213	150	81	-	581
Provisions made (reversed) included in operating profit (loss)*	(34)	128	53	-	-	147
Share in net income (losses) of equity affiliates	-	-	-	(14)	-	(14)
Capital expenditures (tangible and intangible assets)	160	269	140	69	-	638
Net tangible assets	271	197	286	357	-	1,111
Shares in equity affiliates	-	-	-	606	-	606
Operating assets (assets included in operating working capital)**	2,154	2,062	1,688	30	-	5,934
Operating liabilities (liabilities included in operating working capital)***	(1,898)	(1,696)	(2,036)	(22)	-	(5,652)

(In millions of euros)

2004	Fixed Communications	Mobile Communications	Private Communications	Other	Eliminations	Total Group
Revenues:						
– segments	5,125	3,313	3,946	13	(153)	12,244
– between segments	(40)	(9)	(104)	-	153	-
TOTAL - REVENUES	**5,085**	**3,304**	**3,842**	**13**	**-**	**12,244**
Operating profit (loss)	576	418	267	(82)	-	1,179
Depreciation and amortization (tangible and intangible assets)	146	153	146	100	-	545
Provisions made (reversed) included in operating profit (loss)*	69	(138)	(6)	-	-	(75)
Share in net income (losses) of equity affiliates	-	-	-	(61)	-	(61)
Capital expenditures (tangible and intangible assets)	163	208	143	65	-	579
Net tangible assets	325	159	297	314	-	1,095
Shares in equity affiliates	-	-	-	604	-	604
Operating assets (assets included in operating working capital)**	1,770	1,613	1,533	7	-	4,923
Operating liabilities (liabilities included in operating working capital)***	(1,781)	(1,412)	(2,023)	(40)	-	(5,256)

* *Provisions for product sales (see note 27), impairment losses on inventories and work in progress and customer receivables (including those recorded in amounts due from / to customers on construction contracts, see note 18).*

** *Operating assets comprise inventories and work in progress and customer receivables (including those recorded in amounts due from / to customers on construction contracts) and advances and progress payments. These captions are presented in note 18.*

*** *Operating liabilities comprise trade payables and related accounts, customers' deposits and advances and provisions for product sales (including those provisions recorded in amounts due from / to customers on construction contracts). These captions are presented in notes 18 and 27.*

b) Information by geographical segment

(In millions of euros)

2005	France	Germany	Other Western Europe	Rest of Europe	Asia Pacific	North America	Rest of world	Consolidated
Revenues:								
– by geographical market	1,661	820	2,919	952	1,915	1,895	2,973	13,135
– by subsidiary location	4,599	1,318	2,607	260	1,481	1,930	940	13,135
Other information by geographical segment								
Operating profit (loss)	227	176	176	33	110	406	61	1,189
Operating assets (assets included in operating working capital)	2,353	374	1,060	118	908	450	671	5,934
Total assets	10,585	764	3,464	205	2,395	2,674	1,028	21,115
Capital expenditures (tangible and intangible assets)	291	38	68	8	81	138	14	638

(In millions of euros)

2004	France	Germany	Other Western Europe	Rest of Europe	Asia Pacific	North America	Rest of world	Consolidated
Revenues:								
– by geographical market	1,677	799	2,711	895	1,867	1,768	2,527	12,244
– by subsidiary location	4,371	1,191	2,309	254	1,424	1,814	881	12,244
Other information by geographical segment								
Operating profit (loss)	291	108	240	30	146	329	35	1,179
Operating assets (assets included in operating working capital)	2,172	357	815	115	722	276	466	4,923
Total assets	11,517	761	3,104	235	2,033	2,240	739	20,629
Capital expenditures (tangible and intangible assets)	291	37	70	6	63	106	6	579

Note 5

Revenues

(In millions of euros)	2005	2004
Product sales (construction contracts)	3,256	3,135
Other equipment sales and service revenues	9,766	8,969
License revenues	36	67
Rental income and other revenues	77	73
TOTAL	**13,135**	**12,244**

Note 6

Research and development costs

(In millions of euros)	2005	2004
Research costs	57	83
Development costs	1,386	1,407
Research and development costs, net	**1,443**	**1,490**
as a percentage of revenues	*11.0%*	*12.2%*
Customer design engineering costs	193	237
Capitalized development costs	101	130
Research and development effort	**1,737**	**1,857**
as a percentage of revenues	*13.2%*	*15.2%*

In accordance with IFRSs, development costs meeting certain criteria described in note 1f are capitalized.

The net impact of capitalization (capitalization of eligible expenses and cumulative amortization of previously capitalized expenses) is presented on the line "impact of capitalization of development expenses" in the income statement.

As certain capitalization criteria required by IAS 38 "Intangible Assets" could not be met for 2002 and prior years, full retrospective application of IAS 38 has not been possible due primarily to the lack of information systems monitoring development costs and testing their eligibility for capitalization. Such systems were put in place during 2003.

To facilitate an analysis of the Group's accounts and to better appreciate the ramp-up effect of the capitalization of development costs, the net capitalization impact (expenses capitalized less amortization of previously capitalized expenses) is presented in "impact of capitalization of development expenses" in the income statement and is also separately identified in the "net cash provided (used) by operating activities before changes in working capital" (impact of amortization of capitalized expenses) and in the "net cash provided (used) by investing activities" (impact of capitalization of development expenses during the period).

Note 7

Impairment losses on assets recognized in the income statement

(In millions of euros)

2005	Fixed Communications	Mobile Communications	Private Communications	Other	Eliminations	Total Group
Impairment losses for goodwill	-	-	-	-	-	-
Impairment losses for capitalized development costs	-	-	-	-	-	-
Impairment losses for other intangible assets	-	(3)	-	-	-	(3)
Impairment losses for property, plant and equipment	-	-	-	-	-	-
Impairment losses for shares in equity affiliates	-	-	-	-	-	-
Impairment losses for financial assets	11	(10)	(11)	(12)	-	(22)
TOTAL - NET	**11**	**(13)**	**(11)**	**(12)**	**-**	**(25)**
*of which reversal of impairment loss **	*11*	*6*	*-*	*17*	*-*	*34*

** Recorded in income statement caption "Other financial income (loss)".*

(In millions of euros) 2004	Fixed Communications	Mobile Communications	Private Communications	Other	Eliminations	Total Group
Impairment losses for goodwill	-	-	-	-	-	-
Impairment losses for capitalized development costs*	(88)	-	-	-	-	(88)
Impairment losses for other intangible assets	(18)	-	-	-	-	(18)
Impairment losses for property, plant and equipment	-	-	(4)	(6)	-	(10)
Impairment losses for shares in equity affiliates	-	-	-	(30)	-	(30)
Impairment losses for assets	-	6	48	(24)	-	30
TOTAL - NET	**(106)**	**6**	**44**	**(60)**	**-**	**(116)**
*of which reversal of impairment loss***	-	*6*	*67*	*8*	-	*81*

** Recorded in income statement caption "Impairment of capitalized development costs".*
*** Recorded in income statement caption "Other financial income (loss)".*

Note 8
Financial income (loss)

(In millions of euros)	Q4 2005	2005	2004
Finance costs	**(20)**	**(96)**	**(121)**
Dividends	1	4	6
Provisions for financial risks	-	-	2
Impairment losses on financial assets*	18	(22)	30
Net exchange gain (loss)	2	(18)	(31)
Financial component of pension costs	(12)	(46)	(50)
Actual and potential capital gain/(loss) on financial assets (shares of equity affiliates or non-consolidated securities and financial receivables) and marketable securities**	17	137	36
Other	(9)	(9)	21
Other financial income (loss)	**17**	**46**	**14**
TOTAL FINANCIAL INCOME (LOSS)	**(3)**	**(50)**	**(107)**

** Impairment loss of €23 million on the Avanex shares recorded in the first and second quarters of 2005 due to an unfavorable change in market price.*
*** Net gain on disposal of Alcatel's stake in Nexans for €69 million during the first quarter 2005 and net gain on disposal of Mobilrom shares for €45 million during the second quarter of 2005.*

Note 9
Income tax

a) Analysis of income tax (charge) benefit

(In millions of euros)	Q4 2005	2005	2004
Current income tax (charge) benefit	(52)	(52)	82
Deferred income tax (charge) benefit, net	(63)	(39)	(118)
INCOME TAX (CHARGE) BENEFIT	**(115)**	**(91)**	**(36)**

Based on tax results forecasted, net deferred tax assets of €87 million were recorded during the first half of 2005, mainly in Europe and in North America. A deferred income tax charge of €63 million has been accounted for during the third quarter 2005 corresponding to the utilization of deferred tax assets in North America and as a result of Alcatel Space's exit from the French tax consolidation following its alliance with Alenia, a subsidiary of Finmeccanica (see note 3). A deferred tax charge of €63 million was recorded during the fourth quarter 2005 corresponding to the utilization of deferred tax assets primarily in North America.

The current income tax charge of €52 million relates to countries in which the Group has no tax loss carry forwards and to changes in provisions for tax litigation. In 2004, the current income tax benefit resulted mainly from changes in provisions for tax litigation.

b) Effective income tax rate

The effective tax rate can be analyzed as follows:

(In millions of euros except for percentage)	2005	2004
Income (loss) before taxes from continuing operations	1,075	539
Average income tax rate	32.2%	26.0%
Expected tax (charge) benefit	**(346)**	**(140)**
Impact on tax (charge) benefit of:		
– reduced taxation of certain revenues	-	-
– utilization of / (unrecognized) tax loss carry forwards	297	(60)
– effect of tax rate changes	(5)	(20)
– tax credits	5	12
– other permanent differences	(42)	172
Actual income tax (charge) benefit	**(91)**	**(36)**
Effective tax rate	**8.47%**	**6.68%**

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 from continuing operations.

c) Deferred tax balances

(In millions of euros)

Balances	**2005**	**2004**
Deferred tax assets:		
– deferred tax assets recognizable	7,042	6,105
– of which not recognized	(5,274)	(4,467)
Net deferred tax assets recognized	**1,768**	**1,638**
Net deferred tax (liabilities)	**(162)**	**(132)**
Net deferred tax assets (liabilities)	**1,606**	**1,506**

Analysis of deferred tax by temporary differences

(In millions of euros)	December 31, 2004	Impact on net income (loss)	Impact on shareholders' equity	Translation adjustments	Change in consolidated companies	Other	December 31, 2005
Fair value adjustments of tax assets and liabilities resulting from business combinations	(12)	5	-	(3)	(2)	4	(8)
Provisions	603	(82)	-	24	(3)	5	547
Property, plant and equipment and intangible assets	241	(152)	-	35	38	54	216
Temporary differences arising from other balance sheet captions	283	53	1	42	26	(10)	289
Tax loss carry forwards and tax credits	4,858	380	-	210	(169)	557	5,836
Deferred tax assets, gross (liabilities)	**5,973**	**98**	**(1)**	**308**	**(110)**	**610**	**6,880**
Deferred tax assets not recognized	(4,467)	137	(1)	(172)	137	(634)	(5,274)
Net deferred tax assets (liabilities)	**1,506**	**(39)**	**-**	**136**	**27**	**(24)**	**1,606**
of which directly included in shareholders' equity	*(50)*	*7*	-	-	-	-	*(43)*

Change during the period

(In millions of euros)	December 31, 2004	Impact on net income (loss)	Impact on shareholders' equity	Translation adjustments	Change in consolidated companies	Other	December 31, 2005
Deferred tax assets recognized	1,638	(18)	-	147	30	(29)	1,768
Deferred tax liabilities	(132)	(21)	-	(11)	(3)	5	(162)
Net deferred tax assets (liabilities)	**1,506**	**(39)**	**-**	**136**	**27**	**(24)**	**1,606**

Deferred taxes not recognized relating to temporary differences on investments in subsidiaries, equity affiliates and joint ventures were zero at December 31, 2005 and December 31, 2004.

The dividend distribution proposed to the Annual Shareholders' Meeting (see note 22) will have no tax consequences.

d) Tax losses carried forward and temporary differences

Total tax losses carried forward represent a potential tax saving of €5,836 million at December 31, 2005 (€4,858 million at December 31, 2004). The potential tax savings relate to tax losses carried forward that expire as follows:

(In millions of euros)

Years	Recognized	Unrecognized	Total
2006	4	10	14
2007	6	114	120
2008	38	38	76
2009	26	13	39
2010 and thereafter	1,482	4,105	5,587
TOTAL	**1,556**	**4,280**	**5,836**

In addition, temporary differences were €1,044 million at December 31, 2005 (€1,115 million at December 31, 2004), of which €50 million have been recognized and €994 million have not been recognized (€20 million and €1,095 million respectively at December 31, 2004).

Note 10

Discontinued operations, assets held for sale and liabilities related to disposal groups held for sale

Discontinued operations for 2005 and 2004 are as follows:

- In 2005: no discontinued operations. Initial capital gain (loss) on discontinued operations that were sold in 2004 was adjusted in 2005 due to ongoing legal proceedings related to these disposals.
- In 2004: disposal of Saft announced in October 2003 and finalized in January 2004, sale 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.

Other assets held for sale concern real estate property sales in progress at December 31, 2005 and December 31, 2004.

Income statement

(In millions of euros)	Q4 2005	2005	2004
Income (loss) on discontinued operations	9	(13)	142

Income statements of discontinued operations for 2005 and 2004 in accordance with IFRSs are as follows:

Income statements of discontinued operations

(In millions of euros)	Q4 2005	2005	2004
Revenues	-	-	571
Cost of sales	-	-	(476)
Gross profit	**-**	**-**	**95**
Administrative and selling expenses	-	-	(93)
Research and development costs	-	-	(61)
Net capital gain (loss) on disposal of discontinued operations	9	(13)	211
Operating profit (loss)	**9**	**(13)**	**152**
Other operating income (loss)	-	-	(7)
Financial income (loss)	-	-	(3)
Income (loss) from discontinued operations	**9**	**(13)**	**142**

Balance sheet

(In millions of euros)	December 31, 2005	December 31, 2004
Assets of disposal groups	-	124
Other assets held for sale	50	72
Assets held for sale	**50**	**196**
Liabilities related to disposal groups held for sale	**-**	**(97)**

The cash flows of discontinued operations for 2005 and 2004 in accordance with IFRSs are as follows:

(In millions of euros)	Q4 2005	2005	2004
Net income (loss)	9	(13)	142
Net cash provided (used) by operating activities before changes in working capital	(12)	(19)	(122)
Other net increase (decrease) in net cash provided (used) by operating activities	-	-	(125)
Net cash provided (used) by operating activities)2*	(12)	(19)	(247)
Net cash provided (used) by investing activities (2)	-	14	210
Net cash provided (used) by financing activities (3)	-	-	(30)
TOTAL (1)+(2)+(3)	**(12)**	**(5)**	**(67)**

Note 11

Earnings per Share

Basic earnings per share is computed using the number of shares issued after deduction of the weighted average number of shares owned by consolidated subsidiaries and the weighting effect of shares issued during the year. 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 bonds redeemable for shares is included in the calculation of basic earnings per share.

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 (loss) is adjusted for after-tax interest expense relating to convertible bonds.

The dilutive effects of stock option and 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").

The tables below reconcile basic earnings per share to diluted earnings per share for the four periods presented:

2005	Net income (loss) (In millions of euros)	Number of shares	Per share amount
Basic earnings per share, attributable to the equity holders of the parent	930	1,367,994,653*	€0.68
Stock option plans	-	8,582,256	-
Convertible bonds	-	-	-
Diluted earnings per share, attributable to the equity holders of the parent	**930**	**1,376,576,909**	**€0.68**

** See note 23a.*

Ordinary shares

Consolidated subsidiaries of the Group owned 59,323,183 Alcatel ordinary shares (weighted average number) and no share equivalents.

Shares subject to future issuance

The number of stock options not exercised as of December 31, 2005 amounted to 149,359,801 shares. Only 8,582,256 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.

Q4 2005	Net income (loss) (In millions of euros)	Number of shares	Per share amount
Basic earnings per share, attributable to the equity holders of the parent	344	1,369,320,171	€0.25
Stock option plans	-	9,721,724	-
Convertible bonds	-	-	-
Diluted earnings per share, attributable to the equity holders of the parent	**344**	**1,379,041,895**	**€0.25**

Ordinary shares

Consolidated subsidiaries of the Group owned 58,893,516 Alcatel ordinary shares (weighted average number) and no share equivalents.

Shares subject to future issuance

The number of stock options not exercised as of December 31, 2005 amounted to 149,359,801 shares. Only 9,721,724 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.

2004	Net income (loss) (In millions of euros)	Number of shares	Per share amount
Basic earnings per share, attributable to the equity holders of the parent	576	1,349,528,158*	€0.43
Stock option plans	-	12,849,283	-
Convertible bonds	-	-	-
Diluted earnings per share, attributable to the equity holders of the parent	**576**	**1,362,377,441**	**€0.42**

** See note 23a.*

Ordinary shares

Consolidated subsidiaries of the Group owned 61,839,627 Alcatel ordinary shares (weighted average number) 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 12,849,283 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.

Q4 2004	Net income (loss) (In millions of euros)	Number of shares	Per share amount
Basic earnings per share, attributable to the equity holders of the parent	7	1,350,765,457	€0.01
Stock option plans	-	12,241,849	-
Convertible bonds	-	-	-
Diluted earnings per share, attributable to the equity holders of the parent	**7**	**1,363,007,306**	**€0.00**

Ordinary shares

Consolidated subsidiaries of the Group owned 60,624,711 Alcatel ordinary shares (weighted average number) 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 12,241,849 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.

Note 12
Goodwill

(In millions of euros)	Gross value	Amortization and impairment losses	Net
Goodwill at January 1, 2004	**10,011**	**(6,381)**	**3,630**
Additions	214	-	214
Disposals and discontinued operations	(21)	14	(7)
Impairment losses for the period	(16)	15	(1)
Reversals of impairment losses resulting from disposals	-	-	-
Net effect of exchange rate changes	(145)	86	(59)
Other changes	-	(3)	(3)
Goodwill at December 31, 2004	**10,043**	**(6,269)**	**3,774**
Additions	173	-	173
Disposals and discontinued operations	(372)	72	(300)
Changes during goodwill allocation period	3	-	3
Impairment losses for the period	-	-	-
Reversals of impairment losses resulting from disposals	-	-	-
Net effect of exchange rate changes	319	(196)	123
Other changes	(1)	-	(1)
Goodwill at December 31, 2005	**10,165**	**(6,393)**	**3,772**

Additions to goodwill recorded in 2005 relate primarily to the acquisitions of Native Networks and the industrial activities (Alenia Spazio) and service activities (Telespazio) of Finmeccanica (see note 3).

Reduction in goodwill presented in the caption “disposals and discontinued operations” relates to the proportionate consolidation of the satellite industrial activity goodwill (fully consolidated in 2004 but now consolidated at 67%) (see note 3).

All goodwill recognized in 2005 and 2004 has been allocated to cash generating units by the accounting year-ends concerned.

The goodwill amounts relating to business combinations, for which the initial accounting period has not yet been completed at December 31, 2005, are not definitive.

One impairment test of goodwill was carried out at the IFRS transition date. This impairment test led to recording no impairment losses.

An additional impairment test was carried out at December 31, 2005 on the SSD business division (Space Solutions Division), as a result of the business combination that occurred during the year (see note 3). The test did not lead to the recording of any impairment losses.

An impairment loss of €30 million was recorded in 2004 for the goodwill included in shares in equity affiliates, due to an unfavorable change in the market value of the shares of a company consolidated under the equity method.

The 2005 annual impairment tests of goodwill (performed in May/June 2005 on the basis of published data at March 31, 2005) resulted in recording no impairment losses in 2005.

In those cash generating units (“CGU”) in which there is significant goodwill, the data and assumptions used for the goodwill impairment tests were as follows:

2005 Test	Net carrying amount of goodwill	Difference between recoverable amount and the carrying amount of the net assets	Discount rate	Valuation method
CGU OND (Optical Network Division)	1,387	790	9.45%	Discounted cash flows and other data**
CGU SSD (Space Solutions Division)	885	325*	9.45%	Same as above**
Other CGU	1,502	-	9.45%	Same as above**
TOTAL NET	**3,774**			

* *The fair value of SSD is that used in the context of the business combination described in note 3.*

** *Future cash flows for 5 years and disposal value. Other data: market capitalizations and transactions. Growth rates are those used in the Group’s budgets and industry rates for the subsequent periods. Perpetual growth rates used for the residual values are between 0% and 4% depending on the CGU.*

Note 13

Intangible assets

a) Gross value

(In millions of euros)	Capitalized development costs	Other intangible assets	Total
At January 1, 2004	**828**	**342**	**1,170**
Capitalization	326		326
Additions	-	27	27
Assets held for sale, discontinued operations and disposals	(4)	(18)	(22)
Business combinations	-	80	80
Net effect of exchange rate changes	(8)	(20)	(28)
Other changes	(120)	43	(77)
At December 31, 2004	**1,022**	**454**	**1,476**
Capitalization	349	-	349
Additions	-	27	27
Assets held for sale, discontinued operations and disposals	(67)	(22)	(89)
Impairment losses for the period	-	-	-
Reversals of impairment losses	-	-	-
Business combinations	-	33	33
Net effect of exchange rate changes	23	37	60
Other changes	(48)	(32)	(80)
At December 31, 2005	**1,279**	**497**	**1,776**

Other intangible assets include primarily technologies acquired in business combinations, patents and licenses.

b) Amortization and impairment losses

(In millions of euros)	Capitalized development costs	Other intangible assets	Total
At January 1, 2004	**(290)**	**(297)**	**(587)**
Amortization	(196)	(32)	(228)
Impairment losses for the period	(88)	(18)	(106)
Reversals of impairment losses	-	-	-
Assets held for sale, discontinued operations and disposals	4	18	22
Business combinations	-	-	-
Net effect of exchange rate changes	5	12	17
Other changes	119	(8)	111
At December 31, 2004	**(446)**	**(325)**	**(771)**
Amortization	(248)	(49)	(297)
Impairment losses for the period	-	(3)	(3)
Reversals of impairment losses	-	-	-
Assets held for sale, discontinued operations and disposals	54	21	75
Business combinations	-	(9)	(9)
Net effect of exchange rate changes	(9)	(24)	(33)
Other changes	50	31	81
At December 31, 2005	**(599)**	**(358)**	**(957)**

c) Net value

(In millions of euros)	Capitalized development costs	Other intangible assets	Total
At January 1, 2004	**538**	**45**	**583**
Capitalization	326	-	326
Additions	-	27	27
Amortization	(196)	(32)	(228)
Impairment losses for the period	(88)	(18)	(106)
Reversals of impairment losses	-	-	-
Assets held for sale, discontinued operations and disposals	-	-	-
Business combinations	-	80	80
Net effect of exchange rate changes	(3)	(8)	(11)
Other changes	(1)	35	34
At December 31, 2004	**576**	**129**	**705**
Capitalization	349	-	349
Additions	-	27	27
Amortization	(248)	(49)	(297)
Impairment losses for the period	-	(3)	(3)
Reversals of impairment losses	-	-	-
Assets held for sale, discontinued operations and disposals	(13)	(1)	(14)
Business combinations	-	24	24
Net effect of exchange rate changes	14	13	27
Other changes	2	(1)	1
At December 31, 2005	**680**	**139**	**819**

Note 14

Property, plant and equipment

a) Changes in property, plant and equipment, gross

(In millions of euros)	Land	Buildings	Plant, equipment and tools	Other	Total
At January 1, 2004	**148**	**1,634**	**3,533**	**777**	**6,092**
Additions	-	12	134	80	226
Assets held for sale, discontinued operations and disposals	(60)	(481)	(1,003)	(125)	(1,669)
Business combinations	-	-	6	-	6
Net effect of exchange rate changes	(1)	(26)	(79)	(3)	(109)
Reclassifications and other changes	(6)	59	156	(81)	128
At December 31, 2004	**81**	**1,198**	**2,747**	**648**	**4,674**
Additions	3	12	152	95	262
Assets held for sale, discontinued operations and disposals	(13)	(255)	(522)	(76)	(866)
Business combinations	9	104	138	14	265
Net effect of exchange rate changes	4	56	171	10	241
Reclassifications and other changes	1	(48)	100	(72)	(19)
At December 31, 2005	**85**	**1,067**	**2,786**	**619**	**4,557**

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

(In millions of euros)	Land	Buildings	Plant, equipment and tools	Other	Total
At January 1, 2004	**(21)**	**(1,016)**	**(2,988)**	**(631)**	**(4,656)**
Depreciation charge	(1)	(69)	(207)	(40)	(317)
Impairment losses	(3)	(2)	(5)	-	(10)
Assets held for sale, discontinued operations and disposals	14	347	930	102	1,393
Business combinations	-	-	(3)	-	(3)
Net effect of exchange rate changes	-	12	67	2	81
Reclassifications and other changes	(1)	13	(123)	44	(67)
At December 31, 2004	**(12)**	**(715)**	**(2,329)**	**(523)**	**(3,579)**
Depreciation charge	(1)	(55)	(193)	(35)	(284)
Impairment losses	-	(1)	-	-	(1)
Assets held for sale, discontinued operations and disposals	1	176	463	64	704
Business combinations	-	(35)	(96)	(6)	(137)
Net effect of exchange rate changes	-	(25)	(143)	(7)	(175)
Reclassifications and other changes	(2)	65	(50)	13	26
At December 31, 2005	**(14)**	**(590)**	**(2,348)**	**(494)**	**(3,446)**

c) Changes in property, plant and equipment, net

(In millions of euros)	Land	Buildings	Plant, equipment and tools	Other	Total
At January 1, 2004	**127**	**618**	**545**	**146**	**1,436**
Additions	-	12	134	80	226
Depreciation charge	(1)	(69)	(207)	(40)	(317)
Impairment losses	(3)	(2)	(5)	-	(10)
Assets held for sale, discontinued operations and disposals	(46)	(134)	(73)	(23)	(276)
Business combinations	-	-	3	-	3
Net effect of exchange rate changes	(1)	(14)	(12)	(1)	(28)
Reclassifications and other changes	(7)	72	33	(37)	61
At December 31, 2004	**69**	**483**	**418**	**125**	**1,095**
Additions	3	12	152	95	262
Depreciation charge	(1)	(55)	(193)	(35)	(284)
Impairment losses	-	(1)	-	-	(1)
Assets held for sale, discontinued operations and disposals	(12)	(79)	(59)	(12)	(162)
Business combinations	9	69	42	8	128
Net effect of exchange rate changes	4	31	28	3	66
Reclassifications and other changes	(1)	17	50	(59)	7
At December 31, 2005	**71**	**477**	**438**	**125**	**1,111**

The 2005 figures presented in the caption “Assets held for sale, discontinued operations and disposals” relate primarily to property, plant and equipment of the space activity, which following the business combination with Alenia, are now proportionately consolidated at 67%.

Note 15

Finance leases and operating leases

a) Finance leases (IFRS)

Property, plant and equipment held under finance leases have a net carrying amount of €54 million at December 31, 2005 (€49 million at December 31, 2004). Such finance leases relate primarily to plant and equipment.

Future minimum lease payments under non-cancelable finance leases are shown in note 31a – Off balance sheet commitments.

The main finance lease contract concerns a company consolidated proportionately at 51%, Alda Marine, which leases four vessels as part of its activity of laying and maintaining submarine cables. The net carrying amount of these vessels recognized in property, plant and equipment was €53 million at December 31, 2005. The corresponding obligation to pay future lease payments was €59 million at December 31, 2005.

b) Operating leases

Future minimum lease payments under non-cancelable operating leases are shown in note 31a - Off balance sheet commitments.

Future minimum sublease payments expected to be received under non-cancelable operating subleases were €27 million at December 31, 2005 (€7 million at December 31, 2004).

Lease payments under operating leases recognized as an expense in the income statement are analyzed as follows:

(In millions of euros)	2005	2004
Lease payments – minimum	97	49
Lease payments – conditional	42	61
Sublease rental income	(10)	(5)
TOTAL RECOGNIZED IN THE INCOME STATEMENT	**129**	**105**

Note 16

Share in net assets of equity affiliates and joint ventures

a) Share in net assets of equity affiliates

	Percentage owned		Value	
(In millions of euros)	2005	2004	2005	2004
Thales*	9.5%	9.5%	334	288
Draka Comteq BV**	49.9%	49.9%	127	132
TAMP***	-	45.0%	-	33
Other (less than €50 million)	-	-	145	151
Share in net assets of equity affiliates			**606**	**604**

* *Although Alcatel only has a 9.5% stake in Thales, Alcatel is nevertheless the largest private shareholder of this group, 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, 2005, Alcatel's stake was 9.5% (12.8% in voting rights).*

** *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 beginning July 1, 2004 (see note 3).*

*** *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, TAMP, was created. Alcatel owned 45% of this company, which was consolidated under the equity method from September 1, 2004 to July 18, 2005, when Alcatel swapped its 45% stake in the joint venture for shares in TCL Communication Holding Ltd, representing 4.8% of this listed company in which the Group has no significant influence (see note 3).*

Alcatel's share in the market capitalization of listed equity affiliates at December 31 is as follows:

(In millions of euros)	2005	2004
Thales	624	575

b) Change in share of net assets of equity affiliates

(In millions of euros)	2005	2004
Carrying amount at January 1	**604**	**501**
Change in equity affiliates	(16)	195
Share of net income (loss)*	(14)	(61)
Net effect of exchange rate changes	28	(11)
Other changes	4	(20)
Carrying amount at December 31	**606**	**604**

** Including €30 million of impairment losses in 2004 relating to equity affiliate goodwill (see note 7).*

c) Summarized financial information for equity affiliates

Summarized financial information for Thales:

(In millions of euros)	December 31, 2005 (1)	January 1, 2005 (2)	December 31, 2004
Balance sheet			
Non-current assets	4,774	4,323	4,372
Current assets	9,663	9,325	9,157
TOTAL ASSETS	**13,887**	**13,648**	**13,529**
Shareholders' equity	2,103	1,770	1,630
Non-current liabilities	2,583	2,604	2,553
Current liabilities	9,201	9,274	9,346
TOTAL LIABILITIES	**13,887**	**13,648**	**13,529**
Income statement			
Revenues	10,263	-	10,276
Income (loss) from operating activities	549	-	590
Net income (loss) attributable to equity holders of the parent	334	-	339

(1) In view of the timing of the publication of Thales' financial statements, and as this equity affiliate is listed on a securities exchange, the Group's share of net income (loss) is calculated based on the most recently published financial statements under IFRSs. It does not therefore include, due to the rules of communication applicable to listed companies, any possible non-published information between two publication dates that may have been obtained by the directors representing Alcatel on the Thales Board of Directors. As Thales' financial data for 2005 was not available at the date of authorization for issue of Alcatel's financial statements, the Group's share of net income (loss) has been calculated on the basis of Thales' latest available financial statements at June 30, 2005.

(2) The accounting options made by Thales governing the first-time adoption of IFRSs are similar to those made by Alcatel, except for the timing of the first application of the standards, IAS 32 and 39, relating to financial instruments (Alcatel first applied these at January 1, 2004 and Thales at January 1, 2005). As it is not possible to restate the 2004 accounts of Thales for the impact of the application of these standards, Alcatel's share of the change in shareholders' equity resulting from this first application has been recognized in 2005 in "net income (loss) changes recognized directly in equity".

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

(In millions of euros)	2005	2004
Total assets	1,195	1,248
Liabilities (excluding shareholders' equity)	563	573
Shareholders' equity	632	675
Revenues	1,146	712
Net income (loss) attributable to equity holders of the parent	(68)	(96)

d) Aggregated financial information for joint ventures

Aggregated financial information for the Group's share in the net assets of joint ventures proportionately consolidated (Alcatel Alenia Space, Telespazio, Alda Marine and Evolium in 2005 and Alda Marine and Evolium in 2004) are as follows:

(In millions of euros)	2005	2004
Balance sheet data		
Non-current assets	1,314	209
Current assets	773	6
Shareholders' equity	983	90
Other non-current liabilities	135	47
Current liabilities	969	78
Income statement data*		
Revenues	560	9
Cost of sales	(367)	65
Operating profit (loss)	(3)	(1)
Net income (loss) attributable to equity holders of the parent	44	(5)
Cash flow statement data*		
Net cash provided (used) by operating activities	80	60
Net cash provided (used) by investing activities	(62)	(53)
Net cash provided (used) by financing activities	11	(9)

** Aggregated financial information for Alcatel Alenia Space and Telespazio only relates to six months of activity in 2005 (see note 3).*

Note 17

Financial assets

	2005			2004		
(In millions of euros)	Other non-current financial assets *	Marketable securities	Total	Other non-current financial assets	Marketable securities	Total
Financial assets available for sale	122	-	**122**	213	105	**318**
Financial assets at fair value through profit or loss		640	**640**		447	**447**
Financial assets at amortized cost	184		**184**	341		**341**
TOTAL	**306**	**640**	**946**	**554**	**552**	**1,106**

** Of which €21 million matures within one year.*

No financial asset is considered as being held to maturity.

a) Financial assets available for sale

	2005			2004		
(In millions of euros)	Other non-current financial assets	Marketable securities	Total	Other non-current financial assets	Marketable securities	Total
Net carrying amount at January 1	**213**	**105**	**318**	**215**	**92**	**307**
Additions / (disposals)	(4)	(49)	(53)	23	5	28
Fair value changes	(13)	(56)	(69)	23	8	31
Impairment losses*	(47)	-	(47)	(44)	-	(44)
Other changes	(27)	-	(27)	(4)	-	(4)
Net carrying amount at December 31	**122**	**-**	**122**	**213**	**105**	**318**
of which:						
– at fair value	36	-	36	70	105	175
– at cost	86		86	143		143

** See note 7 – of which €23 million in 2005 relates to the Avanex shares due to an unfavorable change in the market price.*

Financial assets available for sale are stated at fair value, except for non-listed financial assets, which are stated at cost, if no reliable fair value exists.

(In millions of euros)	2005	2004
Fair value changes		
Fair value changes recognized directly in shareholders' equity	(13)	32
Changes resulting from gains (losses) previously recognized in shareholders' equity now recognized in net income (loss) due to:		
– disposals*	(56)	-

** Relates to the sale of the Nexans shares during the first quarter of 2005 (see note 8).*

b) Financial assets at fair value through profit or loss

(In millions of euros)	2005	2004
Net carrying amount at January 1	**447**	**174**
Additions / (disposals)	148	264
Fair value changes	19	6
Impairment losses	-	-
Other changes	26	3
Net carrying amount at December 31	**640**	**447**

c) Financial assets at amortized cost

(In millions of euros)	2005	2004
Net carrying amount at January 1	**341**	**829**
Additions / (disposals)	(94)	(569)
Impairment losses*	25	74
Other changes (reclassifications)	(88)	7
Net carrying amount at December 31	**184**	**341**

** See note 7.*

Note 18
Operating working capital

(In millions of euros)	December 31, 2005	December 31, 2004
Inventories and work in progress, net	1,438	1,273
Trade receivables and related accounts, net	3,420	2,693
Advances and progress payments	124	90
Customers' deposits and advances	(1,144)	(973)
Trade payables and related accounts	(3,755)	(3,350)
Amounts due from customers on construction contracts	917	729
Amounts due to customers on construction contracts	(138)	(133)
Currency derivatives on working capital – other assets	-	102
OPERATING WORKING CAPITAL, NET	**862**	**431**

(In millions of euros)	December 31, 2005	December 31, 2004
Analysis of amounts due from/to customers on construction contracts		
Amounts due from customers on construction contracts	917	729
Amounts due to customers on construction contracts	(138)	(133)
TOTAL	**779**	**596**
Work in progress on construction contracts, gross	281	291
Work in progress on construction contracts, depreciation	(29)	(30)
Customer receivables on construction contracts	700	606
Product sales reserves – construction contracts	(173)	(271)
TOTAL	**779**	**596**

(In millions of euros)	December 31, 2004	Cash flow	Change in consolidated companies	Translation adjustments and other	December 31, 2005
Inventories and work in progress*	2,029	7	148	(71)	2,113
Trade receivables and related accounts*	3,583	497	(69)	337	4,348
Advances and progress payments	90	31	(1)	4	124
Customers' deposits and advances	(973)	(157)	16	(30)	(1,144)
Trade payables and related accounts	(3,350)	(180)	(46)	(179)	(3,755)
Currency derivatives on working capital – other assets	102	-	-	(102)	-
Operating working capital, gross	**1,481**	**198**	**48**	**(41)**	**1,686**
Product sales reserves – construction contracts*	(271)	-	29	69	(173)
Impairment losses	(779)	-	9	119	(651)
Operating working capital, net	**431**	**198**	**86**	**147**	**862**

** Including amounts relating to construction contracts presented in the balance sheet captions "amounts due from/to customers on construction contracts".*

Receivables sold without recourse

Balances

(In millions of euros)	December 31, 2005	December 31, 2004
Receivables sold without recourse*	999	841

** See accounting policies in note 1s.*

Changes in receivables sold without recourse

	Q4 2005	2005	2004
Impact on cash flows from operating activities	158	158	(57)

Note 19

Inventories and work in progress

a) Analysis of net value

(In millions of euros)	2005	2004
Raw materials and goods	467	501
Work in progress excluding construction contracts	712	592
Finished products	653	645
Gross value (excluding construction contracts)	**1,832**	**1,738**
Valuation allowance	(394)	(465)
Net value (excluding construction contracts)	**1,438**	**1,273**
Work in progress on construction contracts, gross*	281	291
Valuation allowance*	(29)	(30)
Work in progress on construction contracts, net	**252**	**261**
TOTAL, NET	**1,690**	**1,534**

** Included in the amounts due from/to customers on construction contracts.*

b) Change in valuation allowance

(In millions of euros)	2005	2004
At January 1	**(495)**	**(978)**
(Additions) / reversals	(18)	20
Utilization	131	427
Changes in consolidation group	11	40
Net effect of exchange rate changes and other changes	(52)	(4)
At December 31	**(423)**	**(495)**

Note 20

Trade receivables and related accounts

(In millions of euros)	2005	2004
Receivables bearing interest	138	101
Other trade receivables	3,510	2,876
Gross value – (excluding construction contracts)	**3,648**	**2,977**
Valuation allowance	(228)	(284)
Net value – (excluding construction contracts)	**3,420**	**2,693**
Receivables on construction contracts*	700	606
TOTAL, NET	**4,120**	**3,299**
*of which due after one year on the "Net value – (excluding construction contracts)" ** *	-	-

** Included in the amounts due from/to customers on construction contracts.*
*** Data is not available for 2004.*

Note 21

Other assets and liabilities

(In millions of euros)	December 31, 2005	December 31, 2004
Other assets		
Other current assets	827	1,418
Other non-current assets	468	332
TOTAL	**1,295**	**1,750**
of which:		
– currency derivatives on working capital	-	102
– other currency derivatives	105	420
– interest-rate derivatives	178	148
– other current and non-current assets	1,012	1,080
Other liabilities	**December 31, 2005**	**December 31, 2004**
Other current liabilities	1,931	2,157
Other non-current liabilities	295	201
TOTAL	**2,226**	**2,358**
of which:		
– currency derivatives on working capital	-	-
– other currency derivatives	128	360
– interest-rate derivatives	71	43
– other current and non-current liabilities	2,027	1,955

Note 22

Allocation of 2005 net income

The Board of Directors will propose to the Shareholders' Ordinary Annual General Meeting to distribute a dividend of €0.16 per share for the year ended December 31, 2005, which aggregate amount is €229 million (distributions in previous years: no dividends were distributed for 2004 and 2003).

Note 23

Shareholders' equity

a) Number of shares comprising the capital stock

December 31, 2005	Number of shares
Number of ordinary shares issued (share capital)	1,428,541,640
Treasury shares	(58,920,710)
Number of shares in circulation	**1,369,620,930**
Weighting effect of share issues for stock options exercised	(1,223,804)
Weighting effect of treasury shares	(402,473)
Weighting effect of share issues in respect of business combinations	-
Number of shares used for calculating basic earnings per share	**1,367,994,653**
December 31, 2004	**Number of shares**
Number of ordinary shares issued (share capital)	1,305,455,461
Number of notes mandatorily redeemable for new or existing shares	120,780,519
Treasury shares	(60,262,153)
Number of shares in circulation	**1,365,973,827**
Weighting effect of share issues for stock options exercised	(1,664,706)
Weighting effect of treasury shares	(1,577,474)
Weighting effect of share issues in respect of business combinations	(13,203,489)
Number of shares used for calculating basic earnings per share	**1,349,528,158**

b) 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.

c) Capital stock and additional paid-in capital

At December 31, 2005, the capital stock consisted of 1,428,541,640 ordinary shares of nominal value €2 (1,305,455,461 ordinary shares of nominal value €2 at December 31, 2004 and 1,284,410,024 ordinary shares of nominal value €2 at January 1, 2004).

During 2005, increases in capital stock and additional paid-in capital amounted to €662.1 million. These increases related to the following actions:

- issuance of 1,855,913 shares for €12.0 million, as a result of the exercise of 1,855,913 options (including additional paid-in capital of €8.3 million);
- redemption of 450,000 bonds redeemable for Alcatel shares in connection with the acquisition of iMagic TV in 2003 and Spatial Wireless in 2004 generating a capital increase of €5.1 million (including additional paid-in capital of €4.2 million);
- redemption of 120,780,266 ORANE notes issued in 2002 and redeemable for new or existing Alcatel shares, generating a capital increase of €645.0 million, including additional paid-in capital of €403.4 million.

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);
- redemption of 3,212 ORANE notes issued in 2002 and redeemable for new or existing Alcatel shares, generating a capital increase of €0.017 million, including additional paid-in capital of €0.011 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.

d) Stock options

At December 31, 2005, stock options plans were as follows:

(In number of options)			1996 Plans		1997 Plans	1998 Plan	1999 Plans	1999-2000 U.S. Plans				2000 Plans
Exercise price		**€12.96**	**€13.42**	**€19.27**	**€20.95**	**€20.52**	**€28.40**	**USD 21.40- USD 84.88**	**€48.00**	**€48.00**	**€65.00**	**€64.00**
Exercise period	from	07/01/98	07/01/98	05/01/02	12/11/02	12/09/03	09/08/04		04/01/03 04/01/05	07/01/03 07/01/05	12/13/03 12/13/05	12/13/01 12/13/04
	to	12/31/03	12/31/03	12/31/04	12/31/04	12/31/05	12/31/05		12/31/05 12/31/07	06/30/04 06/30/06	12/31/05 12/31/07	12/12/08 12/12/08
Outstanding at January 31, 1996		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Granted		9,069,500	394,000	-	-	-	-	-	-	-	-	-
Exercised		-	-	-	-	-	-	-	-	-	-	-
Forfeited		(185,000)	-	-	-	-	-	-	-	-	-	-
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 1996		**8,884,500**	**394,000**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Granted				8,199,500	367,000	-	-	-	-	-	-	-
Exercised		-	-	-	-	-	-	-	-	-	-	-
Forfeited		(396,000)	(7,500)	(115,000)	-	-	-	-	-	-	-	-
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 1997		**8,488,500**	**386,500**	**8,084,500**	**367,000**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Granted		-	-	-	-	11,602,500	-		-	-	-	-
Exercised		(2,163,950)	(114,000)	-	-	-	-	-	-	-	-	-
Forfeited		(30,500)	(5,000)	(45,000)	(5,000)	-	-	-	-	-	-	-
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 1998		**6,294,050**	**267,500**	**8,039,500**	**362,000**	**11,602,500**	**-**	**-**	**-**	**-**	**-**	**-**
Granted		-	-	-	-	-	545,000	7,866,630			-	-
Exercised		(1,630,425)	(38,250)	(35,000)	-	-	-	-	-	-	-	-
Forfeited		(5,000)	-	(100,000)	(7,500)	(427,250)	-	(143,650)	-	-	-	-
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 1999		**4,658,625**	**229,650**	**7,904,500**	**354,500**	**11,175,250**	**545,000**	**7,722,980**	**-**	**-**	**-**	**-**
Granted		-	-	-	-	-	-	19,407,838	15,239,250	8,905,804	1,235,500	306,700
Exercised		(1,277,690)	(92,750)	(56,000)	-	-	-	(393,296)	(10,000)	-	-	-
Forfeited		-	-	(112,500)	(2,500)	(412,000)	(46,250)	(3,060,818)	(923,120)	(47,328)	-	-
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2000		**3,380,935**	**136,500**	**7,736,000**	**352,000**	**10,763,250**	**498,750**	**23,676,704**	**14,306,130**	**8,858,476**	**1,235,500**	**306,700**
Exercised		(732,728)	(1,250)	(15,000)	-	-	-	(261,205)	(3,000)	(376)	-	-
Forfeited		-	-	(30,000)	-	(60,000)	(5,000)	(3,327,376)	(161,500)	(122,364)	(130,150)	(3,600)
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2001		**2,648,207**	**135,250**	**7,691,000**	**352,000**	**10,703,250**	**493,750**	**20,088,123**	**14,141,630**	**8,735,736**	**1,105,350**	**303,100**
Exercised		(6,577)	-	(1,000)	-	-	-	-	-	-	-	-
Forfeited		(12,000)	-	(157,500)	(30,000)	(306,000)	(22,500)	(3,871,401)	(581,075)	(37,684)	(40,000)	(5,100)
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2002		**2,629,630,**	**135,250**	**7,532,500**	**322,000**	**10,397,250**	**471,250**	**16,216,722**	**13,560,555**	**8,698,052**	**1,065,350**	**298,000**
Exercised		-	-	-	-	-	-	-	-	-	-	-
Forfeited		(27,500)	-	(40,000)	(10,000)	(165,000)	(17,500)	(2,797,641)	(320,500)	(6,524)	(32,500)	(86,421)
Expired		-	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2003		**2,602,130**	**135,250**	**7,492,500**	**312,000**	**10,232,250**	**453,750**	**13,419,081**	**13,240,055**	**8,691,528**	**1,032,850**	**211,579**

(In number of options)	1996 Plans		1997 Plans		1998 Plan	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**
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)	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	**-**	**-**	**7,436,500**	**297,000**	**10,122,250**	**443,750**	**11,142,851**	**13,066,055**	**3,261,660**	**1,021,850**	**207,741**
Exercised	-	-	-	-	-	-	-	-	-	-	-
Forfeited	-	-	-	-	(237,500)	(22,500)	(476,095)	(203,750)	(2,956)	(18,000)	(10,241)
Expired	-	-	(7,436,500)	(297,000)	-	-	(608,141)	-	-	-	-
Outstanding at December 31, 2005	**-**	**-**	**-**	**-**	**9,884,750**	**421,250**	**10,058,615**	**12,862,305**	**3,258,704**	**1,003,850**	**197,500**

(In number of options)	2001 Plans									
Exercise price	**€50.00**	**€50.00**	**€41.00**	**€39.00**	**€32.00**	**€19.00**	**€9.00**	**€20.80**	**€9.30**	**€20.80**
Exercise period from	03/07/02 03/07/05	07/01/04 07/01/05	04/02/02	04/02/02	06/15/02 06/15/05	09/03/02 09/03/05	11/15/02 11/15/05	12/19/02 12/19/05	12/19/02 12/19/05	01/01/05 01/01/06
to	03/06/09 03/06/09	06/30/05 06/30/06	04/01/09	04/01/09	06/14/09 06/14/09	09/02/09 09/02/09	11/14/09 11/14/09	12/18/09 12/18/09	12/18/09 12/18/09	12/31/05 12/31/06
Granted	37,668,588	275,778	48,850	2,500	977,410	138,200	162,000	27,871,925	565,800	935,660
Exercised	-	-	-	-	-	-	-	-	-	-
Forfeited	(1,075,160)	(825)	(7,050)	-	(19,350)	-	-	-	-	-
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2001	**36,593,428**	**274,953**	**41,800**	**2,500**	**958,060**	**138,200**	**162,000**	**27,871,925**	**565,800**	**935,660**
Exercised	-	-	-	-	-	-	-	-	-	-
Forfeited	(1,271,749)	(2,343)	(5,500)	-	(21,175)	(10,300)	(30,000)	(2,283,225)	(37,200)	(16,840)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2002	**35,321,679**	**272,610**	**36,300**	**2,500**	**936,885**	**127,900**	**132,000**	**25,588,700**	**528,600**	**918,820**
Exercised	-	-	-	-	-	-	-	-	(64,444)	-
Forfeited	(6,345,632)	(150)	(24,050)	-	(119,780)	(13,050)	(23,000)	(2,517,719)	(68,750)	(23,950)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2003	**28,976,047**	**272,460**	**12,250**	**2,500**	**817,105**	**114,850**	**109,000**	**23,070,981**	**395,406**	**894,870**
Exercised	-	-	-	-	-	-	(3,000)	-	(42,574)	-
Forfeited	(1,047,721)	(240)	-	-	(33,484)	(8,800)		(2,539,840)	(13,326)	(240)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2004	**27,928,326**	**272,220**	**12,250**	**2,500**	**783,621**	**106,050**	**106,000**	**20,531,141**	**339,506**	**894,630**
Exercised	-	-	-	-	-	-	-	-	(2,500)	-
Forfeited	(806,956)	(194,670)	-	-	(15,981)	(2,250)	-	(1,547,776)	(101)	(640)
Expired	-	-	-	-	-	-	-	-	-	-
Outstanding at December 31, 2005	**27,121,370**	**77,550**	**12,250**	**2,500**	**767,640**	**103,800**	**106,000**	**18,983,365**	**336,905**	**893,990**

(In number of options)									2002 Plans
Exercise price		**€17.20**	**€16.90**	**€14.40**	**€13.30**	**€5.20**	**€3.20**	**€4.60**	**€5.40**
Exercise period	from	02/15/03 02/15/06	04/02/03	05/13/03 05/13/06	06/03/03 06/03/06	09/02/03 09/02/06	10/07/03 10/07/06	11/14/03 11/14/06	12/02/03 12/02/06
	to	02/14/10 02/14/10	04/01/10	05/12/10 05/12/10	06/02/10 06/02/10	06/01/10 06/01/10	10/06/10 10/06/10	11/13/10 11/13/10	12/01/10 12/01/10
Granted		123,620	55,750	54,300	281,000	1,181,050	30,500	111,750	54,050
Exercised		-	-	-	-	-	-	-	-
Forfeited		(14,250)	(1,000)	-	(17,660)	(64,250)	-	-	-
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2002		**109,370**	**54,750**	**54,300**	**263,340**	**1,116,800**	**30,500**	**111,750**	**54,050**
Exercised		-	-	-	-	(32,182)	(853)	(3,375)	-
Forfeited		(20,425)	(13,000)	(5,250)	(14,090)	(165,232)	(9,138)	(4,250)	(10,250)
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2003		**88,945**	**41,750**	**49,050**	**249,250**	**919,386**	**20,509**	**104,125**	**43,800**
Exercised		-	-	-	-	(204,147)	(3,165)	(20,838)	(3,562)
Forfeited		(5,578)	(6,000)	(4,469)	(5,771)	(60,849)	(3,885)	(7,294)	(2,000)
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2004		**83,367**	**35,750**	**44,581**	**243,479**	**654,390**	**13,459**	**75,993**	**38,238**
Exercised		-	-	-	-	(228,445)	(3,000)	(25,873)	(15,685)
Forfeited		(10,537)	(1,000)	(3,281)	(11,500)	(15,544)	-	-	(10,918)
Expired		-	-	-	-	-	-	-	-
Adjustments		-	-	-	-	-	-	1,104	-
Outstanding at December 31, 2005		**72,830**	**34,750**	**41,300**	**231,979**	**410,401**	**10,459**	**51,224**	**11,635**

(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 03/07/07	07/01/06 07/01/07	06/18/04 06/18/07	07/01/04 07/01/07	09/01/04 09/01/07	10/01/04 10/01/07	11/14/04 11/14/07	12/01/04 12/01/07
	to	03/06/11 03/06/11	06/30/07 06/30/08	06/17/11 06/17/11	06/30/11 06/30/11	08/31/11 08/31/11	09/30/11 09/30/11	11/13/11 11/13/11	11/30/11 11/30/11
Granted		25,626,865	827,348	338,200	53,950	149,400	101,350	63,600	201,850
Exercised		(7,750)	(28)	-	-	-	-	-	-
Forfeited		(1,583,230)	(17,193)	-	-	-	-	-	-
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2003		**24,035,885**	**810,127**	**338,200**	**53,950**	**149,400**	**101,350**	**63,600**	**201,850**
Exercised		(1,221,749)	(111)	(6,944)	(473)	(1,603)	-	-	(562)
Forfeited		(1,142,822)	(605)	(31,654)	(23,951)	(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**
Exercised		(1,566,542)	(147)	(10,746)	(1,842)	(833)	-	-	-
Forfeited		(477,617)	(467)	(10,378)	(5,434)	(2,735)	(10,291)	(1,500)	(29,501)
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2005		**19,627,155**	**808,797**	**278,478**	**22,250**	**137,929**	**61,683**	**60,100**	**134,487**

(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 03/10/08	04/01/05 04/01/08	05/17/05 05/17/08	07/01/05 07/01/08	09/01/05 09/01/08	10/01/05 10/01/08	11/12/05 11/12/08	12/01/05 12/01/08
to	03/09/12 03/09/12	03/31/12 03/31/12	05/16/12 05/16/12	06/30/12 06/30/12	08/31/12 08/31/12	09/30/12 09/30/12	11/11/12 11/11/12	11/30/12 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**
Exercised	-	-	-	-	-	(300)	-	-
Forfeited	(1,017,737)	(11,292)	(6,050)	(22,450)	(1,300)	(27,700)	(800)	(5,000)
Expired	-	-	-	-	-	-	-	-
Outstanding at December 31, 2005	**16,352,513**	**29,458**	**56,500**	**277,500**	**37,150**	**193,300**	**68,800**	**37,900**

(In number of options)					2005 Plans
Exercise price	**€11.41**	**€10.00**	**€8.80**	**€9.80**	**€10.20**
Exercise period from	01/03/06	03/10/06 03/10/09	06/01/06 06/01/09	09/01/06 09/01/09	11/14/06 11/14/09
to	01/02/13	03/09/13 03/09/13	05/31/13 05/31/13	08/31/13 08/31/13	11/13/13 11/13/13
Granted	497,500	16,756,690	223,900	72,150	54,700
Exercised	-	-	-	-	-
Forfeited	(17,400)	(707,210)	(8,800)	-	-
Expired	-	-	-	-	-
Outstanding at December 31, 2005	**480,100**	**16,049,480**	**215,100**	**72,150**	**54,700**

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 that issued these plans, the number of outstanding and exercisable options as of December 31, 2005, the weighted average exercise price and the weighted average exercise period.

				Outstanding options		Exercisable options
Company	**Exercise price**	**Number outstanding at December 31, 2005***	**Weighted remaining exercise period (years)**	**Weighted average exercise price**	**Amount exercisable at December 31, 2005***	**Weighted average exercise price**
Packet Engines	USD 0.29 – USD 0.86	10,372	2.10	0.59	10,372	0.59
Xylan	USD 0.05 – USD 18.14	1,393,928	2.21	9.08	1,393,928	9.08
Internet Devices Inc	USD 0.26 – USD 1.17	23,980	2.88	0.92	23,980	0.92
DSC	USD 16.57 – USD 44.02	45,690	1.25	20.40	45,690	20.40
Genesys	USD 0.01 – USD 41.16	3,018,403	3.25	20.70	3,018,403	20.70
Newbridge	USD 11.72 – USD 52.48	4,253	2.40	12.73	4,253	12.73
Astral Point	EUR 0.29 – EUR 58.71	74,510	4.29	16.57	74,510	16.57
Telera	EUR 0.43 – EUR 6.36	136,161	4.88	5.15	135,759	5.14
iMagic TV	EUR 2.84 – EUR 64.68	78,506	1.74	18.69	78,069	18.77
TiMetra	EUR 0.53 – EUR 7.97	1,703,423	4.96	5.91	1,152,000	5.10
Spatial Wireless	EUR 0.24 – EUR 9.10	858,123	8.24	2.97	248,177	2.99
TOTAL NUMBER OF OPTIONS		**7,347,349**			**6,185,141**	

** 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, Internet Devices, DSC, Genesys and Newbridge entitle the holders to purchase existing ADSs held by Group subsidiaries.

e) Share-based payments

Only stock option plans established after November 7, 2002, and whose stock options were not yet fully vested at January 1, 2005, are restated according to IFRS 2 "Share-based Payment". Those stock options that were fully vested at December 31, 2004 do not therefore result in either a charge in 2004 or in subsequent accounting periods.

By simplification, during the vesting period and as a result of employees leaving the Group, no option cancellations are considered when determining compensation expense for stock options granted. During the vesting period and as a result of employees leaving the Group, the accounting impact of option cancellations is recognized when the cancellation is made. For options cancelled before the end of the vesting period, this can mean correcting the charge, recognized in prior accounting periods, in the period following the cancellation.

Options cancelled after the vesting period and options not exercised do not result in correcting charges previously recognized.

Fair value of granted options

The fair value of stock options is measured using the Cox-Ross-Rubinstein Binomial model. This allows behavioral factors governing the exercise of stock options to be taken into consideration and to consider that all options will not be systematically exercised by the end of the exercise period. The expected volatility is determined as being the implied volatility at the grant date.

Assumptions for the plans representing more than 1,000,000 outstanding options are as follows:

- expected volatility: 60% for the 2002 and March 2003 plans and 40% for the later plans;
- risk-free rate: 4.58% for the 2002 plans, 3.84% for the March 2003 plan, 3.91% for the March 2004 plan and 3.50% for the March 2005 plan;
- distribution rate on future income: 0% in 2003, 2004 and 2005 and 1% for later years.

Based on these assumptions, the fair values of options used in the calculation of compensation expense for share-based payments are as follows:

- 2002 plans: weighted average fair value of €2.48;
- March 2003 plan with an exercise price of €6.70: fair value of €3.31;
- March 2004 plan with an exercise price of €13.20: fair value of €5.06;
- March 2005 plan with an exercise price of €10.00: fair value of €3.72;

Other plans have fair values between €2.89 and €5.08 and a weighted average fair value of €3.86.

Impact on net income (loss) of share-based payments resulting from stock option or stock purchase plans

Compensation expense recognized for share-based payments in accordance with IFRS 2 is analyzed as follows:

(In millions of euros)	2005	2004
Compensation expense for share-based payments	69	60
These amounts are presented on a separate line in the income statement and concern the following captions:		
– cost of sales	*22*	*19*
– administrative and selling expenses	*29*	*26*
– research and development costs	*18*	*15*

The entire expense recognized in application of IFRS 2 concerns share-based payments. None of these transactions results in the outflow of cash.

Characteristics of subscription stock option plans or stock purchase plans recognized in compliance with IFRS 2

Vesting conditions

The following rules are applicable to all plans granted in 2002, 2003, 2004 and 2005:

- vesting is gradual: options vest in successive portions over 4 years, for which 25% of the options are vested if the employee remains employed after 12 months and, for each month after the first year, 1/48th additional options are vested if the employee remains employed by the Group.
- Exercise period depends on countries: in some countries, stock options can be exercised as soon as they are vested; in other countries, a four-year period of inalienability exists. Whatever the beginning of the period is, stock options terminate 8 years after the grant date.

Exceptionally, certain plans that existed in companies acquired in a business combination have been converted into Alcatel subscription stock option plans or stock purchase plans. The vesting conditions are not necessarily aligned to Alcatel's vesting conditions.

Conditions of settlement

All stock options granted are exclusively settled in shares.

Number of options granted and change in number of options

Stock option plans covered by IFRS 2 and the change in number of stock options generating compensation expense are:

(In number of options)		2002 Plans		2003 Plans		2004 Plans		2005 Plans	Total
Exercise price		**€4,60 to 5.40**	**€6.70**	**€7.60 to €11.20**	**€13.20**	**€9.80 to €13.10**	**€10.00**	**€8.80 to €11.41**	
Exercise period	from	11/14/03 12/02/06	03/07/04 03/07/07	06/18/04 12/01/07	03/10/05 03/10/08	04/01/05 12/01/08	03/10/06 03/10/09	01/03/06 11/14/09	
	to	11/13/10 12/01/10	06/30/07 06/30/07	06/17/11 11/30/11	03/09/12 03/09/12	03/31/12 11/30/12	03/09/13 03/09/13	01/31/13 11/13/13	
Outstanding at December 31, 2004		**65,181**	**12,079,954**	**536,493**	**17,370,250**	**775,500**	**-**	**-**	**30,827,378**
Granted		-	-	-	-	-	16,756,690	848,250	17,604,940
Exercised		(20,774)	(1,172,079)	(10,050)	-	(300)	-	-	(1,203,203)
Forfeited		(4,907)	(357,667)	(44,854)	(1,017,737)	(74,592)	(707,210)	(26,200)	(2,233,167)
Expired		-	-	-	-	-	-	-	-
Outstanding at December 31, 2005		**39,500**	**10,550,208**	**481,589**	**16,352,513**	**700,608**	**16,049,480**	**822,050**	**44,995,948**
of which could be exercised		*29,189*	*5,809,745*	*271,665*	*7,316,197*	*208,096*	*-*	*-*	*13,634,892*
Weighted average share price at exercise date		**€9.86**	**€9.99**	**€10.39**	**-**	**€9.80**	**-**	**-**	**€9.99**

f) Treasury stock

Alcatel has established a buy-back program for the ordinary shares, authorized at the shareholders' ordinary annual general meetings held on April 17, 2003, June 4, 2004 and May 20, 2005, 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, 2005 (no shares had been purchased in 2004).

Alcatel shares owned by Group consolidated subsidiaries were €1,575 million at December 31, 2005 (€1,607 million at December 31, 2004). They are deducted at cost from retained earnings.

g) Minority interests

(In millions of euros)	
Balance at January 1, 2004	**388**
Minority interests in 2004 income	69
Other changes *	(84)
Balance at December 31, 2004	**373**
Minority interests in 2005 income	41
Other changes **	63
Balance at December 31, 2005	**477**

** This amount relates to translation adjustments and to changes related to discontinued operations.*

*** This amount primarily relates to translation adjustments.*

Note 24

Compound financial instruments

	ORANE		OCEANE	
(In millions of euros)	**December 31, 2005**	**December 31, 2004**	**December 31, 2005**	**December 31, 2004**
Balance sheet				
Capital stock	242	242	-	-
Additional paid-in capital	403	403	-	-
Reserves (prepaid interest)	(132)	(132)	-	-
Reserves (equity component)	-	-	126	146
Shareholders' equity	**513**	**513**	**126**	**146**
Convertible bonds – due after one year	-	-	901	886
Convertible bonds – due within one year (interest paid and payable)	-	-	48	49
Financial debt	**-**	**-**	**949**	**935**
Income statement				
Finance costs relating to gross debt	-	-	(68)	(67)

a) ORANE (Obligations Remboursables en Actions Nouvelles ou Existantes)

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 carried an annual interest rate of 7.917%. On January 2, 2003, Alcatel paid the full amount of the discounted interest of €132 million, calculated from the settlement date to the maturity date at a discount rate of 7.917%, which amounted to €1.09115 for each bond.

For the repayment of the ORANEs, Alcatel issued only new shares.

During 2004, 3,660 notes were repaid by issuance of 3,212 shares. During 2005, and prior to the redemption of the notes on December 23, 2005, 10,560 notes were repaid by issuance of 10,307 shares (the difference between the number of notes repaid and the number of shares issued (253) results from the impact of discounted interest at the time of the debt issuance).

The notes were entirely redeemed on December 23, 2005 by the issuance of 120,769,959 shares.

The ORANE notes are considered as a component of equity that is classified from the outset in shareholders' equity. As the discounted interest was paid in full on January 2, 2003, that amount was also recognized in shareholders' equity and no interest expense was recognized either in the 2004 or 2005 income statements. The net amount of €513 million received from the note issuance has therefore been reclassified to shareholders' equity in the opening balance sheet at January 1, 2004 in accordance with IFRSs.

b) OCEANE (Obligations Convertibles ou Echangeables en Actions Nouvelles ou Existantes)

On June 12, 2003, Alcatel issued 63,192,019 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.

These bonds have a buy-back option that Alcatel can exercise in the period from June 12, 2008 to December 31, 2010.

The OCEANE bonds are considered as a compound financial instrument containing an equity component and a debt component. Early application of the buy-back option does not require any separate accounting, as the repurchase price is at nominal value and the buy-back option is a derivative closely linked to the debt issuance. The buy-back option is therefore included in the debt component of this compound financial instrument. At the time of issuance, the debt component was valued at €860.7 million, which corresponds to the present value of a similar bond issue but without any equity component. The equity component included in shareholders' equity was valued at €161.8 million at the date of issuance. The contra entry to the equity component, which is amortized to income over the life of the debt, increases the interest cost of this financial debt by €20.0 million in 2005 and by €18.6 million in 2004.

The effective rate of interest of the debt component is 7.83% including debt issuance costs.

At December 31, 2005, the fair value of the debt component of the OCEANE bonds was €1,099 million (see note 26g) and the market value of the OCEANE bonds was €1,151 million.

Note 25

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 (listed shares, bonds, insurance contracts or other types of dedicated investments).

State plans

In certain countries, and more particularly in France and Italy, the Group participates in mandatory social security plans organized at state or industry level, for which contributions expensed correspond to the contributions due to such state or equivalent organizations. Such plans are considered to be defined contribution plans. However, in certain countries, the element of social security contributions paid that relates to pension plans is not clearly identifiable.

Other 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.

Contributions made to defined contribution plans (excluding mandatory social security plans organized at state or industry level) are €40 million for 2005 (€40 million for 2004).

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:

- life annuity: the retirees benefit from receiving 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 reimburses medical expenses of certain retired employees.

Pensions and retirement obligations are determined in accordance with the accounting policies presented in note 1k.

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 period).

For plans providing for the reimbursement of medical expenses, actuarial gains and losses are recognized as income or expense over the average remaining working period.

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 2005 and 2004 are as follows (the rates indicated are weighted average rates):

	2005	2004
Discount rate	3.95%	4.46%
Future salary increases	3.34%	3.52%
Expected long-term return on assets	4.28%	4.70%
Post-retirement cost trend rate	7.50%	7.50%
Average residual active life	15-27 years	15-27 years

The above rates are broken down by geographical segment as follows for 2005 and 2004:

2005	Discount rate	Future salary increases	Estimated long-term return on assets
France	3.75%	3.49%	4.27%
Belgium	3.75%	3.70%	3.75%
United Kingdom	5.00%	4.25%	6.50%
Germany	3.75%	2.75%	3.50%
Rest of Europe	3.32%	2.86%	3.85%
North America	4.98%	4.93%	5.37%
Other	4.25%	4.89%	5.12%
2004			
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%

The discount rates are obtained by reference to market yields on high quality bonds (government and prime-rated corporations – AA or AAA) having maturity dates equivalent to those of the plans.

The returns on plan assets are determined plan by plan and depend upon the asset allocation of the investment portfolio and the expected future performance.

Components of net periodic cost of post-employment benefit plans are:

(In millions of euros)	2005	2004
Service cost	(60)	(72)
Interest cost	(139)	(146)
Expected return on plan assets	93	96
Amortization of prior service cost	-	-
Amortization of recognized actuarial gain/(loss)	8	5
Effect of curtailments	5	15
Effect of settlements	-	-
Effect of adjustment on net assets	-	(2)
Net periodic benefit cost	**(93)**	**(104)**
of which:		
– recognized in operating profit (loss)	*(47)*	*(54)*
– recognized in other financial income (loss)	*(46)*	*(50)*

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

(In millions of euros)	2005	2004
CHANGE IN BENEFIT OBLIGATION		
Benefit obligation at January 1	**(3,282)**	**(3,212)**
Service cost	(60)	(72)
Interest cost	(139)	(146)
Plan participants' contributions	(5)	(4)
Amendments	-	(72)
Business combinations	(31)	-
Disposals	2	53
Curtailments	7	14
Settlements	26	19
Special termination benefits	(2)	0
Actuarial (gains) and losses	(129)	(46)
Benefits paid	177	166
Other (foreign currency translation)	(60)	18
Benefit obligation at December 31	**(3,496)**	**(3,282)**
Benefit obligation excluding effect of future salary increases	(3,230)	(2,934)
Effect of future salary increases	(266)	(348)
Benefit obligation	**(3,496)**	**(3,282)**
Pertaining to retirement plans	*(3,476)*	*(3,265)*
Pertaining to post-employment medical care plans	*(20)*	*(17)*
CHANGE IN PLAN ASSETS		
Fair value of plan assets at January 1	**2,106**	**1,974**
Actual return on plan assets	93	96
Actuarial gains and (losses)	111	47
Employers' contributions	80	84
Plan participants' contributions	5	4
Amendments	-	32
Business combinations	-	-
Disposals	-	-
Curtailments	-	-
Settlements	(26)	(15)
Benefits paid / Special termination benefits	(117)	(108)
Other (foreign currency translation)	34	(8)
Fair value of plan assets at December 31	**2,286**	**2,106**
Present value of defined benefit obligations that are wholly or partly funded	(2,426)	(2,323)
Fair value of plan assets	2,286	2,106
Funded status of defined benefit obligations that are wholly or partly funded	**(140)**	**(217)**
Present value of defined benefit obligations that are wholly unfunded	(1,070)	(959)
Funded status	**(1,210)**	**(1,176)**
Unrecognized actuarial losses/(gains)	46	9
Unrecognized prior service cost	-	-
Unrecognized surplus (due to application of asset ceiling)	(3)	(5)
Net amount recognized	**(1,167)**	**(1,172)**
of which:		
– prepaid pension costs	*294*	*287*
– pensions, retirement indemnities and other post-retirement benefits	*(1,461)*	*(1,459)*

The unfunded status, which amounted to €1,210 million at December 31, 2005 (€1,176 million at December 31, 2004), 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.

The benefit obligation, the fair value of the plan assets and the actuarial gains (losses) generated for the current year and the previous year are as follows:

				Experience adjustments generated on the benefit obligation		Experience adjustments generated on the plan assets	
(In millions of euros)	Benefit obligation	Plan assets	Funded (unfunded) status	Amount	In percentage of the benefit obligation	Amount	In percentage of the plan assets
2005	(3,496)	2,286	(1,210)	72	2.06%	111	4.86%
2004	(3,282)	2,106	(1,176)	6	0.18%	47	2.23%

In respect of the medical care plans, a change of one percentage point in the assumed medical costs has the following impact:

	Increase of 1%	Decrease of 1%
Impact on the current service cost and interest costs	(0)	0
Impact on the benefit obligation	(0)	0

The plan assets of retirement plans are invested as follows:

(In millions of euros and percentage)	Bonds	Equity securities	Short-term investments	Property assets	Total
2005	941	626	348	371	2,286
	41%	28%	15%	16%	100%
2004	853	576	365	312	2,106
	41%	27%	17%	15%	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 property assets are not occupied by Group entities.

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

The contributions that are expected to be paid for 2006 are €66 million for the retirement plans.

Note 26

Financial debt

a) Analysis of financial debt, net

(In millions of euros)	2005	2004
Marketable securities, net	640	552
Cash and cash equivalents	4,510	4,611
Cash, cash equivalents and marketable securities	**5,150**	**5,163**
(Convertible and other bonds – long-term portion)	(2,393)	(3,089)
(Other long-term debt)	(359)	(402)
(Current portion of long-term debt)	(1,046)	(1,115)
(Financial debt, gross)	**(3,798)**	**(4,606)**
Derivative interest rate instruments – other current and non-current assets	178	148
Derivative interest rate instruments – other current and non-current liabilities	(71)	(43)
CASH (FINANCIAL DEBT), NET	**1,459**	**662**

b) Analysis of financial debt, gross – by type

(In millions of euros)	2005	2004
Convertible bonds	901	886
Other bonds	1,960	2,788
Bank loans and overdrafts	629	687
Commercial paper	127	61
Finance lease obligations	60	45
Accrued interest	121	139
FINANCIAL DEBT, GROSS	**3,798**	**4,606**

Convertible bonds

The characteristics of these bonds and how they are recognized are detailed in note 24b.

Other bonds

Changes in 2005

Repurchases

Certain other bonds were subject to buy-back and cancellation in 2005, amounting to €291 million and corresponding to a nominal value of €280 million, detailed as follows:

Recent history of Alcatel's long-term debt credit rating	
5.875% EUR due September 2005	€51,627,000
Zero-rate coupon due June 2006	€4,838,724
5.625% EUR due March 2007	€150,925
7.00% EUR due December 2006	€72,603,000
4.375% EUR due February 2009	€150,676,000

The difference between the repurchased amount and the nominal value was included in financial income (loss) in other financial income (loss), net (see note 8).

Repayments

The balance of the bonds carrying interest at 5.875% was repaid in September 2005 for a residual nominal amount of €524.7 million.

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. 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. In accordance with IAS 39, such exchange of debt is not considered as an extinguishment of the initial debt and the issuance of new debt, because the borrowing conditions are not substantially different as a result of the exchange transaction. The loss arising on the exchange offer and the related transaction fees are recognized as an adjustment of the carrying amount of the existing debt and are amortized over the remaining life of the adjusted bonds.

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 income (loss), net (see note 8).

The other changes for 2004 were the repayment on February 17, 2004 of the residual €183 million on 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.

c) Analysis by maturity date

(In millions of euros)	2005	2004
Current portion of long-term debt	769	910
Short-term debt	277	205
Financial debt due within one year	**1,046**	**1,115**
2006	-	627
2007	364	393
2008	104	61
2009	878	1,043
2010	9	-
2011 and thereafter	1,397	1,367
Financial debt due after one year	**2,752**	**3,491**
TOTAL	**3,798**	**4,606**

d) Debt analysis by rate

(In millions of euros)			2005
	Amounts	Effective interest rate	Interest rate after hedging
Convertible bonds	901	7.83%	7.40%
Other bonds	1,960	6.16%	4.57%
Bank loans and overdrafts and finance lease obligations	689	3.58%	3.29%
Commercial paper	127	2.47%	2.47%
Accrued interest	121	5.39%	4.18%
FINANCIAL DEBT, GROSS	**3,798**	**5.94%**	**4.93%**

e) Debt analysis by type of rate

(In millions of euros)		2005		2004
	Before hedging	After hedging	Before hedging	After hedging
Total fixed rate debt	3,686	1,132	4,468	1,153
Total floating rate debt	112	2,666	138	3,453
TOTAL	**3,798**	**3,798**	**4,606**	**4,606**

f) Debt analysis by currency

(In millions of euros)		2005		2004
	Before hedging	After hedging	Before hedging	After hedging
Euro	3,609	3,609	4,512	4,512
U.S. Dollar	141	141	52	52
Other	48	48	42	42
TOTAL	**3,798**	**3,798**	**4,606**	**4,606**

g) Fair value of debt

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, 2005, the fair value of debt before hedging (and credit spread) amounted to €4,141 million.

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, 2005, the fair value of the debt after hedging was €4,033 million.

At December 31, 2004, the fair value of debt before hedging (and credit spread) amounted to €4,926 million.

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 €4,748 million.

h) Credit rating

At January 31, 2006, Alcatel credit ratings were as follows:

Rating Agency	Long-term debt	Short-term debt	Outlook	Last update
Moody's	Ba1	Not Prime	Positive	April 11, 2005
Standard & Poor's	BB	B	Stable	November 10, 2004

On April 11, 2005, Moody's upgraded Alcatel's long-term debt credit rating to Ba1 from Ba3 and maintained its outlook Positive. The Not Prime rating of the short-term debt was reaffirmed.

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

Date		Moody's	Date		Standard & Poor's
April 11, 2005	Ba1	Outlook Positive	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

Rating clauses affecting Alcatel debt at December 31, 2005

Alcatel's short-term debt rating allows a 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 with both agencies move back to investment grade level. However, this interest rate decrease will not take place since the condition relating to Alcatel's ratings was not met before December 31, 2005.

Syndicated bank credit facility

On March 15, 2005, Alcatel amended the three-year multi-currency revolving facility that had been put in place on June 21, 2004. Consequently, the maturity date of the facility was lengthened from June 2007 to June 2009, the financial conditions were improved and one of the financial covenants was eliminated. Moreover, Alcatel decided to reduce the amount of this revolving facility from €1,300 million to €1,000 million.

The availability of this syndicated credit facility of €1,000 million is not dependent upon Alcatel's credit ratings. At December 31, 2005, the credit facility had not been drawn and remained undrawn at the date of approval of the 2005 financial statements by Alcatel's Board of Directors. Alcatel's ability to draw on this facility is conditioned upon its compliance with a financial covenant linked to the capacity of Alcatel to generate sufficient cash to repay its net debt. As the Group had cash, cash equivalents and marketable securities in excess of its gross financial debt at December 31, 2005, September 30, 2005, June 30, 2005, March 31, 2005 and at December 31, 2004, 2003 and 2002, the above-mentioned financial covenant was not applicable at these dates.

Note 27
Provisions

a) Balance at December 31

(In millions of euros	2005	2004
Provisions for product sales	580	662
Provisions for restructuring	417	692
Provisions for litigation	130	95
Other provisions	494	600
TOTAL *	**1,621**	**2,049**
** of which:*		
– portion expected to be used within one year	*1,024*	*1,397*
– portion expected to be used after one year	*597*	*652*

b) Change during 2005

(In millions of euros)	December 31, 2004	Appropriation	Utilization	Reversals	Change in consolidated companies	Other	December 31, 2005
Provisions for product sales	662	305	(212)	(236)	(7)	68	580
Provisions for restructuring	692	172	(414)	(40)	(7)	14	417
Provisions for litigation	95	21	(28)	(10)	-	52	130
Other provisions	600	76	(59)	(41)	(16)	(66)	494
TOTAL	**2,049**	**574**	**(713)**	**(327)**	**(30)**	**68**	**1,621**
Effect on the income statement							
– operating profit (loss)		(360)		267			(93)
– restructuring costs		(161)		40			(121)
– other financial income (loss)		(18)		4			(14)
– income taxes		(19)		13			(6)
– income (loss) from discontinued operations and gain/(loss) on disposal of consolidated shares		(16)		3			(13)
TOTAL		**(574)**		**327**			**(247)**

At period-end, contingent liabilities exist with regard to ongoing tax disputes. Neither the financial impact nor the timing of any outflows of resources that could result from an unfavorable outcome of these disputes can be estimated at present. Nevertheless, the Group is confident in the outcome of these ongoing disputes.

c) Analysis of restructuring provisions

(In millions of euros)	2005	2004
Opening balance	**692**	**1,084**
Utilization during the period	(414)	(606)
New plans and adjustments to previous estimates*	132	334
Effect of acquisition (disposal) of consolidated subsidiaries	(7)	(66)
Cumulative translation adjustments and other changes	14	(54)
Closing balance	**417**	**692**

** For 2005, total restructuring costs were €110 million, representing a reversal of asset impairment losses of €11 million and €121 million of new restructuring plans and adjustments to previous plans (for 2004, total restructuring costs were €324 million relating to new restructuring plans and adjustments to previous plans). In addition, a finance cost of €11 million (€10 million for 2004) was recorded in other financial income (loss) in 2005 for the amount related to reversing the discount element included in provisions.*

For 2005, the costs relate primarily to restructuring plans in Western Europe (Germany, Spain, France).

Note 28

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, 2005 are intended to reduce the cost of debt and to hedge interest rate risk. At December 31, 2005 and 2004, outstanding interest rate derivatives have the following characteristics:

a) Outstanding interest rate derivatives at December 31

Analysis by type and maturity date

	Contract notional amounts Maturity date			2005		2004	
(In millions of euros)	Less than one year	1 to 5 years	After 5 years	Total	Market value	Total	Market value
Interest rate swaps							
– pay fixed rate	1,897	3,579	133	5,609	(10)	4,088	27
– pay floating rate	2,108	5,518	498	8,124	118	7,285	149
Caps							
– buy	890	1,656	-	2,546	12	3,729	13
– sell	763	1,656	-	2,419	(12)	2,971	(11)
Floors							
– buy	-	-	-	-	-	367	2
– sell	-	-	-	-	-	367	(2)
Forward rate agreements							
– buy	-	-	-	-	-	-	-
– sell	-	-	-	-	-	-	-
Options on interest rate swaps USD Libor							
– buy	212	-	-	212	2	-	-
– sell	212	-	-	212	(2)	-	-
TOTAL MARKET VALUE					**108**		**178**

Analysis by accounting category

(In millions of euros)	Market value	
	2005	**2004**
Fair value hedges	78	146
Cash flow hedges	-	-
Instruments not qualifying for hedge accounting	30	32
TOTAL	**108**	**178**

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 2005 (€14 million for 2004).

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 €53 million on the market value of the financial debt in 2005 (€50 million in 2004).

B - Currency risk

a) Outstanding currency derivatives at December 31

Analysis by type and currency

(In millions of euros)					2005		2004
	U.S. dollar	British pound	Other	Total	Market value	Total	Market value
Buy / Lend foreign currency							
Forward exchange contracts	983	192	610	1,785	31	1,722	(37)
Short-term exchange swaps	267	72	250	589	4	132	(2)
Cross currency swaps	-	-	-	-	-	0	0
Currency option contracts:							
– buy call	355	-	235	590	18	1,406	18
– sell put	335	-	1,052	1,387	(19)	2,653	(72)
Total	**1,940**	**264**	**2,147**	**4,351**	**34**	**5,913**	**(93)**
Sell / Borrow foreign currency							
Forward exchange contracts	1,700	129	278	2,107	(58)	2,924	177
Short-term exchange swaps	1,056	125	204	1,385	(16)	385	5
Cross currency swaps	-	-	-	-	-	-	-
Currency option contracts:							
– sell call	250	-	164	414	(15)	1,455	(17)
– buy put	737	-	1,037	1,774	26	3,032	86
Total	**3,743**	**254**	**1,683**	**5,680**	**(63)**	**7,796**	**251**
TOTAL MARKET VALUE					**(29)**		**158**

Analysis by type and maturity

(In millions of euros)				Maturity date
	Less than 1 year	1 to 5 years	After 5 years	Total
Buy / Lend				
Forward exchange contracts	1,779	6	-	1,785
Short-term exchange swaps	589	-	-	589
Cross currency swaps	-	-	-	-
Currency option contracts:				
– buy call	392	198	-	590
– sell put	593	794	-	1,387
TOTAL	**3,353**	**998**	**-**	**4,351**

(In millions of euros)				Maturity date
	Less than 1 year	1 to 5 years	After 5 years	Total
Sell / Borrow				
Forward exchange contracts	2,055	52	-	2,107
Short-term exchange swaps	1,385	-	-	1,385
Cross currency swaps	-	-	-	-
Currency option contracts:				
– buy call	299	115	-	414
– sell put	948	826	-	1,774
TOTAL	**4,687**	**993**	**-**	**5,680**

Analysis by accounting category

(In millions of euros)		Market value
	2005	2004
Fair value hedges	(37)	113
Cash flow hedges	(3)	-
Hedges of net investments	-	-
Instruments not qualifying for hedge accounting	11	45
TOTAL	**(29)**	**158**

b) Reclassification to income statement of gains or losses on hedges of forecast transactions that were originally recognized in equity

(In millions of euros)	
Cash flow hedges accounted for in shareholders' equity at December 31, 2004	**0**
Changes in fair value	2
Reclassification of gains or losses to income statement	-
Cash flow hedges accounted for in shareholders' equity at December 31, 2005	**2**

Changes in the fair values of cash flow hedges accounted for in shareholders' equity at December 31, 2005 are expected to be reclassified to the income statement for €2 million in 2006.

c) Stock market risk

Alcatel and its subsidiaries do not engage in speculative stock market transactions. On Alcatel approval, subsidiaries may hold stable, non-consolidated investments.

At December 31, 2005, neither Alcatel shares non other shares held by Alcatel were the object of any ongoing significant transaction.

Note 29

Customers' deposits and advances

(In millions of euros)	2005	2004
Advance payments received on construction contracts	704	448
Other deposits and advances received from customers	440	525
TOTAL CUSTOMERS' DEPOSITS AND ADVANCES	**1,144**	**973**
of which:		
*– portion due within one year**	*961*	-
*– portion due after one year**	*183*	-

** Data is not available for 2004*

Note 30

Net cash provided (used) by operating activities before changes in working capital, interest and taxes

(In millions of euros)	Q4 2005	2005	2004
Net income (loss) attributable to the equity holders of the parent	**344**	**930**	**576**
Minority interests	**11**	**41**	**69**
Adjustments			
– depreciation and amortization of tangible and intangible assets	164	581	545
of which impact of capitalized development costs	*65*	*248*	*196*
– amortization of capitalized development costs	-	-	88
– changes in pension obligations, net	(28)	(49)	(38)
– provisions, impairment losses and fair value changes	(65)	(500)	(607)
– net (gain) loss on disposal of assets	(47)	(317)	(139)
– share in net income (losses) of equity affiliates (net of dividends received)	1	29	81
– (income) loss from discontinued operations	(9)	13	(142)
– finance costs	20	96	121
– share-based payments	14	69	60
– taxes	115	91	36
Sub-total of adjustments	**165**	**13**	**5**
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES BEFORE CHANGES IN WORKING CAPITAL, INTEREST AND TAXES	**520**	**984**	**650**

Note 31

Contractual obligations and disclosures 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 as of December 31, 2005. Amounts related to financial debt and finance lease obligations are fully reflected in the consolidated balance sheet.

(In millions of euros)				**Maturity date**	
Contractual cash obligations	**Less than one year**	**1 to 3 years**	**4 to 5 years**	**After 5 years**	**Total**
Financial debt (excluding finance leases)	986	468	887	1,397	3,738
Finance lease obligations	60	-	-	-	60
Equity component of OCEANE	-	-	-	126	126
Sub-total – included in balance sheet	**1,046**	**468**	**887**	**1,523**	**3,924**
Finance costs on financial debt	164	200	152	89	605
Operating leases	150	264	182	350	946
Commitments to purchase fixed assets	28	-	-	-	28
Other unconditional purchase obligations*	81	15	3	-	99
Sub-total – Commitments	**423**	**479**	**337**	**439**	**1,678**

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

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).

Guarantees given in the normal course of the Group's business are presented below.

For guarantees given for contract performance, only those granted by financial institutions are presented below.

(In millions of euros)	2005	2004
Guarantees given on contracts performed by consolidated subsidiaries or by non-consolidated subsidiaries	2,034	1,742
Discounted notes receivable and other	-	5
Other contingent commitments	624	793
Sub-total – Contingent commitments	**2,658**	**2,540**
Debt security interests granted and other debt guarantees	97	156
Guarantees on cash pooling	639	605
TOTAL	**3,394**	**3,301**

Contingent commitments at December 31, 2005

(In millions of euros)				Maturity date	
Contingent commitments	**Less than one year**	**1 to 3 years**	**4 to 5 years**	**After 5 years**	**Total**
Guarantees on Group contracts*	1,223	292	180	123	1,818
Guarantees on third party contracts	139	59	9	9	216
Discounted notes receivable and other	-	-	-	-	-
Other contingent commitments	171	169	134	150	624
TOTAL	**1,533**	**520**	**323**	**282**	**2,658**
Counter guarantees received	**272**	**41**	**4**	**2**	**319**
** Reflected in balance sheet*					*302*

The amounts reflected in the preceding tables 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 construction contracts. For more information concerning litigation, see note 34.

Guarantees given on Group construction 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 debt, advance payments received, contingencies and security interests granted at December 31, 2005" 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 "provisions" (see note 28) or in inventory reserve. The amounts concerned are given in the preceding table in the specific caption "*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 takes into account the insurance proceeds that may be received in case of a claim.

Guarantees given on third party construction 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 €2 million at December 31, 2005 (€3 million at December 31, 2004).

Guarantees granted on debt, advance payments received, contingencies and security interests granted at December 31, 2005

(In millions of euros)				Maturity date			
Guarantees on borrowings and advance payments received	**Less than one year**	**1 to 3 years**	**4 to 5 years**	**After 5 years**	**Total**	**Total of the balance sheet caption**	**% of the balance sheet caption**
Security interests granted	5	-	-	4	9		
Other guarantees given	61	1	6	20	88		
TOTAL	**66**	**1**	**6**	**24**	**97**		
Net book value of assets given in guarantee							
– intangible assets	-	-	-	-	-	819	0.0
– tangible assets	5	-	-	-	5	1,111	0.5
– financial assets	-	-	-	4	4	306	1.3
– inventories and work in progress	-	-	-	-	-	1,438	0.0
TOTAL	**5**	**-**	**-**	**4**	**9**	**3,674**	**0.2**

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. At December 31, 2005, this guarantee was valued at €639 million (€605 million at December 31, 2004).

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. As indicated in note 38-IV-E, this receivable is kept in the consolidated balance sheet with the contra entry in financial debt because of the Group's ability to recover this receivable before its maturity date.

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 SIC 12. The receivables sold at December 31, 2005, which amounted to €61 million (€82 million at December 31, 2004), are therefore maintained in the consolidated balance sheet. At December 31, 2005, the maximum amount of receivables that could be sold amounted to €150 million (€150 million at December 31, 2004), 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

To the Group's knowledge, the only shareholder holding more than 5% of the parent company's share capital is Brandes Investment Partners LP.

Transactions with related parties (as defined by IAS 24 "Related Party Disclosures") during 2005 and 2004 were as follows:

(In millions of euros)	2005	2004
Revenues		
– non-consolidated affiliates	44	42
– joint ventures	-	-
– equity affiliates	9	11
Cost of sales		
– non-consolidated affiliates	(48)	(67)
– joint ventures	(145)	(120)
– equity affiliates	(23)	(4)
Research and development costs		
– non-consolidated affiliates	(7)	(5)
– joint ventures	(36)	(41)
– equity affiliates	(3)	-

Outstanding balances arising from related party transactions at December 31, 2005 and 2004 were as follows:

(In millions of euros)	2005	2004
Other assets		
– non-consolidated affiliates	21	41
– joint ventures	30	35
– equity affiliates	29	14
– valuation allowances	(20)	(6)
Other liabilities		
– non-consolidated affiliates	(22)	(20)
– joint ventures	(50)	(18)
– equity affiliates	(18)	(15)
Cash (financial debt), net		
– non-consolidated affiliates	-	(11)
– joint ventures	(11)	15
– equity affiliates	(38)	(31)

Members of the Board of Directors and members of the Group's executive committee are those present during the year and listed in the Corporate Governance section of the Annual Report. In 2005 and 2004, compensation, benefits and social security contributions attributable to members of the Board of Directors and to the executive committee members ("key management personnel") were as follows:

Recorded expense in respect of compensation and related benefits attributable to key management personnel during the year

(In millions of euros)	2005	2004
Short-term benefits		
Fixed remuneration	7	7
Variable remuneration	7	4
Directors' fees	1	1
Employer's social security contributions	4	4
Termination benefits and retirement indemnities	5	-
Other benefits		
Post-employment benefits	5	4
Share-based payments (stock option plans)	5	5
TOTAL	**34**	**25**

Note 33

Payroll and staff training rights

(In millions of euros)	2005	2004
Wages and salaries (including social security / pension costs)	3,702	3,740

The law of May 4, 2004 in France provides French company employees with the right to receive individual training of at least 20 hours per year that can be accumulated over six years. Costs incurred relating to these individual training rights are considered as period costs. Cost accruals are not required to be made except in exceptional circumstances. Accumulated individual staff training rights were 601,179 hours at December 31, 2005 (312,400 hours at December 31, 2004).

Note 34

Contingencies

In addition to legal proceedings incidental to the conduct of its business (including employment-related collective actions in France and the U.S.) 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. By a decision dated June 29, 2005, which has now become final, the division of the Paris Court of Appeals dealing with issues arising in the context of criminal investigation definitely rejected a final request for annulment. As a result, the investigating magistrate may now close his judicial inquiry at any time.

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. The 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 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. This was filed, and fully briefed as of August 5, 2005. The parties are now waiting for the judge's decision.

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, 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 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 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 have been 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 payments by Alcatel in foreign countries. 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 harm 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 its business. If the Costa Rican authorities conclude criminal violations have occurred, Alcatel may be banned from participating in government procurement 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 €10 million in revenue from Costa Rican contracts in 2006. 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 Alcatel in Latin America.

Taiwan

Certain employees of 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 Taisel by Taiwan Railways in 2003. It has been alleged that persons in Taisel and Siemens Taiwan and subcontractors hired by them were involved in a bid rigging and illicit 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 president of Taisel. A director of international sales and marketing development of a German subsidiary who was involved in the Taiwan Railways contract has resigned.

On February 21, 2005, the former president of Taisel, Taisel and others were indicted for violation of the Taiwanese Government Procurement Act.

On November 15, 2005, the Taipei criminal district court found Taisel not guilty of the alleged violation of the Government Procurement Act. The former President of Taisel was not judged because he was not present or represented at the proceedings. The court found two Taiwanese businessmen involved in the matter guilty of violations of the Business Accounting Act.

The prosecutor has filed an appeal with the Taipei court of appeal. Should the higher court find Taisel guilty of the bid-rigging allegations in the indictment, Taisel may be banned from participating in government procurement contracts within Taiwan for a certain period and fines or penalties may be imposed on Alcatel, in an amount not to exceed €25,000.

Other allegations made in connection with this matter may still be under ongoing investigation by the Taiwanese authorities.

As a group, Alcatel expects to generate approximately €126 million of revenue from Taiwanese contracts in 2006, of which only a part will be from governmental contracts. Based on the amount of revenue expected 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 consolidated financial position or its income (loss) from operating activities. 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 (loss) or the assets of Alcatel or the Group.

Note 35

Events after the balance sheet date

There were no events, favorable or unfavorable, that occurred between the balance sheet date and February 1, 2006, the date when the Board of Directors authorized the consolidated financial statements for issue. However, the consolidated financial statements will only be final once approved by the Annual Shareholders' Meeting.

Note 36

Main consolidated companies

Company	Country	% control	% interest	Consolidation method
Alcatel ** and ***	France			Parent company
OPERATING COMPANIES*				
Alcatel Australia Limited	Australia			Full consolidation
Alcatel Austria A.G.	Austria			Full consolidation
Alcatel Bell NV	Belgium			Full consolidation
Alcatel Business Systems S.A.	France			Full consolidation
Alcatel Canada Inc	Canada			Full consolidation
Alcatel CIT	France			Full consolidation
Alcatel China Investment Co. Ltd	R.P.C.			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 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 Alenia Space	France	67	67	Proportionate
Telespazio	Italy	33	33	Proportionate
Alcatel Submarine Networks Limited	U.K.			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 Telecommunicacoes SA	Brazil			Full consolidation
Alcatel Teletas Telekommunikasyon**	Turkey	65	65	Full consolidation
Alcatel USA Inc	U.S.			Full consolidation
Radio Frequency Systems GmbH	Germany			Full consolidation
Radio Frequency Systems Inc	U.S.			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

* *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".*

Company	Country	% control	% interest	Consolidation method
HOLDINGS AND OTHER SEGMENT ***				
Aerospace, defence and IT&S				
Thales (ex Thomson-CSF) **	France	12.8	9.5	Equity
Financial Holdings				
Alcatel Holding Canada Corp.	Canada			Full consolidation
Alcatel NV	The Netherlands			Full consolidation
Alcatel Participations	France			Full consolidation
Alcatel UK Limited	U.K.			Full consolidation
Compagnie Financière Alcatel	France			Full consolidation
Coralec	France			Full consolidation
Telpart	France			Full consolidation
Financial Services				
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 (unaudited)

a) Consolidated income statements

(In millions of euros)

2005	Q1	Q2	Q3	Q4	Total
Revenues	2,607	3,145	3,289	4,094	13,135
Cost of sales	(1,658)	(2,026)	(2,151)	(2,668)	(8,503)
Gross profit	**949**	**1,119**	**1,138**	**1,426**	**4,632**
Administrative and selling expenses	(498)	(515)	(498)	(489)	(2,000)
Research and development expenses before capitalization of development expenses	*(366)*	*(385)*	*(376)*	*(417)*	*(1,544)*
Impact of capitalization of development expenses	*22*	*44*	*14*	*21*	*101*
Research and development costs	(344)	(341)	(362)	(396)	(1,443)
Operating profit (loss)	**107**	**263**	**278**	**541**	**1,189**
Share-based payments (stock option plans)	(18)	(20)	(17)	(14)	(69)
Restructuring costs	(15)	(34)	2	(63)	(110)
Impairment of capitalized development costs	-	-	-	-	-
Gain/(loss) on disposal of consolidated shares	-	-	129	-	129
Income (loss) from operating activities	**74**	**209**	**392**	**464**	**1,139**
Financial interest on gross financial debt	*(55)*	*(55)*	*(58)*	*(50)*	*(218)*
Financial interest on cash and cash equivalents	*24*	*36*	*32*	*30*	*122*
Finance costs	(31)	(19)	(26)	(20)	(96)
Other financial income (loss)	42	31	(44)	17	46
Share in net income (losses) of equity affiliates	(1)	(22)	9	-	(14)
Income before tax and discontinued operations	**84**	**199**	**331**	**461**	**1,075**
Income tax expense	49	27	(52)	(115)	(91)
Income (loss) from continuing operations	**133**	**226**	**279**	**346**	**984**
Income (loss) from discontinued operations	3	(18)	(7)	9	(13)
NET INCOME (LOSS)	**136**	**208**	**272**	**355**	**971**
attributable to:					
– equity holders of the parent	**124**	**196**	**266**	**344**	**930**
– minority interests	12	12	6	11	41
Net income (loss) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share	0.09	0.14	0.19	0.25	0.68
– diluted earnings per share	0.09	0.14	0.19	0.25	0.68
Net income (loss) (before discontinued operations) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share	0.09	0.15	0.19	0.25	0.69
– diluted earnings per share	0.09	0.15	0.19	0.25	0.69
Net income (loss) of discontinued operations per share (in euros)					
– basic earnings per share	-	(0.01)	-	0.00	(0.01)
– diluted earnings per share	-	(0.01)	-	0.00	(0.01)

(In millions of euros)

2004	**Q1**	**Q2**	**Q3**	**Q4**	**Total**
Revenues	2,515	2,899	3,024	3,806	12,244
Cost of sales	(1,607)	(1,714)	(1,865)	(2,445)	(7,631)
Gross profit	**908**	**1,185**	**1,159**	**1,361**	**4,613**
Administrative and selling expenses	(487)	(532)	(429)	(496)	(1,944)
Research and development expenses before capitalization of development expenses	*(378)*	*(429)*	*(385)*	*(428)*	*(1,620)*
Impact of capitalization of development expenses	*41*	*33*	*27*	*29*	*130*
Research and development costs	(337)	(396)	(358)	(399)	(1,490)
Operating profit (loss)	**84**	**257**	**372**	**466**	**1,179**
Share-based payments (stock option plans)	(7)	(17)	(18)	(18)	(60)
Restructuring costs	(65)	(68)	(18)	(173)	(324)
Impairment of capitalized development expenses	0	0	0	(88)	(88)
Income (loss) from operating activities	**12**	**172**	**336**	**187**	**707**
Financial interest on gross financial debt	*(50)*	*(58)*	*(63)*	*(55)*	*(226)*
Financial interest on cash, cash equivalents and marketable securities	*22*	*26*	*29*	*28*	*105*
Finance costs	**(28)**	**(32)**	**(34)**	**(27)**	**(121)**
Other financial income (loss)	32	(8)	16	(26)	14
Share in net income (losses) of equity affiliates	6	(3)	(34)	(30)	(61)
Income before tax and discontinued operations	**22**	**129**	**284**	**104**	**539**
Income tax expense	21	28	(14)	(71)	(36)
Income (loss) from continuing operations	**43**	**157**	**270**	**33**	**503**
Income (loss) from discontinued operations	232	(40)	(44)	(6)	142
NET INCOME (LOSS)*	**275**	**117**	**226**	**27**	**645**
attributable to:					
– equity holders of the parent	**278**	**96**	**195**	**7**	**576**
– minority interests	(3)	21	31	20	69
Net income (loss) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share	0.21	0.07	0.14	0.01	0.43
– diluted earnings per share	0.21	0.07	0.14	0.00	0.42
Net income (loss) (before discontinued operations) attributable to the equity holders of the parent per share (in euros)					
– basic earnings per share	0.04	0.10	0.17	0.01	0.32
– diluted earnings per share	0.04	0.10	0.17	0.00	0.31
Net income (loss) of discontinued operations per share (in euros)					
– basic earnings per share	0.17	(0.03)	(0.03)	0.00	0.11
– diluted earnings per share	0.17	(0.03)	(0.03)	0.00	0.11

** See "Preliminary remarks" in note 38.*

b) Information by business segment

(In millions of euros)

2005	Q1	Q2	Q3	Q4	Total
Revenues					
Fixed communications	987	1,224	1,282	1,720	5,213
Mobile communications	789	958	1,092	1,257	4,096
Private communications	848	981	928	1,161	3,918
Other and eliminations	(17)	(18)	(13)	(44)	(92)
TOTAL	**2,607**	**3,145**	**3,289**	**4,094**	**13,135**
Operating profit (loss)					
Fixed communications	50	120	121	288	579
Mobile communications	66	115	116	139	436
Private communications	34	59	64	117	274
Other	(43)	(31)	(23)	(3)	(100)
TOTAL	**107**	**263**	**278**	**541**	**1,189**

(In millions of euros)

2005	Q1	Q2	Q3	Q4	Total
Operating profit (loss) excluding capital gains (losses) on disposal of tangible and intangible assets					
Fixed communications	50	112	121	280	563
Mobile communications	66	109	116	132	423
Private communications	35	52	64	102	253
Other	(44)	(32)	(23)	(3)	(102)
TOTAL	**107**	**241**	**278**	**511**	**1,137**

(In millions of euros)

2004	Q1	Q2	Q3	Q4	Total
Revenues					
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 and eliminations	(37)	(39)	(29)	(35)	(140)
TOTAL	**2,515**	**2,899**	**3,024**	**3,806**	**12,244**
Operating profit (loss)					
Fixed communications	46	167	184	179	576
Mobile communications	80	70	119	149	418
Private communications	28	40	92	107	267
Other	(70)	(20)	(23)	31	(82)
TOTAL	**84**	**257**	**372**	**466**	**1,179**
Operating profit (loss) excluding capital gains (losses) on disposal of tangible and intangible assets					
Fixed communications	45	159	156	170	530
Mobile communications	80	67	105	145	397
Private communications	28	39	74	101	242
Other	(70)	(27)	(23)	36	(84)
TOTAL	**83**	**238**	**312**	**452**	**1,085**

Note 38

Reconciliation schedules from French GAAP to IFRSs

Preliminary remarks

As indicated in the section “Transition to IFRS” of the 2004 Reference Document, Alcatel’s 2004 IFRS financial information presented hereafter has been changed marginally compared to that previously communicated.

The changes are explained primarily by:

- the completion of the analysis of the impact of the application of IAS 38 “Intangible Assets”, IAS 32 “Financial Instruments: Disclosure and Presentation” and IAS 39 “Financial Instruments: Recognition and Measurement”;
- the publication of IFRS data from certain companies consolidated under the equity method, for which the transition impact to IFRSs was either provisional or not available at the time of publishing the 2004 Reference Document;
- consideration of the latest available information in terms of interpreting the existing standards;
- completion of the verification of adjustments relating to the cumulative translation adjustments and to accrued pensions and retirement obligations; and
- the reclassifications between the current and non-current portions of other assets and liabilities.

I. Reconciliation of equity as of January 1, 2004

		Adjustments									
(In millions of euros)	French GAAP	R&D (IV.A)	ORANE & OCEANE (IV.B)	Other impacts IAS 32 and 39 (IV.C)	Stock-options (IV.D)	Carry-back receivable and SVF (IV.E)	Pensions (IV.F)	Other	Total adjustments	Reclassifications (IV.F)	IFRS
Goodwill, net	3,839							(21)	(21)	(188)	3,630
Other intangible assets, net	284	299							299		583
Property, plant and equipment, net	1,500							5	5	(69)	1,436
Share in net income (losses) of equity affiliates	391							32	32	78	501
Inventories and work in progress, net	1,432									(226)	1,206
Amount due from customers on construction contracts										527	527
Trade receivables and other related accounts, net	3,364			(101)				(4)	(105)	(496)	2,763
Advances and progress payments										106	106
Deferred tax assets		(38)			(31)		0	(1)	(70)	2,064	1,994
Other current and non-current assets	4,053		(109)	1,126		342			1,359	(2,102)	3,310
Assets held for sale				2					2	432	434
Cash, cash equivalents and marketable securities	6,269			48					48	(15)	6,302
Total assets	**21,132**	**261**	**(109)**	**1,075**	**(31)**	**342**	**0**	**11**	**1,549**	**111**	**22,792**
Accrued pension and retirement obligations	1,010						222	6	228		1,238
Other equity (notes mandatorily redeemable for shares)	645		(645)						(645)		
Financial debt	5,293		(165)	95		375		9	314	224	5,831
Deferred tax liabilities							(13)	5	(8)	122	114
Provisions	3,049			(5)		(32)		2	(35)	(253)	2,761
Customers' deposits and advances	1,181									(116)	1,065
Amount due to customers on construction contracts										93	93
Trade payables and related accounts	3,617			(3)					(3)	6	3,620
Debt linked to bank activity	224									(224)	
Liabilities related to discontinued operations										253	253
Other current and non-current liabilities	2,720			775	(231)			14	558	6	3,284
Total liabilities	**17,739**	**0**	**(810)**	**862**	**(231)**	**343**	**209**	**36**	**409**	**111**	**18,259**
NET ASSETS	**3,393**	**261**	**701**	**213**	**200**	**(1)**	**(209)**	**(25)**	**1,140**	**(0)**	**4,533**
Capital stock and additional paid-in capital	10,131		645		35				680		10,811
Deferred compensation					(35)				(35)		(35)
Treasury stock owned by consolidated companies	(1,728)									(2)	(1,730)
Other reserves	(4,855)	261	56	213	200	(21)	(209)	(30)	470	(516)	(4,901)
Cumulative translation adjustments	(518)									518	
Net income (loss) attributable to the Group	-								-	-	-
Shareholders' equity attributable to the equity holders of the parent	**3,030**	**261**	**701**	**213**	**200**	**(21)**	**(209)**	**(30)**	**1,115**	**0**	**4,145**
Minority interests – Net income (loss)	-										-
Minority interests – Shareholders' equity	363					20		5	25	0	388
TOTAL SHAREHOLDERS' EQUITY	**3,393**	**261**	**701**	**213**	**200**	**(1)**	**(209)**	**(25)**	**1,140**	**0**	**4,533**

II. Reconciliation of equity as of December 31, 2004

		Adjustments									
(In millions of euros)	French GAAP	R&D (IV.A)	ORANE & OCEANE (IV.B)	Other impacts IAS 32 and 39 (IV.C)	Stock-options (IV.D)	Carry back receivables (IV.E)	Business combinations (IV.G)	Other	Total adjustments	Reclassifications (V.G)	IFRS
Goodwill, net	3,586						388	(6)	382	(194)	3,774
Other intangible assets, net	397	308							308	0	705
Property, plant and equipment, net	1,161							5	5	(71)	1,095
Share in net income (losses of equity affiliates	454							(24)	(24)	174	604
Inventories and work in progress, net	1,527									(254)	1,273
Amount due from customers on construction contracts										729	729
Trade receivables and other related accounts, net	3,520			(98)				(4)	(102)	(725)	2,693
Advances and progress payments										90	90
Deferred tax assets		(38)			(14)			(7)	(59)	1,697	1,638
Other current and non-current assets	3,281		(57)	721		158		12	834	(1,733)	2,382
Assets held for sale										196	196
Prepaid pension costs										287	287
Cash, cash equivalents and marketable securities	5,111			64					64	(12)	5,163
Total assets	**19,037**	**270**	**(57)**	**687**	**(14)**	**158**	**388**	**(24)**	**1,408**	**184**	**20,629**
Accrued pension and retirement obligations	1,144									315	1,459
Other equity (notes mandatorily redeemable for shares)	645		(645)						(645)	0	
Financial debt	4,359		(146)	106		173		9	142	105	4,606
Deferred tax liabilities								6	6	126	132
Provisions	2,278			15				40	55	(284)	2,049
Customers' deposits and advances	1,164									(191)	973
Amount due to customers on construction contracts										133	133
Trade payables and related accounts	3,360			(3)					(3)	(7)	3,350
Debt linked to bank activity	105									(105)	
Liabilities related to discontinued operations										97	97
Other current and non-current liabilities	2,238			370	(79)			13	304	(5)	2,537
Total liabilities	**15,293**	**0**	**(791)**	**488**	**(79)**	**173**	**0**	**68**	**(141)**	**184**	**15,336**
NET ASSETS	**3,744**	**270**	**734**	**199**	**65**	**(15)**	**388**	**(92)**	**1,549**	**0**	**5,293**
Capital stock and additional paid-in capital	10,369		645		126			4	775		11,144
Deferred compensation					(66)				(66)		(66)
Treasury stock owned by consolidated companies	(1,605)							(2)	(2)		(1,607)
Other reserves	(5,041)	261	56	244	68	(22)	4	2	613	(516)	(4,944)
Cumulative translation adjustments	(636)	(1)			(3)		(25)	(34)	(63)	516	(183)
Net income (loss) attributable to the Group	281	9	33	(45)	(60)	7	408	(55)	295		576
Shareholders' equity attributable to the equity holders of the parent	**3,368**	**267**	**734**	**199**	**65**	**(15)**	**387**	**(85)**	**1,552**	**(0)**	**4,920**
Minority interests – Net income (loss)	66	3							3	0	69
Minority interests – Shareholders' equity	310						1	(7)	(6)	0	304
TOTAL SHAREHOLDERS' EQUITY	**3,744**	**270**	**734**	**199**	**65**	**(15)**	**388**	**(92)**	**1,549**	**(0)**	**5,293**

III. Reconciliation of 2004 net income (loss)

		Adjustments									
(In millions of euros)	French GAAP	R&D (IV.A)	ORANE & OCEANE (IV.B)	Other impacts IAS 32 and 39 (IV.C)	Stock-options (IV.D)	Carry back (IV.E)	Business combinations (IV.G)	Other	Total adjustments	Reclassifications (V.H)	IFRS
Revenues	12,265			(31)				15	(16)	(5)	12,244
Cost of sales	(7,690)							5	5	54	(7,631)
Gross profit	**4,575**	**0**	**0**	**(31)**	**0**		**0**	**20**	**(11)**	**49**	**4,613**
Administrative and selling expenses	(2,010)							2	2	64	(1,944)
Research and development costs	(1,587)	98							98	(1)	(1,490)
Operating profit (loss)	**978**	**98**	**0**	**(31)**	**0**		**0**	**22**	**89**	**112**	**1,179**
Share-based payments (stock subscription or stock option plans)					(60)				(60)		(60)
Restructuring costs	(304)							(21)	(21)	1	(324)
Impairment of goodwill and other intangible assets		(88)							(88)		(88)
Amortization of goodwill	(409)						408		408	1	
Income (loss) from operating activities		**10**	**0**	**(31)**	**(60)**		**408**	**1**	**328**	**114**	**707**
Interest expense on notes mandatorily redeemable for shares	(44)		44						44		
Financial income, net	(132)		(11)	(14)		7		(8)	(26)	51	(107)
Other revenue (expense)	364							(14)	(14)	(350)	
Share in net income (loss) of equity affiliates	(97)							(27)	(27)	63	(61)
Income before tax and discontinued operations		**10**	**33**	**(45)**	**(60)**	**7**	**408**	**(48)**	**305**	**(122)**	**539**
Income tax expense	(9)	0	0	0	0		0	(7)	(7)	(20)	(36)
Income (loss) from continuing operations		**10**	**33**	**(45)**	**(60)**	**7**	**408**	**(55)**	**298**	**(142)**	**503**
Income (loss) from discontinued operations									0	142	142
NET INCOME (LOSS)	**347**	**10**	**33**	**(45)**	**(60)**	**7**	**408**	**(55)**	**298**	**(0)**	**645**
attributable to:											
– equity holders of the parent	281	7	33	(45)	(60)	7	408	(55)	295	(0)	576
– minority interests	66	3							3		69

IV. Main adjustments

A. Capitalization of development costs (IAS 38)

As indicated in Note 1e to Alcatel's French GAAP audited consolidated financial statements as of December 31, 2004, research and development costs were expensed as incurred under French GAAP, with the exception of certain software development costs (€32 million in 2004, see Note 4 to Alcatel'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 costs that had been expensed under French GAAP. Furthermore, IFRS 1 "First-time Adoption of International Financial Reporting Standards" requires retrospective application of IFRS standards at the transition date, January 1, 2004. Consequently, development expenditures capitalized in the opening IFRS balance sheet corresponding to periods prior to January 1, 2004 amount to €299 million while related deferred tax assets amount to €38 million, or a net €261 million impact on shareholders' equity.

Alcatel has put in place the information systems required to test the eligibility of development costs for capitalization, as set out in IAS 38. However, full retrospective application of IAS 38 has not been possible due to the lack of complete and reliable information for prior periods. If Alcatel's research and development effort remains constant, this new IAS 38 implementation will have a positive, though diminishing impact, on net income (loss) (€98 million for 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 reconciliation adjustment in 2004 consolidated net income (loss) of €10 million, resulting from the aforementioned capitalized development costs of €98 million (period development expenses of €199 million eligible for capitalization in accordance with IAS 38, minus amortization charge of €101 million from prior-periods' capitalized development costs) offset to a large extent in 2004 by an exceptional €88 million charge corresponding to an impairment loss related to prior periods' capitalized development costs.

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis).

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Intangible assets, net	299					308
Deferred tax assets	(38)					(38)
Assets	**261**					**270**
Liabilities	**0**					**0**
NET ASSETS	**261**					**270**
Other retained earnings	261					261
Cumulative translation adjustments	0					(1)
Net income (loss)	0	32	22	24	(68)	10
SHAREHOLDERS' EQUITY	**261**					**270**

(In millions of euros)

Income statement adjustments	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Research and development expenses	32	22	24	20	98
Impairment of goodwill and other intangibles	0	0	0	(88)	(88)
NET INCOME (LOSS)	**32**	**22**	**24**	**(68)**	**10**

B. ORANE / OCEANE (IAS 32 and IAS 39)

The convertible bonds (OCEANE) and notes mandatorily redeemable for shares (ORANE) issued by Alcatel in 2003 and 2002, respectively, are compound financial instruments that, according to IAS 32 "Financial Instruments: Disclosure and Presentation", include a debt component (none, in the case of the ORANE, since all interest was pre-paid at issuance date) and an equity component (see note 1m).

The first-time adoption of IFRSs calls for recognition of these instruments' equity components valued at the issuance date within shareholders' equity as of January 1, 2004. The ORANE bonds, reported at their nominal issuance value of €645 million in other equity under French GAAP, are reported as shareholders' equity in the IFRS opening balance sheet at their issuance value, reduced by the amount of related issuance expenses and prepaid interest that had not been amortized as of December 31, 2003. Prepaid interest was €132 million at the issuance date. Interest cost recorded under French GAAP but reversed under IFRSs amounted to €44 million for 2004. The balance of issuance expenses capitalized under French GAAP but written off against retained earnings under IFRSs was €84 million at January 1, 2004 and €40 million at December 31, 2004.

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 the IFRS opening balance sheet as financial debt for €857 million (before the impact of interest rate derivatives in accordance with IAS 32 and 39, see section C below) 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 interest) against shareholders' equity as of January 1, 2004 for €109 million in the aggregate for the two instruments, and negatively due to the amortization charge of OCEANE's equity component until their maturity in January 2011.

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis):

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Other current and non-current assets	(109)					(57)
Assets	**(109)**					**(57)**
Other equity (notes mandatorily redeemable for shares)	(645)					(645)
Financial debt	(165)					(146)
Liabilities	**(810)**					**(791)**
NET ASSETS	**701**					**734**
Capital stock and additional paid-in capital	645					645
Other retained earnings	56					56
Net income (loss)	0	8	8	8	9	33
SHAREHOLDERS' EQUITY	**701**					**734**

(In millions of euros)

Income statement adjustments	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 (loss)	(3)	(3)	(3)	(2)	(11)
NET INCOME (LOSS)	**8**	**8**	**8**	**9**	**33**

C. Other IAS 32 and 39 adjustments (hedging & investments available for sale)

Under IFRSs, financial assets available for sale (as defined in IAS 39) are recorded at fair value. For listed securities, the opening shareholders' equity as of January 1, 2004 for IFRSs was adjusted for the difference between carrying value and market value, net of any possible deferred tax impacts. As such securities were recorded under French GAAP at the lower of historical acquisition cost and market value, the impact on shareholders' equity under IFRSs is positive. As a result, the Group's financial assets were 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 €84 million, of which €56 million related to the Group's holding in 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 Alcatel's French GAAP financial statements at December 31, 2004, for changes in consolidated companies). Accordingly, this investment, which was accounted for as an equity affiliate at January 1, 2004, is now recorded in shares in non-consolidated subsidiaries in other non-current financial assets at December 31, 2004. The revaluation of the Group's holding in Nexans resulted in an increase of €48 million and €56 million in the Group's net cash position at January 1, 2004 and at December 31, 2004, respectively, as this holding is recorded in marketable securities.

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 the revaluation of the Group's derivative instruments at fair value at the closing date are recognized in the income statement in the 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 (see note 1s) covering the entirety of its financial debt (fixed-interest rate debt, primarily). Most of these derivatives are fully attached to a well-identified financial liability and qualify as fair value hedges. The changes in their fair value are therefore largely offset in earnings by revaluations of the underlying debt.

Currency derivatives held by the Group are of two types: foreign exchange derivatives used to hedge balance sheet items or firm commitments that are eligible for fair value hedge accounting and derivatives used to hedge foreign exchange 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, which is recorded in financial income (loss), so long as the changes in fair value of the derivatives offset 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 (loss) because hedge accounting cannot be applied. These derivatives are marked-to-market at each financial statement closing date and corresponding changes in fair value are accounted for in net income (loss). However, IAS 39 does not allow changes in fair value of the underlying commercial bid to be recorded in net income (loss).

The application of IAS 39 leads therefore to volatility in net income (loss) during the period preceding the coming into force of commercial contracts. Changes in fair value of the instruments hedging commercial bids are recorded in cost of sales.

The documentation of foreign currency hedging relationships, which was completed at the beginning of 2005, enabled some derivatives related to future revenues to qualify as cash flow hedges. Such treatment should limit the volatility in net income (loss) caused by the usual accounting for these instruments (see note 1e). The impact on 2004 cost of sales of recording hedging instruments for commercial bids was €(28) million for Q1, €0 million for Q2, €10 million for Q3 and €49 million for Q4, representing a total impact of €31 million for the year 2004. The impact on 2005 cost of sales was €(22) million for Q1, €(12) million for Q2, €(10) million for Q3 and €(16) million for Q4, representing a total impact of €(60) million for the year 2005.

Changes in fair value of interest rate derivatives and currency derivatives are reported under IFRSs as other assets and liabilities. Due to the IAS 32 rules on the offsetting of financial assets and liabilities, and depending on the instruments used, it is generally not possible to set off the hedged balance sheet items against the derivatives representing the same hedged transaction. Application of these rules leads to a significant increase in other assets and liabilities.

Accounting for derivative instruments in accordance with IAS 32 and 39 as discussed above increases the Group's retained earnings by €160 million at January 1, 2004 and by €110 million at December 31, 2004.

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis):

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Trade receivables and related accounts, net	(101)					(98)
Other current and non-current assets	1,126					721
Assets held for sale	2					0
Cash, cash equivalents and marketable securities	48					**64**
Assets	**1,075**					**687**
Financial debt	95					106
Provisions	(5)					15
Trade payables and related accounts	(3)					(3)
Other current and non-current liabilities	775					370
Liabilities	**862**					**488**
NET ASSETS	**213**					**199**
Other retained earnings	160					160
Fair value changes of shares available for sale	53					84
Cumulative translation adjustments	0					0
Net income (loss)	0	(4)	(43)	22	(20)	(45)
SHAREHOLDERS' EQUITY	**213**					**199**

(In millions of euros)

Income statement adjustments	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Revenues	(7)	(6)	(7)	(11)	(31)
Cost of sales *	(31)	6	5	20	0
Gross profit (loss)	**(38)**	**(0)**	**(2)**	**9**	**(31)**
Net financial income (loss)	34	(43)	24	(29)	(14)
NET INCOME (LOSS)	**(4)**	**(43)**	**22**	**(20)**	**(45)**

** Of which related to hedging of exchange risks on commercial bids: €(28) million in Q1, €0 million in Q2, €10 million in Q3 and €49 million in Q4. Total impact on 2004 was €31 million.*

D. Stock options (IFRS 2 and IFRS 3)

The application of IFRS 2 "Share-based Payment" changed the method of accounting for stock options that are granted by the Group to its employees. Alcatel elected not to opt for full retrospective application as allowed by IFRS 2. Only stock option plans established after November 7, 2002, and whose stock options are 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 therefore apply to the 2003 and 2004 plans, to the plans resulting from business combinations completed after November 7, 2002, under which stock options had not yet fully vested at December 31, 2004 (see notes 2 and 21c to Alcatel's French GAAP consolidated financial statements as of December 31, 2004), and to future plans.

The Group uses a Cox-Ross-Rubinstein binomial model to measure the compensation expense related to those certain stock options granted in the preceding paragraph. Their fair value has been determined at their respective grant dates and represents deferred compensation expense of €35 million recorded in the IFRS opening shareholders' equity as of January 1, 2004, which is set off by an identical amount recorded in additional paid-in capital. The net impact on shareholders' equity is therefore zero. The deferred compensation expense is amortized to income statement over the vesting period of the stock options, being 4 years for most of the plans concerned. The amortization to income statement is not straight-line but depends on the vesting conditions attached to each plan.

For stock options that vested during 2004, the compensation expense recorded in the 2004 consolidated net income (loss) was €60 million. This impact is presented under a specific income statement caption. However, as the compensation expense does not result in an outflow of cash and a 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 have a negative impact on future earnings, as vesting progresses. While there is a ramp-up effect due to the 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 (primarily, stock price changes and volatility, stock-option exercise practices, etc.).

The IFRS opening balance sheet at January 1, 2004 also contains a net €200 million increase in shareholders' equity (offset by a reduction of €231 million in other liabilities reduced by €31 million of related deferred taxes), which corresponds to the cancellation of provisions under French GAAP related to stock options existing in companies that were acquired by the Group before January 1, 2004. These provisions were booked based on the intrinsic value of existing stock options at the acquisition date, which is an accounting treatment that does not comply with IFRS 2 and IFRS 3 "Business Combinations". At December 31, 2004, these liabilities were €79 million and related deferred tax assets were €14 million, with a corresponding impact of €65 million on shareholders' equity.

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis):

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Deferred tax assets	(31)					(14)
Assets	**(31)**					**(14)**
Other current and non-current liabilities	(231)					(79)
Liabilities	**(231)**					**(79)**
NET ASSETS	**200**					**65**
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 (loss)	0	(7)	(17)	(18)	(18)	(60)
SHAREHOLDERS' EQUITY	**200**					**65**

(In millions of euros)

Income statement adjustments	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Share-based payments (stock option plans)	(7)	(17)	(18)	(18)	(60)
NET INCOME (LOSS)	**(7)**	**(17)**	**(18)**	**(18)**	**(60)**

E. SVF trust and sale of a carry-back tax receivable

IFRSs require recognition of certain commitments and financial assets that are considered as off balance sheet in Alcatel's 2004 French GAAP financial statements, namely a securitization scheme and the sale of a carry-back receivable. The Group's off balance sheet commitments are described in note 31 to Alcatel's French GAAP consolidated financial statements at December 31, 2004.

Securitization schemes

At December 31, 2003, the Group participated in two structured securitization schemes (the SVF trust program and a customer receivables securitization program). The special purpose vehicle used in the SVF trust program was consolidated in the Group's French GAAP financial statements as of January 1, 2004, following changes in French accounting regulations. The impact on the opening IFRS balance sheet at January 1, 2004 resulted in recording €200 million in "other current assets and non-current assets" and €212 million in "financial debt". As a result of consolidating this special purpose vehicle in the French GAAP financial statements in 2004 and due to the termination of the trust program in 2004, the transition to IFRSs had no impact at December 31, 2004.

As the special purpose entity used in the customer receivables securitization program was already consolidated in the French GAAP financial statements at December 31, 2003, the transition to IFRSs had no impact on this program.

Sale of carry-back receivable

The carry-back receivable sold in 2002 is reported under IFRSs in "other current assets and other non-current assets" at its discounted value (using the implicit rate of the transaction in the sale to a credit institution) and in "financial debt" at the discounted value of the debt (using the French state bonds' rate).

The impact of recognizing the SVF trust program and the carry-back receivable at January 1, 2004 and December 31, 2004 are as follows:

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis).

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Other current and non-current assets	342					158
Assets	**342**					**158**
Financial debt	375					173
Provisions	(32)					0
Liabilities	**343**					**173**
NET ASSETS	**(1)**					**(15)**
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 (loss)	0	2	2	1	2	7
Minority interests	20					0
SHAREHOLDERS' EQUITY	**(1)**					**(15)**

(In millions of euros)

Income statement adjustments	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004
Net financial income (loss)	2	2	1	2	7
NET INCOME (LOSS)	**2**	**2**	**1**	**2**	**7**

F. Pension and retirement obligations (IAS 19)

The methods for determining pension obligations and other post-employment benefits, as described in notes 1k and 24 to Alcatel's French GAAP consolidated financial statements at December 31, 2004, comply with IAS 19 "Employee Benefits", on the basis that, at the end of 2004 and with retroactive effect to January 1, 2004, the Group applied the "Conseil National de la Comptabilité"'s recommendation (2003-R.01) in anticipation of IFRS implementation. The pre-tax impact of applying this recommendation is a reduction of €222 million in shareholders' equity, as shown in note 24b to Alcatel's 2004 French GAAP consolidated financial statements. This adjustment only impacts shareholders' equity under IFRSs at January 1, 2004 and not shareholders' equity at December 31, 2004.

G. Business combinations (IFRS 3)

The Group abandoned, starting January 1, 2004, the "pooling of interests" method (in accordance with paragraph 215 of regulation No. 99-02) in its French GAAP financial statements in anticipation of the changeover to IFRSs.

Since the Group elected to adopt the IFRS 1 option not to restate business combinations that do not comply with IFRS 3 "Business Combinations" and which occurred before January 1, 2004, first-time adoption of IFRSs has not resulted in any changes to the accounting methods previously applied.

In application of IFRS 3, goodwill is no longer amortized beginning January 1, 2004. This increases shareholders' equity under IFRSs at December 31, 2004 by €388 million and also increases net income (loss) by €408 million.

The table below presents the impacts on the 2004 opening and closing balance sheets and on 2004 net income (loss) (on a quarterly basis).

(In millions of euros)

Balance sheet adjustments	January 1, 2004	Q1 2004	Q2 2004	Q3 2004	Q4 2004	December 31, 2004
Goodwill, net	0					388
Assets	**0**					**388**
Liabilities	**0**					**0**
NET ASSETS	**0**					**388**
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 (loss)	0	105	102	103	98	408
SHAREHOLDERS' EQUITY	**0**					**388**

(In millions of euros)

Income statement adjustments	Q12004	Q22004	Q32004	Q42004	2004
Amortization of goodwill	105	102	103	98	408
NET INCOME (LOSS)	**105**	**102**	**103**	**98**	**408**

V. Reclassifications

Under IAS 1 "Presentation of Financial Statements", a distinction is required to be made between current and non-current items in the balance sheet. This presentation is different from the previous balance sheet presentation under French GAAP that was based on the type and and/or liquidity of assets and liabilities. The presentation of the balance sheet has therefore been appropriately adapted. Assets and liabilities related to the operating cycle and other items due within 12 months from the balance sheet date are classified as current; all other assets and liabilities are classified as non-current. In addition, certain specific rules governing the offsetting of assets and liabilities (for example, certain provisions for product sales relating to construction contracts that have to be deducted from contract assets in accordance with IAS 11 "Construction Contracts") result in reclassifications compared to French GAAP. Also, in application of IAS 1, minority interests are now included in shareholders' equity, including the detailed distinction between the amounts attributable to the equity holders of the parent and those attributable to the minority interests.

The application of IAS 1 (as revised in December 2003), IAS 12 "Income Taxes", IAS 11 "Construction Contracts", IFRS 1 "First-time Adoption of International Financial Reporting Standards", 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.

The reclassifications relating to the consolidated statements of cash flows are presented in note VII.

A. IAS 1 and IAS 12

The main impacts on the balance sheet presentation coming from these standards are firstly the presentation of deferred tax assets and liabilities in separate balance sheet captions (in non-current) compared to the previous practice of presenting them within other accounts receivable, net and other payables, and secondly, the inclusion within financial debt of the debt linked to our bank activity (€224 million at January 1, 2004 and €105 million at December 31, 2004).

For the income statement, the application of IAS 1 resulted in reclassifying exceptional and non-recurring items previously accounted for in "other revenue (expense)", such as gains on disposal of property, plant and equipment (€94 million gain in 2004) or on disposal of shares (€256 gain in 2004), to income statement captions corresponding to the nature of the underlying asset (cost of sales, administrative and selling expenses, research and development costs, financial income (loss) or income (loss) from discontinued operations).

B. IAS 11 Construction contracts

The principles of IAS 11 are very similar to those already used by the Group under French GAAP to account for construction contracts (or long-term contracts). In particular, the percentage of completion method of accounting applied by the Group (see note 1l to Alcatel's French GAAP consolidated financial statements 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 provisions (changes are recorded in contract revenues under IFRSs but in cost of sales in Alcatel's French GAAP consolidated financial statements), and for the financial impact on revenues of deferred payments when they are material, have had a limited effect on the income statement and no impact on the Group's gross profit and opening IFRS shareholders' equity. Penalties related to construction contracts have resulted in a €27 million reclassification, in 2004, between revenues and cost of sales with no effect on either gross profit or on opening IFRS shareholders's equity.

On the balance sheet side, the adjustments introduced by IAS 11 are more significant. For each construction contract, the aggregate amount of costs incurred and recognized profits less the sum of recognized losses and progress billings is measured. If the amount obtained is positive, it is presented as an asset in "amount due from customers on construction contracts" and if the amount obtained is negative, it is presented as a liability in "amounts due to customers on construction contracts". This reclassification reduced assets and liabilities respectively by €188 million at January 1, 2004 and by €248 million at December 31, 2004.

The presentation of assets and liabilities related to construction contracts under specific balance sheet captions (included in working capital) and the application of specific offset rules as required by IAS 11 reduced the Group's working capital (representing €178 million at January 1, 2004 and €185 million at December 31, 2004), due to presenting certain provisions for product sales as deductions from the specific captions.

C. IFRS 1 First-time adoption – Cumulative translation adjustments

IFRS 1 "First-time Adoption of IFRSs" allows companies to reclassify cumulative translation adjustments in consolidated reserves at January 1, 2004. As a result, in the event of a disposal of a business division or subsidiary whose accounts are expressed in a currency other than the consolidation currency (euro), the gain or loss on disposal will not include any translation differences generated before January 1, 2004. Adoption of this treatment results in a transfer in Alcatel's January 1, 2004 opening IFRS balance sheet of €518 million from cumulative translation adjustments to retained earnings, which had no impact on total shareholders' equity at January 1, 2004.

D. IAS 28 Investment in associates

By applying this standard, goodwill related to companies consolidated using the equity method is now recorded in "share in net assets of equity affiliates" and no longer in "goodwill". This reclassification impacts the balance sheet by €188 million at January 1, 2004 and by €194 million at December 31, 2004, but has no effect on total shareholders' equity.

E. IFRS 5 Non-current assets held for sale and discontinued operations

Net assets of a disposal group or tangible assets held for sale, as defined in IFRS 5, are reported as "Assets held for sale" and "Liabilities related to disposal groups held for sale", without the possibility to set off the assets and liabilities concerned. Property, plant and equipment reported as "assets held for sale" are no longer depreciated.

The reclassifications made under this standard impacted the opening balance sheet by €247 million and by €99 million at December 31, 2004 (of which SAFT battery operations and other assets held for sale represented €432 million and related liabilities €253 million at January 1, 2004, and of which SAFT Power System activities and other assets held for sale represented €196 million and related liabilities €97 million at December 31, 2004).

The application of this standard has no material impact on the Group's 2004 net income (loss), except for income statement reclassifications. As a result, the net capital gain of €211 million from the disposal of the SAFT activities and from the transfer of the optical fiber and mobile phone activities to Draka JV and to TAMP JV respectively was reclassified from "other revenue (expense)" to "income (loss) from discontinued operations".

Income (loss) from discontinued operations from January 1, 2004 until the date of disposal was reported under French GAAP in "share in net income (losses) of equity affiliates" for €66 million and was reclassified under IFRSs to "income (loss) from discontinued operations" for €142 million.

Several tables detailing all the reclassification entries are presented below for the balance sheets at January 1, 2004 and at December 31, 2004, and for the 2004 consolidated income statement.

F. Balance sheet at January 1, 2004 - Reclassifications

(In millions of euros)	IAS 1 Specific caption	IAS 11 Construction contracts	IFRS 1 Cumulative translation adjustments	IAS 28 Investments in associates ("equity affiliates")	IFRS 5 Assets and disposal groups held for sale and other	Total
Goodwill, net				(188)		(188)
Intangible assets, net					(69)	(69)
Share in net assets of equity affiliates				188	(110)	78
Inventories and work in progress, net		(226)				(226)
Amounts due from customers on construction contracts		527				527
Trade receivables and related accounts, net		(489)			(7)	(496)
Advances and progress payments	106					106
Deferred tax assets	2,064					2,064
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)
Assets	**52**	**(188)**	**0**	**0**	**247**	**111**
Financial debt	224				0	224
Provisions		(253)				(253)
Deferred tax liabilities	122					122
Customers' deposits and advances		(33)			(83)	(116)
Amounts due to customers on construction contracts		93				93
Trade payables and related accounts		6				6
Debt linked to bank activity	(224)					(224)
Liabilities related to discontinued operations					253	253
Other current and non-current liabilities	(70)	(1)			77	6
Liabilities	**52**	**(188)**			**247**	**111**
NET ASSETS	**0**	**0**	**0**	**0**	**0**	**0**
Other retained earnings			(518)			(518)
Cumulative translation adjustments			518			518
SHAREHOLDERS' EQUITY	**0**	**0**	**0**	**0**	**0**	**0**

G. Balance sheet at December 31, 2004 - Reclassifications

(In millions of euros)	IAS 1 Specific caption	IAS 11 Construction contracts	IFRS 1 Cumulative translation adjustments	IAS 28 Investments in associates ("equity affiliates")	IFRS 5 Assets and disposal groups held for sale and other	Total
Goodwill, net				(194)		(194)
Intangible assets, net					(71)	(71)
Share in net assets of equity affiliates				194	(20)	174
Inventories and work in progress, net		(254)				(254)
Amounts due from customers on construction contracts		729				729
Trade receivables and related accounts, net		(723)			(2)	(725)
Advances and progress payments	90					90
Deferred tax assets	1,697					1,697
Prepaid pension costs	287					287
Other current and non-current assets	(1,741)				8	(1,733)
Assets held for sale					196	196
Cash, cash equivalents and marketable securities					(12)	(12)
Assets	**333**	**(248)**	**0**	**0**	**99**	**184**
Accrued pension and retirement obligations	287				28	315
Financial debt	105					105
Provisions		(264)			(20)	(284)
Deferred tax liabilities	126					126
Customers' deposits and advances		(109)			(82)	(191)
Amounts due to customers on construction contracts		133				133
Trade payables and related accounts		(7)				(7)
Debt linked to bank activity	(105)					(105)
Liabilities related to discontinued operations					97	97
Other current and non-current liabilities	(80)	(1)			76	(5)
Liabilities	**333**	**(248)**			**99**	**184**
NET ASSETS	**0**	**0**	**0**	**0**	**0**	**0**
Other retained earnings			(518)		2	(516)
Cumulative translation adjustments			518		(2)	516
SHAREHOLDERS' EQUITY	**0**	**0**	**0**	**0**	**0**	**0**

H. Income statement 2004 – Reclassifications

(In millions of euros)	IAS 1 Disposal of assets	IAS 11 Construction contracts	IAS 1 Disposal of financial assets	IFRS 5 Assets and disposal groups held for sale	Other	Total
Revenues		(27)			22	(5)
Cost of sales	23	27			4	54
Gross profit	**23**	**0**	**0**		**26**	**49**
Administrative and selling expenses	71				(7)	64
Research and development costs					(1)	(1)
Operating profit (loss)	**94**	**0**	**0**	**0**	**18**	**112**
Share-based payments						
Restructuring costs					1	1
Amortization of capitalized development costs						
Amortization of goodwill					1	1
Interest expense on notes mandatorily redeemable for shares						
Net financial income (loss)			45		6	51
Other revenue (expense)	(94)		(45)	(211)		(350)
Share in net income (losses) of equity affiliates				66	(3)	63
Income tax					(20)	(20)
Income (loss) from discontinued operations				145	(3)	142
NET INCOME (LOSS)	**0**	**0**	**0**	**0**	**0**	**0**

VI. Operating working capital and cash (financial debt), net at January 1, 2004 and December 31, 2004

A. Operating working capital at January 1, 2004 - Reconciliation

		Adjustments				
(In millions of euros)	French GAAP	Other impacts IAS 32 and 39 IV.C	Other	Total Adjustments	Reclassifications V.F	IFRS
Inventories and work in progress, net	1,432			0	(226)	1,206
Amounts due from customers on construction contracts				0	527	527
Trade receivables and related accounts, net	3,364	(101)	(4)	(105)	(496)	2,763
Advances and progress payments, net	106	0		0	0	106
Customers' deposits and advances	(1,181)	0	0	0	116	(1,065)
Amounts due to customers on construction contracts				0	(93)	(93)
Trade payables and related accounts	(3,617)	3	0	3	(6)	(3,620)
Currency derivatives on working capital*		98	0	98	,	98
Operating working capital, net	**104**	**0**	**(4)**	**(4)**	**(178)**	**(78)**

** Recorded in other current assets and other current liabilities.*

Note:

- each of the columns presented above is discussed in sections IV and V of this note.

B. Cash (financial debt), net at January 1, 2004 – Reconciliation

(In millions of euros)	French GAAP	Adjustments ORANE & OCEANE IV.B	Other impacts IAS 32 and 39 IV.C	Carry-back receivable, SVF and other IV.E	Total Adjustments	Reclassifications V.F	IFRS
Cash, cash equivalents and marketable securities	6,269		48		48	(15)	6,302
Financial debt	(5,293)	165	(95)	(384)	(314)	(224)	(5,831)
Derivative instruments relating to financial debt, net			107		107		107
Cash (financial debt) net	**976**	**165**	**60**	**(384)**	**(159)**	**(239)**	**578**

Notes:

- each of the columns presented above is discussed in sections IV and V of this note.
- The reclassification related to the debt linked to the bank activity (€224 million), which is included in financial debt under IFRSs, was classified in "other payables" under French GAAP.
- The other impacts of IAS 32 and 39 correspond to recording our investment in Nexans at market value in marketable securities, representing an impact of €48 million, and to recording the impact of changes in interest rates on the value of financial debt that is offset for the most part by related derivative instruments (interest-rate hedges).
- The adjustment of €384 million indicated in the column "Carry-back receivable, SVF and other" comprises a €375 million adjustment relating to the consolidation of the SVF trust program and to the sale of the carry-back receivable (impact of €212 million for the consolidation of the SVF trust program and €163 million for recording the receivable relating to the sale of the carry-back receivable).

C. Operating working capital at December 31, 2004 – Reconciliation

(In millions of euros)	French GAAP	Adjustments Other impacts IAS 32 and 39 IV.C	Other	Total Adjustments	Reclassifications V.G	IFRS
Inventories and work in progress, net	1,527				(254)	1,273
Amounts due from customers on construction contracts					729	729
Trade receivables and related accounts, net	3,520	(98)	(4)	(102)	(725)	2,693
Advances and progress payments, net	89		1	1	(0)	90
Customers' deposits and advances	(1,164)		0	0	191	(973)
Amounts due to customers on construction contracts					(133)	(133)
Trade payables and related accounts	(3,360)	3	0	3	7	(3,350)
Currency derivatives on working capital*		95	7	102		102
Operating working capital, net	**612**	**0**	**4**	**4**	**(185)**	**431**

** Recorded in other current assets and other current liabilities.*

Note:

- each of the columns presented above is discussed in sections IV and V of this note.

D. Cash (financial debt), net at December 31, 2004 – Reconciliation

		Adjustments					
(In millions of euros)	French GAAP	ORANE & OCEANE IV.B	Other impacts IAS 32 and 39 IV.C	Carry-back receivable and other IV.E	Total Adjustments	Reclassifications V.G	IFRS
Cash, cash equivalents and marketable securities	5,111		64	0	64	(12)	5,163
Financial debt	(4,359)	146	(106)	(182)	(142)	(105)	(4,606)
Derivative instruments relating to financial debt, net			105		105		105
Cash (financial debt), net	**752**	**146**	**63**	**(182)**	**27**	**(117)**	**662**

Notes:

- each of the columns presented above is discussed in sections IV and V of this note.
- The reclassification related to the debt linked to the bank activity (€105 million), which is included in financial debt under IFRSs, compares with a classification in other payables under French GAAP.
- The other impacts of IAS 32 and 39 correspond primarily to recording our investment in Nexans at market value in marketable securities, representing an impact of €56 million, and to recording the impact of changes in interest rates on the value of financial debt that is offset for the most part by related derivative instruments (interest-rate hedges).
- The adjustment of €182 million indicated in the column "Carry-back receivable and other" includes a €173 million adjustment relating to recording the receivable relating to the sale of the carry-back receivable. The consolidation of the SVF trust program has no impact at December 31, 2004, because it had already been included in the French GAAP consolidated financial statements in 2004 and because this program was terminated during 2004.

VII. Adjustment impacts on consolidated statement of cash flows

Most of the adjustments made from applying IFRSs (recording of financial assets available for sale at fair value, accounting for share-based payments, recording of derivatives at market value, etc.) have no impact on the statement of cash flows.

The only adjustment impacting the presentation of the statement of cash flows is the capitalization of development costs. The amounts capitalized are presented in "net cash provided (used) by investing activities", whereas the corresponding research and development costs were shown as a reduction in "net cash provided (used) by operating activities" under French GAAP.

The reclassification entries are as follows:

- cash flows from discontinued operations are classified differently under the two accounting practices (as part of "net cash provided (used) by investing activities" under French GAAP but in a specific caption at the foot of the statement of cash flows under IFRSs).
- The different presentation of debt linked to the bank activity under French GAAP and IFRSs (see notes VI-B and VI-D) results in presenting changes in this debt in "net cash provided (used) by financing activities" under IFRSs and no longer in "net cash provided (used) by operating activities".
- Non-listed marketable securities were included in "cash and cash equivalents" in the statement of cash flows under French GAAP, whereas, under IFRSs, the change in this caption is presented in "net cash provided (used) by investing activities".

		Reclassifications					
(In millions of euros)	**French GAAP**	**Discontinued operations V.B**	**Debt linked to the bank activity V.C**	**Marketable securities and other**	**Total Reclassifications**	**Adjustments – Research and development IV.A**	**IFRS**
Net cash provided (used) by operating activities	**(289)**		**119**	**29**	**148**	**199**	**58**
Cash flows from investing activities							
Proceeds from disposal of tangible and intangible assets	218			(1)	(1)		217
Capital expenditures	(380)				-	(199)	(579)
Decrease in loans and other financial assets	569						569
Cash expenditures for acquisition of consolidated and unconsolidated companies	(205)	85			85		(120)
Cash proceeds from sale of consolidated and unconsolidated companies	359	(295)			(295)		64
Changes in marketable securities	-			(265)	(265)		(265)
Discontinued operations	(247)	247			247		-
Net cash provided (used) by investing activities	**314**	**37**	**-**	**(266)**	**(229)**	**(199)**	**(114)**
Cash flows from financing activities							
Issuance/(repayment) of debt	(1,105)		(119)	(30)	(149)		(1,254)
Other changes in cash from financing activities	3				-		3
Net cash provided (used) by financing activities	**(1,102)**		**(119)**	**(30)**	**(149)**	**-**	**(1,251)**
Discontinued operations	-	(67)			(67)		(67)
Net effect of exchange rate changes	(51)			1	1		(50)
Net increase (decrease) in cash and cash equivalents	**(1,128)**	**(30)**	**-**	**(266)**	**(296)**	**-**	**(1,424)**
Cash and cash equivalents at beginning of year	**6,195**	**30**		**(190)**	**(160)**	**-**	**6,035**
Cash and cash equivalents at end of year	**5,067**	**-**		**(456)**	**(456)**	**-**	**4,611**

VIII. Reconciliation of 2004 net income (loss) by quarter

A. Reconciliation of Q1 2004 net income (loss)

		Adjustments									
(In millions of euros)	French GAAP	Research and development	ORANE & OCEANE	Other impacts IAS 32 and 39	Stock options	Carry-back receivable	Business combinations	Other	Total Adjustments	Reclassifications	IFRS
Revenues	2,533			(7)				5	(2)	(16)	2,515
Cost of sales	(1,562)			(31)				1	(30)	(15)	(1,607)
Gross profit	**971**	**0**	**0**	**(38)**	**0**		**0**	**6**	**(32)**	**(31)**	**908**
Administrative and selling expenses	(498)							(2)	(2)	13	(487)
Research and development costs	(369)	32						1	33	(1)	(337)
Operating profit (loss)	**104**	**32**	**0**	**(38)**	**0**		**0**	**5**	**(1)**	**(19)**	**84**
Share-based payments (stock option or stock purchase plans)					(7)			0	(7)	0	(7)
Restructuring costs	(64)							(1)	(1)	0	(65)
Impairment of capitalized development costs								0	0	0	0
Amortization of goodwill	(105)						105	1	106	(1)	
Income (loss) from operating activities		**32**	**0**	**(38)**	**(7)**		**105**	**5**	**97**	**(20)**	**12**
Interest expense on notes mandatorily redeemable for shares	(11)		11					0	11	0	
Financial income (loss)	(40)		(3)	34		2		1	34	10	4
Other revenue (expense)	245		0	0				(1)	(1)	(244)	
Share in net income (losses) of equity affiliates	(16)							1	1	21	6
Income (loss) before tax and discontinued operations		**32**	**8**	**(4)**	**(7)**	**2**	**105**	**6**	**142**	**(233)**	**22**
Income tax expense	16	0						4	4	1	21
Income (loss) from continuing operations		**32**	**8**	**(4)**	**(7)**	**2**	**105**	**10**	**146**	**(232)**	**43**
Income (loss) from discontinued operations								(0)	(0)	232	232
NET INCOME (LOSS)	**129**	**32**	**8**	**(4)**	**(7)**	**2**	**105**	**10**	**146**	**(0)**	**275**
attributable to:											
- equity holders of the parent	**134**	**30**	**8**	**(4)**	**(7)**	**2**	**105**	**10**	**144**	**(0)**	**278**
- minority interests	(5)	2				0	0	0	2	0	(3)

B. Reconciliation of Q2 2004 net income (loss)

		Adjustments									
(In millions of euros)	**French GAAP**	**Research and development**	**ORANE & OCEANE**	**Other impacts IAS 32 and 39**	**Stock options**	**Carry-back receivable**	**Business combinations**	**Other**	**Total Adjustments**	**Reclassifications**	**IFRS**
Revenues	2,911			(6)				3	(3)	(9)	2,899
Cost of sales	(1,755)			6				3	9	32	(1,714)
Gross profit	**1,156**	**0**	**0**	**(0)**	**0**		**0**	**6**	**6**	**23**	**1,185**
Administrative and selling expenses	(532)			0				(1)	(1)	1	(532)
Research and development costs	(413)	22		0				(5)	17	0	(396)
Operating profit (loss)	**211**	**22**	**0**	**(0)**	**0**		**0**	**0**	**22**	**24**	**257**
Share-based payments (stock option or stock purchase plans)				0	(17)			0	(17)	0	(17)
Restructuring costs	(67)			0				1	1	(2)	(68)
Impairment of capitalized development costs				0				0	0	0	0
Amortization of goodwill	(102)			0			102		102	0	
Income (loss) from operating activities		**22**	**0**	**(0)**	**(17)**		**102**	**1**	**108**	**22**	**172**
Interest expense on notes mandatorily redeemable for shares	(11)		11	0				0	11	0	
Financial income (loss)	(3)		(3)	(43)		2		(3)	(47)	10	(40)
Other revenue (expense)	32		0	0				0	0	(32)	
Share in net income (losses) of equity affiliates	(43)							(0)	(0)	40	(3)
Income (loss) before tax and discontinued operations		**22**	**8**	**(43)**	**(17)**	**2**	**102**	**(2)**	**72**	**40**	**129**
Income tax expense	28	0						0	0	(0)	28
Income (loss) from continuing operations		**22**	**8**	**(43)**	**(17)**	**2**	**102**	**(2)**	**72**	**40**	**157**
Income (loss) from discontinued operations										(40)	(40)
NET INCOME (LOSS)	**45**	**22**	**8**	**(43)**	**(17)**	**2**	**102**	**(2)**	**72**	**(0)**	**117**
attributable to:											
– equity holders of the parent	**23**	**23**	**8**	**(43)**	**(17)**	2	102	(2)	73	(0)	96
– minority interests	22	(1)				0	0	0	(1)	0	21

C. Reconciliation of Q3 2004 net income (loss)

		Adjustments									
(In millions of euros)	French GAAP	Research and development	ORANE & OCEANE	Other impacts IAS 32 and 39	Stock options	Carry-back receivable	Business combinations	Other	Total Adjustments	Reclassifications	IFRS
Revenues	3,009			(7)				4	(3)	18	3,024
Cost of sales	(1,872)			5				5	10	(3)	(1,865)
Gross profit	**1,137**	**0**	**0**	**(2)**	**0**		**0**	**9**	**7**	**15**	**1,159**
Administrative and selling expenses	(486)			0						57	(429)
Research and development costs	(381)	24		0				(2)	22	1	(358)
Operating profit (loss)	**270**	**24**	**0**	**(2)**	**0**		**0**	**7**	**29**	**73**	**372**
Share-based payments (stock option or stock purchase plans)				0	(18)			0	(18)	0	(18)
Restructuring costs	(14)			0				(4)	(4)	0	(18)
Impairment of capitalized development costs				0				0	0	0	0
Amortization of goodwill	(103)			0			103	0	103	0	
Income (loss) from operating activities		**24**	**0**	**(2)**	**(18)**		**103**	**3**	**110**	**73**	**336**
Interest expense on notes mandatorily redeemable for shares	(11)		11					0	11	0	
Financial income (loss)	(44)		(3)	24		1		5	27	(1)	(18)
Other revenue (expense)	47		0	0				(6)	(6)	(41)	
Share in net income (losses) of equity affiliates	(19)							(28)	(28)	13	(34)
Income (loss) before tax and discontinued operations		**24**	**8**	**22**	**(18)**	**1**	**103**	**(26)**	**114**	**44**	**284**
Income tax expense	(13)							(1)	(1)	0	(14)
Income (loss) from continuing operations		**24**	**8**	**22**	**(18)**	**1**	**103**	**(27)**	**113**	44	270
Income (loss) from discontinued operations										**(44)**	**(44)**
NET INCOME (LOSS)	**113**	**24**	**8**	**22**	**(18)**	**1**	**103**	**(27)**	**113**	**0**	**226**
attributable to:											
– equity holders of the parent	**84**	**23**	**8**	**22**	**(18)**	**1**	**103**	**(28)**	**111**	**0**	**195**
– minority interests	29	1				0		1	2	0	31

D. Reconciliation of Q4 2004 net income (loss)

		Adjustments									
(In millions of euros)	**French GAAP**	**Research and development**	**ORANE & OCEANE**	**Other impacts IAS 32 and 39**	**Stock options**	**Carry-back receivable**	**Business combinations**	**Other**	**Total Adjustments**	**Reclassifications**	**IFRS**
Revenues	3,812			(11)				3	(8)	2	3,806
Cost of sales	(2,501)			20				(4)	16	40	(2,445)
Gross profit	**1,311**	**0**	**0**	**9**	**0**		**0**	**(1)**	**8**	**42**	**1,361**
Administrative and selling expenses	(494)			0				5	5	(7)	(496)
Research and development costs	(424)	20						6	26	(1)	(399)
Operating profit (loss)	**393**	**20**	**0**	**9**	**0**		**0**	**10**	**39**	**34**	**466**
Share-based payments (stock option or stock purchase plans)					(18)			0	(18)	0	(18)
Restructuring costs	(159)							(17)	(17)	3	(173)
Impairment of capitalized development costs		(88)						0	(88)	0	(88)
Amortization of goodwill	(99)						98	(1)	97	2	
Income (loss) from operating activities		**(68)**	**0**	**9**	**(18)**		**98**	**(8)**	**13**	**39**	**187**
Interest expense on notes mandatorily redeemable for shares	(11)		11					0	11	0	
Financial income (loss)	(45)		(2)	(29)		2		(11)	(40)	32	(53)
Other revenue (expense)	40		0	0				(7)	(7)	(33)	
Share in net income (losses) of equity affiliates	(19)									(11)	(30)
Income (loss) before tax and discontinued operations		**(68)**	**9**	**(20)**	**(18)**	**2**	**98**	**(26)**	**(23)**	**27**	**104**
Income tax expense	(40)			(0)				(10)	(10)	(21)	(71)
Income (loss) from continuing operations		**(68)**	**9**	**(20)**	**(18)**	**2**	**98**	**(36)**	**(33)**	**6**	**33**
Income (loss) from discontinued operations										(6)	(6)
NET INCOME (LOSS)	**60**	**(68)**	**9**	**(20)**	**(18)**	**2**	**98**	**(36)**	**(33)**	**(0)**	**27**
attributable to:											
– equity holders of the parent	**40**	**(69)**	**9**	**(20)**	**(18)**	**2**	**98**	**(35)**	**(33)**	**(0)**	**7**
– minority interests	20	1		0				(1)		0	20

IX. IFRS balance sheet at January 1, 2004

(In millions of euros)

ASSETS	**January 1, 2004**
Goodwill	3,630
Intangible assets, net	583
Goodwill and intangible assets, net	**4,213**
Property, plant and equipment, gross	6,092
Depreciation	(4,656)
Property, plant and equipment, net	**1,436**
Share in net assets of equity affiliates	501
Other non-current financial assets, net	1,043
Deferred tax assets	1,994
Other non-current assets	353
TOTAL NON-CURRENT ASSETS	**9,540**
Inventories and work in progress, net	1,206
Amounts due from customers on construction contracts	527
Trade receivables and related accounts, net	2,763
Advances and progress payments	106
Other current assets	1,837
Assets held for sale	434
Current income taxes	77
Marketable securities, net	267
Cash and cash equivalents	6,035
TOTAL CURRENT ASSETS	**13,252**
TOTAL ASSETS	**22,792**

(In million of euros)

LIABILITIES AND SHAREHOLDERS' EQUITY	January 1, 2004
Capital stock	2,810
Additional paid-in capital	7,966
Less treasury stock at cost	(1,730)
Retained earnings, fair value and other reserves	(4,901)
Cumulative translation adjustments	-
Net income (loss) - attributable to the equity holders of the parent	-
Shareholders' equity - attributable to the equity holders of the parent	**4,145**
Minority interests	**388**
TOTAL SHAREHOLDERS' EQUITY	**4,533**
Pensions, retirement indemnities and other post-retirement benefits	1,238
Bonds and notes issued, long-term	4,186
Other long-term debt	483
Deferred tax liabilities	114
Other non-current liabilities	161
TOTAL NON-CURRENT LIABILITIES	**6,182**
Provisions	2,761
Current portion of long-term debt	1,162
Customers' deposits and advances	1,065
Amounts due to customers on construction contracts	93
Trade payables and related accounts	3,620
Liabilities related to disposal groups held for sale	253
Current income tax liabilities	11
Other current liabilities	3,112
TOTAL CURRENT LIABILITIES	**12,077**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**22,792**

STATUTORY AUDITORS' REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended December 31, 2005

(Free translation of a French language original)

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, 2005.

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. These Financial Statements have been prepared for the first time in accordance with IFRSs as adopted by the EU. They include comparative information related to financial year 2004 restated in accordance with the same standards.

I. Opinion on the consolidated financial statements

We conducted our audit in accordance with professional standards applicable in France. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidated 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 IFRSs as adopted by the EU.

II. Justification of our assessments

In accordance with the requirements of article L. 823-9 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, tangible and intangible assets and reserves for liabilities and charges.

- As stated in notes 1n), 1g), 2, 9, 12 and 14 of the notes to the Financial Statements, your Company reports in the balance sheet deferred tax assets amounting to €1,768 million, goodwill amounting to €3,772 million, and tangible assets amounting to €1,111 million.

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

  We have examined the relevance of the methodology outlined in notes 1n) and 1g) to the Financial Statements and the amounts and assumptions used in its implementation.

- As stated in notes 1f), 1g) and 13 of the notes to the Financial Statements, your Company reports in the balance sheet intangible assets amounting to €680 million as capitalized development costs in accordance with IFRSs as adopted by the EU.

  We have examined the relevance of the methodology used by your Company for capitalization, amortization and impairment purpose and ensured that notes 1f), 1g) and 13 to the Financial Statements provide relevant information.

- Your company reports in the balance sheet other reserves for liabilities and charges amounting to €1,621 million as stated in note 27 to the Financial Statements, and product sales reserves amounting to €173 million included in the amounts due from/to customers on construction contracts as stated in note 18 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.

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 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, 2006

The Auditors

DELOITTE & ASSOCIES	BARBIER FRINAULT & AUTRES ERNST & YOUNG
Alain Pons Antoine de Riedmatten	Christian Chiarasini

This is a free translation into English of the Statutory Auditors' report issued in French and is provided solely for the convenience of English speaking users. The Statutory Auditors' report includes information specifically required by French law in such reports, whether modified or not. This information is presented below the opinion on the Consolidated Financial Statements and includes an 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 Consolidated 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.

This report should be read in conjunction with, and is construed in accordance with, French law and professional auditing standards applicable in France.

PARENT COMPANY ACCOUNTS

KEY FIGURES

In application of article 28 of EC regulation N° 809/2004 dated April 29, 2004, the following information is included by reference in this reference document:

- the parent company accounts for the year ending December 31, 2004 and the report of the Statutory Auditors relating thereto from page 142 to 165 of the reference document filed with the AMF on April 1, 2005 under N° D.05-326 and on page 2-2 of the update filed on May 2, 2005 under N° D.05-326-A-01;
- the parent company accounts for the year ending December 31, 2003 and the report of the Statutory Auditors relating there to appearing from page 82 to 105 and on page 106 of the reference document filed with the AMF on April 1, 2004 under N° D.04-379.

The net income of Alcatel, the parent company, amounted to €390.5 million in 2005 compared to €2,178.2 million in 2004.

Total assets decreased from €26.5 billion at the end of 2004 to €23.9 billion at the end of 2005. Shareholders' equity after appropriation increased from €14.7 billion to €15.5 billion over the same period.

APPROPRIATION OF INCOME AND DIVIDEND DISTRIBUTION

The 2005 net income of Alcatel, the parent company, totaled €390,524,042.73.

A dividend of €0.16 per share for the year ended December 31, 2005 will be proposed to the Annual Shareholders' Meeting in 2006.

The following appropriation will therefore be proposed to the Annual Shareholders' Meeting in 2006:

(In euros)	
Available for distribution	
Income of the year	390,524,042.73
Retained earnings brought forward	2,157,271,889.44
TOTAL	**2,547,795,932.17**
Appropriation	
Transfer to legal reserve	19,526,202.14
Proposed dividend	228,566,662.40
Retained earnings	2,299,703,067.63
TOTAL	**2,547,795,932.17**

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

	2005 (proposed)	2004	2003	2002
Number of A shares eligible for dividends	1,428,541,640	1,305,455,461	1,284,410,224	1,239,193,498
Number of O shares eligible for dividends	-*	-*	-*	25,515,000
Par value	2.00	2.00	2.00	2.00
Total number of shares	1,428,541,640	1,305,455,461	1,284,410,224	1,264,708,498
A shares				
Dividend per share including tax credit	0.16	-	-	-
Net dividend per share	0.16	-	-	-
Tax credit ("avoir fiscal") per share	-	-	-	-
O shares				
Dividend per share including tax credit	-	-	-	-
Net dividend per share	-	-	-	-
Tax credit ("avoir fiscal") per share	-	-	-	-

** 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 proposed dividend above will result in the 50% tax credit as provided by article 158 paragraph 3, subsection 2 of the French Tax Code.

PARENT COMPANY INCOME STATEMENTS

(In millions of euros)	Notes	2005	2004	2003
Net sales		775.6	753.3	747.7
Other revenues		29.7	26.2	38.3
Operating revenues		**805.3**	**779.5**	**786.0**
Purchases of services and other expenses		(829.1)	(786.0)	(783.7)
Taxes and similar payments, excluding income tax		(15.7)	(39.9)	(41.3)
Payroll costs		(8.3)	(6.7)	(4.8)
Operating expenses		**(853.1)**	**(832.6)**	**(829.8)**
Operating income (loss)	**(2)**	**(47.8)**	**(53.1)**	**(43.8)**
Interest on notes mandatorily redeemable for shares		(39.6)	(43.7)	(47.2)
Interest on other equity	**(13)**	**(39.6)**	**(43.7)**	**(47.2)**
Revenues from investments in subsidiaries and associates	(3)	111.2	73.2	103.1
Interest income and similar revenues		916.0	964.9	1,315.0
Interest expense and similar expenses		(602.6)	(766.5)	(1,414.8)
Net change in financial provisions and amortization of bond premiums	(4)	500.4	1,298.5	5,018.3
Other financial income (loss)		37.1	(518.3)	69.2
Financial income (loss)	**(2)**	**962.1**	**1,051.8**	**5,090.8**
Income (loss) before non-recurring items and income tax	**(2)**	**874.7**	**955.0**	**4,999.8**
Non-recurring revenues *		261.1	540.3	2,968.1
Non-recurring expenses **		(807.3)	(537.8)	(11,057.9)
Non-recurring income (loss)	**(2)**	**(546.2)**	**2.5**	**(8,089.8)**
Income tax	(2)/(5)	62.0	1,220.7	(165.4)
Net income (loss) after tax		**390.5**	**2,178.2**	**(3,255.4)**

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

PARENT COMPANY BALANCE SHEETS AT DECEMBER 31

ASSETS

	Notes			2005	2004	2003
(In millions of euros)		Gross value	Amortization and depreciation	Net value	Net value	Net value
Intangible assets		**44.5**	**(23.1)**	**21.4**	**1.9**	**3.5**
Land		-	-	-	-	-
Buildings		0.1	(0.1)	-	-	-
Other property, plant and equipment		0.4	(0.4)	-	0.1	0.1
Property, plant and equipment		**0.5**	**(0.5)**	**-**	**0.1**	**0.1**
Investments in subsidiaries and associates	(7)	20,028.0	(12,610.9)	7,417.1	10,378.4	9,738.9
Receivables from subsidiaries and associates	(8)	0.6	(0.6)	-	-	0.5
Other financial assets	(8)	11,096.0	(222.8)	10,873.2	9,602.7	2,029.1
Investments and other non-current assets		**31,124.6**	**(12,834.3)**	**18,290.3**	**19,981.1**	**11,768.5**
TOTAL NON-CURRENT ASSETS		**31,169.6**	**(12,857.9)**	**18,311.7**	**19,983.1**	**11,772.1**
Accounts receivable and other current assets	(9)/(16)	2,423.5	(0.4)	2,423.1	3,257.2	10,767.9
Marketable securities	(9)	1,625.2	-	1,625.2	1,720.2	1,275.7
Cash	(9)	1,515.2	-	1,515.2	1,428.9	3,034.7
TOTAL CURRENT ASSETS		**5,563.9**	**(0.4)**	**5,563.5**	**6,406.3**	**15,078.3**
Prepayments and deferred charges		26.2	-	26.2	115.9	587.7
TOTAL ASSETS	**(6)**	**36,759.7**	**(12,858.3)**	**23,901.4**	**26,505.3**	**27,438.1**

LIABILITIES AND SHAREHOLDERS' EQUITY

	Notes		2005	2004	2003
(In millions of euros)		Before appropriation	After appropriation*	After appropriation	After appropriation
Capital stock	(11)	2,857.1	2,857.1	2,610.9	2,568.8
Additional paid-in capital	(12)	8,173.5	8,173.5	7,757.6	7,562.4
Reserves	(12)	2,129.4	2,148.9	2,134.4	2,119.0
Retained earnings		2,157.2	2,299.7	2,152.2	-
Net income (loss) for the year		390.5	-	-	-
Statutory provisions		-	-	-	-
SHAREHOLDERS' EQUITY		**15,707.7**	**15,479.2**	**14,655.1**	**12,250.2**
OTHER EQUITY	**(13)**	**-**	**-**	**645.0**	**645.0**
RESERVES FOR LIABILITIES AND CHARGES	**(14)/(18)**	**192.5**	**192.5**	**2,826.2**	**3,485.9**
Bonds convertible into new or existing shares ("OCEANE")	(15)/(16)	1,022.4	1,022.4	1,022.4	1,022.4
Other bonds and notes issued	(15)/(16)	1,937.3	1,937.3	2,741.8	3,782.1
Bank loans and overdrafts	(16)	122.7	122.7	160.5	198.8
Miscellaneous borrowings	(16)	1,003.2	1,003.2	227.6	244.7
TOTAL FINANCIAL DEBT		**4,085.6**	**4,085.6**	**4,152.3**	**5,248.0**
Taxation and social security	(16)	15.9	15.9	14.7	4.8
Other liabilities	(16)	3,839.2	4,067.7	4,211.7	5,794.9
TOTAL LIABILITIES		**3,855.1**	**4,083.6**	**4,226.4**	**5,799.7**
Currency translation adjustment		60.5	60.5	0.3	9.3
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**23,901.4**	**23,901.4**	**26,505.3**	**27,438.1**

** Proposed.*

PARENT COMPANY STATEMENTS OF CHANGES IN FINANCIAL POSITION

(After appropriation of the 2005 net income)

(In millions of euros)	2005	2004	2003
Sources of funds			
Net income (loss)	390.5	2,178.2	(3,255.4)
Depreciation and amortization	3.4	3.0	0.5
Changes in valuation allowances and other reserves, net	(497.9)	(957.2)	(5,169.8)
Net (gain) / loss on disposal of non-current assets	554.1	(16.6)	8,171.1
Funds provided (used) by operations	**450.1**	**1,207.4**	**(253.6)**
Increase in capital stock	12.0	9.9	156.7
Increase in other equity	-	-	-
Increase in convertible bonds ("OCEANE")	-	-	1,022.4
Increase in other bonds	-	462.0	-
Increase in long-term debt	-	-	-
Property, plant and equipment sold	-	-	-
Investments sold	275.0	28.9	4,047.8
Other sources of funds	-	-	-
Total sources	**737.1**	**1,708.2**	**4,973.3**
Application of funds			
Increase in property, plant, equipment and intangible assets	22.8	1.4	-
Increase in investments	0.2	-	3,585.3
Dividend payable	228.5	-	-
Conversion of bonds into shares	-	-	-
Other application of funds	846.7	1,532.3	1,586.2
Total application	**1,098.2**	**1,533.7**	**5,171.5**
Analysis of changes in working capital			
Accounts receivable and other current assets	(139.7)	(100.3)	(130.0)
Other liabilities*	(129.9)	1,166.7	(185.2)
Cash and cash equivalents	-	-	-
– short-term financial debt	(483.8)	381.3	764.3
– cash	533.8	(1,709.3)	(1,425.6)
– marketable securities	(141.5)	436.1	778.3
Increase (decrease) in working capital	**(361.1)**	**174.5**	**(198.2)**

** The net change in income tax reserve is shown on the line "Other liabilities"*

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) 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.

b) 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.

c) 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).

d) 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.

e) Accounting for liabilities

In accordance with the "Conseil national de la comptabilité"'s regulation No. 00-06 dated April 20, 2000 on accounting for liabilities, Alcatel records a liability only when it has a present obligation towards a third party and that it is probable or certain that the obligation will result in an outflow 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.

f) 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.

g) 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 having to give back to certain subsidiaries the tax savings that were achieved from their past income tax losses and capital losses. Subsidiaries that are no longer part of the French Tax Group do not benefit from any tax saving.

The principles followed by Alcatel comply with the "Comité d'urgence du Conseil national de la comptabilité"'s regulation No. 2005-G.

h) Pensions

As from January 1, 2004, Alcatel applies the "Conseil national de la comptabilité"'s regulation No. 2003-R01 on pensions and other long-term benefits.

Note 2

Income statement analysis

Net income totaled €390.5 million in 2005, compared with €2,178.2 million in 2004. The increase is analyzed below:

(In millions of euros)	2005	2004
Operating income (loss)	(47.8)	(53.1)
Interest on other equity	(39.6)	(43.7)
Financial income (loss)	962.1	1,051.8
Income (loss) before non-recurring items and income tax	**874.7**	**955.0**
Non-recurring items	(546.2)	2.5
Income tax	62.0	1,220.7
NET INCOME (LOSS) AFTER TAX	**390.5**	**2,178.2**

1) In 2005, operating activities resulted in a loss of €(47.8) million, as compared to a loss of €53.1 million in 2004.

The decrease 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, increased (€730,6 million in 2005 compared to €689.9 million in 2004); globally, the funding paid to the subsidiaries remained proportional.

2) Interest on notes mandatorily redeemable for new or existing shares, issued in December 2002, decreased from €(43.7) million in 2004 to €(39.6) million in 2005 due to the effect of discounting the interest prepaid on January 2, 2003.

3) Financial income decreased from €1,051.8 million in 2004 to €962.1 million in 2005:

- the net change in financial reserves and depreciation resulted in income of €500.4 million in 2005 compared to €1,298.5 million in 2004.

  This income mainly relates to the reversal of the reserve for depreciation of the investment in Alcatel Space (€459.5 million) sold to Alcatel Participations for further contribution by the latter to the Alcatel-Finmeccanica joint venture. The corresponding capital loss has been recorded in non-recurring items as required by the French accounting principles. The value of Alcatel's investment portfolio remained stable. Consequently, no significant net changes in reserves for depreciation were recorded. For information, depreciation reversals were booked in 2004, in particular on the investments in Coralec (€272.6 million), Compagnie Financière Alcatel (€361.3 million), Alcatel Space (€94.2 million) and Alcatel Submarine Networks (€16.7 million) and additions to reserves for depreciation on the investments in Telpart (formerly Saft Partcipations) (€60.6 million) and Alcatel Norway (€33.3 million).

  Financial risk reserves covering Alcatel's commitment regarding Alcatel Canada Inc were fully reversed in 2005 (see note 19). The income statement effect of this reversal is set off by an equivalent addition to the reserve for depreciation of the investment in Coralec because of a reorganization in the shareholding of the Alcatel group's Canadian activities (see note 4).

  2004 was also impacted by the write-back of the reserve for potential foreign exchange losses (€419.2 million), which was utilized following the reorganization of the U.S. dollar loans to Alcatel USA Inc., and by the increase of €25.4 million in a reserve of the same type. In view of the evolution of foreign currency rates, this €25.4 million reserve was written back in 2005 and no potential foreign exchange losses on foreign currency assets and liabilities have been incurred at December 31, 2005 (potential foreign exchange gains on such items are recorded in currency translation adjustment on the liabilities side of the balance sheet).
- The dividends received from subsidiaries increased from €73.1 million in 2004 to €111.2 million in 2005 (see note 3).
- Interest paid on long-term debt remained stable (€132.3 million in 2005 compared to €133.1 million in 2004). Income on short-term cash management, including the Group's system of guaranteeing the exchange rates of subsidiaries' commercial bids in foreign currencies, increased (€480 million in 2005 compared to €400 million in 2004).

4) Non-recurring items resulted in a loss of €(546.2) million in 2005 compared to income of €2.5 million in 2004.

This loss includes the capital loss on the disposal of the investment in Alcatel Space to Alcatel Participations (€554.6 million) prior to the contribution of the investment to the joint venture set up by the Alcatel and Finmeccanica groups in the activity of satellite solutions. The corresponding write-back of the reserve for depreciation has been recorded in financial income as explained above.

5) The income tax profit of €62.0 million relates to the French Tax Group (see note 5).

Note 3

Revenues from investments in subsidiaries and associates

(In millions of euros)	2005	2004
Subsidiaries		
Electro Banque	80.1	40.0
Alcatel Deutschland	21.8	-
Radio Frequency Systems	7.8	4.0
Société Immobilière Nieuport	1.0	2.2
Telpart (ex Saft Participations)	-	26.2
Other	0.5	-
Associates		
Nexans	-	0.7
TOTAL	**111.2**	**73.1**

Note 4

Net change in reserves

	2005		2004	
(In millions of euros)	Increase	(Write-back)	Increase	(Write-back)
Reserves for investments in subsidiaries and associates	2,829.7	(697.3)	94.9	(746.7)
Reserves for other financial investments and other financial assets	19.3	-	-	(33.3)
Reserves for marketable securities	-	(46.5)	0.2	(8.6)
Reserves for financial risks	26.0	(2,638.4)	62.3	(671.7)
Amortization of premiums on bonds	6.8	-	4.4	-
TOTAL	**2,881.8**	**(3,382.2)**	**161.8**	**(1,460.3)**

Increases in reserves for depreciation mainly relate to the investment in Coralec (€2,528.1 million), which now holds 100% of the Group's Canadian holding company, following the absorption of Lubelec by way of a "transmission universelle de patrimoine" in December 2005. Lubelec used to hold part of these shares resulting from the Newbridge acquisition in May 2000. The income statement effect of this addition is set off by the corresponding write-back of the reserve for financial risks that covered Alcatel's commitment to purchase the shares held by Lubelec in the Canadian holding company (€2,580 million). This commitment disappeared because of Lubelec's absorption. Other additions concern Alcatel Submarine Networks (€277.4 million) and Alcatel Norway (€19.7 million). In 2004, additions were for the investments in Saft Participations (€60.6 million) and Alcatel Norway (€33.3 million).

2005 write-backs of reserves for depreciation mainly relate to Compagnie Financière Alcatel (€237.7 million), and to Alcatel Space (€459.6 million) that was sold to Alcatel Participations for onward contribution to the joint venture set up by the Alcatel and Finmeccanica groups. The corresponding capital loss (€554.6 million) is recorded in non-recurring items. In 2004, write-backs of reserves for depreciation were recorded on the investments in Coralec (€272.6 million), Compagnie Financière Alcatel (€361.3 million), Alcatel Space (€94.2 million) and Alcatel Submarine Networks (€16.7 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 consists in calculating for each business division a fair value excluding debt and taxes, based on discounted future cash flows for the period 2006 to 2010 and on a terminal value in 2010. The discount rate used of 9.45% was the weighted average cost of the Group's capital in 2005. 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 is 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 are allocated entity by entity. The value so obtained for each entity is then compared to the historical book value of each investment held by Alcatel and, where necessary, a reserve for depreciation is set up.

The movements on reserves for depreciation of other financial investments relate mainly to Alcatel shares owned by the Company, representing an increase of €19.3 million in 2005 (write-back of €23.3 million in 2004). The carrying value of these shares is calculated on the basis of the December average stock market prices.

The write-back of the reserve for depreciation of marketable securities, calculated at December 31, 2004 by reference to the average December 2004 stock prices, relates to the shares in Nexans, which were sold in 2005. The financial loss incurred on this disposal (€34.2 million) is recorded in other financial income/loss due to the nature of this investment.

Reserves for financial risks covering Alcatel's commitment to buy back a part of the investment in Alcatel Canada Inc. were written back (€2,580.0 million), as the commitment no longer exists (see above). Reserves for risks on guarantees given were written back for €32.6 million due to the ending of the corresponding risks.

Note 5

Income tax

1) French Tax Group

a) The number of French subsidiaries belonging to the French Tax Group ("intégration fiscale") was 31 in 2005, compared to 45 in 2004. The main subsidiaries belonging to the French Tax Group are mentioned in the investment portfolio at December 31, 2005.

b) The tax income recorded in the 2005 income statement results from:

– the difference between the 2005 income tax receivable from taxable subsidiaries and the income tax payable to non-taxable subsidiaries because of their 2005 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.

This income amounted to €62.1 million in 2005. The 2004 tax income of €1,220.7 million was mainly due to the change in the 2004 tax law on income tax relating to long-term capital gains and to the removal from the French Tax Group during 2004 of certain subsidiaries that had been disposed of. As a consequence, it has become unlikely that Alcatel will be required to give back to the subsidiaries the monies that it has recorded in the tax group suspense account.

2) Tax charge breakdown

The annual parent company tax benefit (charge) is analyzed as follows:

	2005		2004	
(In millions of euros)	Pre-tax amount	Tax	Pre-tax amount	Tax
Operating income (loss)	(47.8)	16.0	(53.1)	38.4
Interest on other equity	(39.6)	-	(43.7)	-
Financial income (loss)	962.1	(92.1)	1,051.8	(48.4)
Income (loss) before non-recurring items and income tax	**874.7**	**(76.1)**	**955.0**	**(10.0)**
Non-recurring items	(546.2)	138.1	2.5	9.9
French Tax Group's suspense account recognized in the income statement*	-	-	-	1,220.8
Total tax benefit (charge)	**62.0**	**62.0**	**1,220.7**	**1,220.7**
Net income (loss) after tax	**390.5**	**-**	**2,178.2**	**-**

** This amount takes into account the 2004 movements following 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 €0.6 million.

Note 6

Balance sheet

Total assets decreased from €26.5 billion at the end of 2004 to €23.9 billion at the end of 2005. Significant changes in the 2005 balance sheet include the following:

- investments in subsidiaries and associates decreased from €10.4 billion at the end of 2004 to €7.4 billion at the end of 2005 (see notes 4 and 7), mainly because of changes in reserves for depreciation;
- other financial assets increased from €9.6 billion at the end of 2004 to €10.9 billion at the end of 2005, mainly as a result of the increase in loans from Alcatel's Central Treasury to subsidiaries within the context of the Group's treasury convention;
- shareholders' equity after appropriation increased from €14.7 billion to €15.5 billion mainly due to the income for the year and to the redemption into new shares of notes mandatorily redeemable for shares (ORANE); the main increases in capital in 2005 were linked to the reimbursement of bonds redeemable for shares issued by Coralec for the acquisition of iMagic TV Inc and Spatial Wireless, and to the exercising of stock options (see notes 11 and 12);
- financial debt remained stable (€4.1 billion at the end of 2005 compared to €4.2 billion at the end of 2004). During 2005, some bonds issued were reimbursed at maturity date or bought back and cancelled (see note 15). Some of the loans from subsidiaries have been reclassified to medium or long-term financial debts;
- other liabilities decreased from €4.2 billion in 2004 to €4.1 billion in 2005; this caption mainly includes short-term advances received from subsidiaries within the context of the Group's Treasury Convention (see note 9).

Note 7

Investments in subsidiaries and associates

(In millions of euros)	Gross value	Depreciation	Net value
December 31, 2004			
Subsidiaries	19,764.4	(10,017.3)	9,747.1
Associates	1,092.6	(461.3)	631.3
TOTAL	**20,857.0**	**(10,478.6)**	**10,378.4**
Acquisitions	0.1	-	0.1
Disposals	(829.1)	-	(829.1)
(Increases)/Write-backs of reserves	-	(2,132.3)	(2,132.3)
December 31, 2005			
Subsidiaries	19,764.2	(12,609.2)	7,155.0
Associates	263.8	(1.7)	262.1
TOTAL	**20,028.0**	**(12,610.9)**	**7,417.1**

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

- the disposal of the investment in Alcatel Space (€795.0 million) to Alcatel Participations for onward contribution by the latter to the Alcatel Alenia Space joint venture set up by the Alcatel and Finmeccanica groups in the activity of satellite solutions;
- the capital reduction of Alcatel Deutschland (€33.7 million).

Note 8

Receivables from subsidiaries and associates and other financial assets

The changes during the year were as follows:

(In millions of euros)	Gross value	Depreciation	Net value
Alcatel shares held	471.9	(181.7)	290.2
Long-term loans to subsidiaries	9,316.3	(4.1)	9,312.2
Other financial assets	18.0	(17.7)	0.3
December 31, 2004	**9,806.2**	**(203.5)**	**9,602.7**
Increases	1,694.0	-	1,694.0
Decreases	(404.2)	-	(404.2)
(Increases)/Write-backs of reserves	-	(19.3)	(19.3)
December 31, 2005	**11,096.0**	**(222.8)**	**10,873.2**
Alcatel shares held	471.9	(201.0)	270.9
Long-term loans to subsidiaries	10,606.0	(4.1)	10,601.9
Other financial assets	18.1	(17.7)	0.4
December 31, 2005	**11,096.0**	**(222.8)**	**10,873.2**

The market value of Alcatel shares owned by the Company amounted to €270.9 million, based on the average stock market prices for December 2005. No acquisition or disposal of such shares occurred in 2005.

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)	2005	2004
Cash*	1,515.2	1,428.9
Group's Treasury Convention with subsidiaries	2,305.3	3,096.6
Total cash and cash equivalents*	**3,820.5**	**4,525.5**
Marketable securities**	**1,625.2**	**1,720.2**
Short-term bank loans and overdrafts	(69.2)	(102.9)
Other short-term financial debt	(270.2)	(227.6)
Group's Treasury Convention with subsidiaries	(3,582.4)	(3,897.3)
Total short-term financial debt***	**(3,921.8)**	**(4,227.8)**
TOTAL	**1,523.9**	**2,017.9**

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

** *Including primarily euro denominated certificates of deposit, whose market value, after taking into account accrued interest, is not significantly different from book value.*

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

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

Note 10

Market-related exposures

Currency risks and interest rate risks are analyzed below.

a) Currency risks

As of December 31, 2005, the off-balance sheet financial instruments, held for hedging purposes, are summarized below:

				Purchaser / Lender
			Principal amount	Fair value
	Within one year	Between 1 and 5 years	Over 5 years	
Forward exchange contracts	1,560.9	-	-	30.3
Forward exchange swaps	589.3	-	-	4.4
Cross currency swaps	-	-	-	-
Currency options:				
– call	346.7	172.8	-	16.1
– put	947.7	826.1	-	25.7

				Seller / Borrower
			Principal amount	Fair value
	Within one year	Between 1 and 5 years	Over 5 years	
Forward exchange contracts	1,885.8	10.5	-	(54.7)
Forward exchange swaps	1,385.1	-	-	(15.9)
Cross currency swaps	-	-	-	-
Currency options:				
– call	299.1	114.8	-	(15.3)
– put	540.9	763.5	-	(15.9)

b) Interest rate risks

At December 31, 2005, off-balance sheet financial instruments held to manage interest rate risks are as follows:

			Principal amount	Fair value
	Within one year	Between 1 and 5 years	Over 5 years	
Interest rate swaps				
Borrower fixed rate	1,759.8	3,579.2	17.6	(12.7)
Borrower floating rate	2,107.7	5,517.9	477.6	119.2
Caps				
Purchaser	890.1	1,656.3	-	12.4
Seller	762.9	1,656.3	-	(12.3)
Floors				
Purchaser	-	-	-	-
Seller	-	-	-	-
Forward Rate Agreements				
Purchaser	-	-	-	-
Seller	-	-	-	-
Interest rate options				
Purchaser	211.9	-	-	2.4
Seller	211.9	-	-	(2.4)

c) Credit rating

As of January 31, 2006, Alcatel credit ratings were as follows:

Rating Agency	Long-term Debt	Short-term Debt	Outlook	Last Update
Moody's	Ba1	Not Prime	Positive	April 11, 2005
Standard & Poor's	BB	B	Stable	November 10, 2004

On April 11, 2005, Moody's upgraded to Ba1 from Ba3 the ratings for Alcatel long-term debt and maintained its Positive outlook. The Not Prime rating of the short-term debt was reaffirmed.

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

Date	Moody's		Date	Standard & Poor's	
April 11, 2005	Ba1	Outlook Positive	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

Rating clauses affecting Alcatel debt at December 31, 2005

Alcatel's short-term debt rating allows a 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 with both agencies move back to investment grade level. However this interest rate decrease will not take place since the condition related to Alcatel ratings was not met before December 31, 2005 as requested.

Syndicated bank credit facility

On March 15, 2005, Alcatel amended the three-year multi-currency revolving facility that had been put in place on June 21, 2004. Consequently the maturity of the line was lengthened from June 2007 to June 2009, the financial conditions were improved and one of the financial covenants was eliminated. Moreover, Alcatel decided to reduce the amount of this revolving facility from €1,300 million to €1,000 million.

The availability of this syndicated credit facility of €1,000 million is not dependent upon Alcatel's credit ratings. At December 31, 2005, the credit facility had not been drawn and remained undrawn at the date of approval of the 2005 financial statements by Alcatel's Board of Directors. Alcatel's ability to draw on this facility is conditioned upon its compliance with a ratio linked to the capacity of Alcatel to generate sufficient cash to repay its net debt. As the Group had cash, cash equivalents and marketable securities in excess of its gross financial debt at December 31, 2005 the above-mentioned ratio was not applicable at these dates.

Note 11
Capital stock

Capital stock, consisting of 1,428,541,640 ordinary shares of nominal value €2, increased from €2,610.9 million at the end of 2004 to €2,857.1 million at the end of 2005. As approved at the Shareholders' meeting of April 17, 2003, the class O shares were converted into ordinary shares on a one-for-one basis.

(number of shares)	
At December 31, 2004	**1,305,455,461**
Capital increases arising from:	
– repayment of notes mandatorily redeemable for new or existing shares ("ORANE") 7.91% 2002-2005	120,780,266
– repayment of bonds reimbursable in shares ("ORA"):	
– issued in 2003 – iMagic TV acquisition*	50,000
– issued in 2004 – Spatial Wireless acquisition *	400,000
– stock options exercised	1,855,913
At December 31, 2005	**1,428,541,640**

* *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 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)	
At December 31, 2004	**7,757.6**
Additional paid-in capital arising from:	
– repayment of notes mandatorily redeemable for new or existing shares ("ORANE") 7.91% 2002-2005	403.4
– repayment of bonds reimbursable in shares ("ORA"):	-
– issued in 2003 – iMagic TV acquisition *	0.3
– issued in 2004 – Spatial Wireless acquisition *	3.9
– stock options exercised	8.3
At December 31, 2005	**8,173.5**

* *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 iMagic TV and Spatial Wireless (later renamed Alcatel Wireless).*

Considering the foregoing and the appropriation of income as proposed during the general meeting of June 1, 2006, the additional paid-in capital and reserves are as follows:

	2005		2004
(In millions of euros)	**Before appropriation**	**After appropriation**	**After appropriation**
Additional paid-in capital	8,173.5	8,173.5	7,757.6
Legal reserve	261.1	280.6	261.1
Statutory reserves	1,673.3	1,673.3	1,673.3
Other reserves	195.0	195.0	195.0
TOTAL	**10,302.9**	**10,322.4**	**9,887.0**

In view of the above-mentioned proposed appropriation of income, the legally distributable reserves amount to €1,868.3 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") of class A (one share for each note), for a total amount of €645 million, maturing on December 23, 2005. The notes carried 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.

During 2005, 10,560 notes (3,600 notes in 2004 and 2,338 in 2003) were repaid by issuance of 10,307 new shares (the difference corresponding to the reimbursement of prepaid interest by the note holders).

At maturity date in December 2005, all of the 120,769,959 outstanding notes were redeemed by issuing the same number of new shares.

Interest due on the ORANEs for 2005 amounted to €39.6 million (€43.8 million in 2004).

Note 14

Reserves for liabilities and charges

The movements on reserves for liabilities and charges in 2005 were as follows:

(In millions of euros)		31/12/2004	Increases	(Write-backs)	(Utilizations)	31/12/2005
Reserve for unrealized foreign exchange losses		25.8	-	(25.8)	-	-
Reserve for financial risks	(see note 4)	2,656.9	-	(84.5)	(2,528.1)	44.3
Reserves for litigation, guarantees given on investments sold and other reserves		117.6	30.4	(20.4)	(1.7)	125.9
Reserves for pensions and retirement indemnities	(see note 18)	20.4	1.4	-	-	21.8
Other reserves		5.5	-	-	(5.0)	0.5
TOTAL		**2,826.2**	**31.8**	**(130.7)**	**(2,534.8)**	**192.5**
Recorded in operating income (loss)			5.4	(1.0)		4.4
Recorded in financial income (loss)			26.0	(110.3)		(84.3)
Recorded in non-recurring income (loss)			0.4	(19.4)		(19.0)
TOTAL CHARGE (CREDIT) TO INCOME STATEMENT			**31.8**	**(130.7)**		**(98.9)**

At period-end, contingent liabilities exist with regard to ongoing tax disputes. Neither the financial impact nor the timing of any outflows of resources that could result from an unfavorable outcome of these disputes can be estimated at present. Nevertheless, the Group is confident in the outcome of these ongoing disputes.

Note 15

Bonds issued

At December 31, 2005, outstanding Alcatel bonds amounted to €2,959.7 million compared to €3,764.2 million at December 31, 2004. These amounts result from the following transactions in 2005:

(In millions of euros)	31/12/2004	Repayment of bonds maturing in 2005	Buy-backs and cancellations	New issuances	31/12/2005
Convertible bonds (OCEANE)					
– bonds convertible into new or existing shares 2003-2011	1,022.4	-	-	-	1,022.4
	1,022.4	**-**	**-**	**-**	**1,022.4**
Other bonds					
– FRF 1.5 billion bond 5.625% 1997-2007	154.5	-	(0.1)	-	154.4
– FRF 1 billion bond zero coupon 2006	41.2	-	(4.8)	-	36.4
– €1,120 million bond 1999-2009	1,009.8	-	(150.7)	-	859.1
– €1 billion bond 2000-2005	576.3	(524.6)	(51.7)	-	-
– €1.2 billion bond 2001-2006	498.0	-	(72.6)	-	425.4
– €462 million bond 2004-2014	462.0	-	-	-	462.0
	2,741.8	**(524.6)**	**(279.9)**	**-**	**1,937.3**
TOTAL	**3,764.2**	**(524.6)**	**(279.9)**	**-**	**2,959.7**

2005 bond repurchases:

Several bonds were subject to buy-back and cancellation in 2005, amounting to €291.3 million, corresponding to a nominal value of €279.9 million, detailed as follows:

(In euros)	Nominal value repurchased
Maturity September 2005	51,627,000
Maturity February 2006	4,838,724
Maturity December 2006	72,603,000
Maturity March 2007	150,925
Maturity February 2009	150,676,000
	279,895,649

The difference between the repurchased amount and the nominal value (€11.4 million) was included in non- recurring income/(loss).

Note 16

Analysis by maturity date of liabilities and receivables and other current assets

(In millions of euros)	Amount at 31/12/2005	Less than one year	1 - 5 years	After 5 years	Out of which accruals
Financial debt					
– convertible bonds (OCEANE)	1,022.4	-	-	1,022.4	-
– other bonds	1,937.3	461.8	1,013.5	462.0	-
– bank loans and overdrafts	122.7	69.3	53.4	-	14.2
– other financial debt	1,003.2	270.2	733.0	-	114.0
Tax and social liabilities	**15.9**	**10.2**	**5.7**	**-**	**1.9**
Other liabilities (after appropriation)	**4,067.7**	**3,999.8**	**65.1**	**2.8**	**154.9**
TOTAL LIABILITIES	**8,169.2**	**4,811.3**	**1,870.7**	**1,487.2**	**285.0**

Analysis of other liabilities at December 31, 2005	
Advances from subsidiaries – Group's Treasury Convention	3,582.4
Accounts payable	144.7
Dividend payable	228.5
Other	112.1
	4,067.7

(In millions of euros)	Amount at 31/12/2005	Less than one year	1 - 5 years	After 5 years	Out of which accruals
Tax and social receivables	5.3	3.4	1.9	-	2.7
Other accounts receivable and other current assets	2,417.8	2,375.4	42.4	-	49.0
TOTAL ACCOUNTS RECEIVABLE AND OTHER CURRENT ASSETS	**2,423.1**	**2,378.8**	**44.3**	**-**	**51.7**

Analysis of accounts receivable and other current assets at December 31, 2005	
Advances to subsidiaries – Group's Treasury Convention	2,305.3
Accounts receivable	47.6
Other	64.9
	2,417.8

Note 17

Related party transactions

Outstanding balances at December 31, 2005 arising from related party transactions were as follows:

(In millions of euros)	Net balance sheet amount	Of which consolidated or related companies
Investments and other non-current assets		
– investments in subsidiaries and associates	7,417.1	7,416.7
– due from subsidiaries and associates	-	-
– other financial assets	10,601.9	10,586.9
– other investments	271.3	270.9
Accounts receivable	**2,423.1**	**2,363.6**
Marketable securities	**1,625.2**	**-**
Financial debt	**-**	**-**
– convertible bonds and other bonds	2,959.7	-
– bank loans and overdrafts	122.7	-
– other financial debt	1,003.2	763.9

(In millions of euros)	Net income statement amount	Of which consolidated or related companies
Financial income (loss)		
– revenues from investments in subsidiaries and associates	111.2	111.2
– interest income and similar revenues	916.0	502.8
– interest expenses and similar expenses	(602.6)	(138.7)
– other financial income (loss)	537.5	434.9

Note 18

Pensions and retirement indemnities

At December 31, 2005, Alcatel's pensions and retirement indemnity obligations were either reserved (the reserve amounts to €21.8 million – see note 14) or were covered by insurance contracts.

The "Conseil national de la comptabilité"'s regulation No. 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.

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 was 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 was 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 was reserved in the 2004 financial statements to cover this commitment.

During 2005, Lubelec was absorbed by its parent company Coralec by way of a "transmission universelle de patrimoine". Coralec has therefore become the sole shareholder of Alcatel Holdings Canada Corporation. Consequently, the sale agreement between Lubelec and Alcatel did not materialize and the reserve for the financial risk on this transaction has been released. The income statement effect of this release is however set off by an addition to the reserve for depreciation of the investment in Coralec to take into account the fair value of the Alcatel Canadian sub-group (see note 4).

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 2005.

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) Guarantees on cash pooling

Guarantees given in respect to Alcatel's centralized treasury management amounted to approximately €639 million at year-end 2005, 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).

d) Other commitments

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

(In millions of euros)	Total amount at December 31, 2005	Less than one year	1 - 5 years	After 5 years
Guarantees granted to subsidiaries or other Group companies*	32.1	32.1	-	-
Assets pledged to secure Alcatel's financial debt	-	-	-	-
Guarantees given on:				
– commercial contracts	2,723.5	1,236.7	886.5	600.3
– loans	47.2	38.7	-	8.5
– other items	564.1	68.8	158.7	336.6
Discounted receivables	-	-	-	-
TOTAL	**3,366.9**	**1,376.3**	**1,045.2**	**945.4**

** Of which €20.7 million is recorded in financial risk reserves as of December 31, 2005.*

e) Guarantees received

Guarantees received	89.9		89.9	
TOTAL	**89.9**	**-**	**89.9**	**-**

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. By a decision dated June 29, 2005, which has become final, the division of the Paris Court of Appeals dealing with issues arising in the context of criminal investigation definitely rejected a final request for annulment. As a result, the investigating magistrate may now close his investigation at any time.

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. The 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 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. This was filed, and fully briefed as of August 5, 2005. The parties are waiting for the judge's decision.

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, 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 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 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 have been 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 payments by Alcatel in foreign countries. 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 harm 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 in government procurement contracts within Costa Rica for a certain period and fines or penalties may be imposed on Alcatel, in an amount that Alcatel is not able to determine at this time. Alcatel expects to generate approximately €10 million in revenue from Costa Rican contracts in 2006. 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 Alcatel in Latin America.

Taiwan

Certain employees of 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 Taisel by Taiwan Railways in 2003. It has been alleged that persons in Taisel and Siemens Taiwan and subcontractors hired by them were involved in a bid rigging and illicit 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 President of Taisel. A Director of international sales and marketing development of a German subsidiary who was involved in the Taiwan Railways contract has resigned.

On February 21, 2005, the former President of Taisel, Taisel and others were indicted for violation of the Taiwanese Government Procurement Act.

On November 15, 2005, the Taipei criminal district court found Taisel not guilty of the alleged violation of the Government Procurement Act. The former President of Taisel was not judged because he was not present or represented at the proceedings. The court found two Taiwanese businessmen involved in the matter guilty of violations of the Business Accounting Act.

The prosecutor has filed an appeal with the Taipei court of appeal. Should the higher court find Taisel guilty of the bid-rigging allegations in the indictment, Taisel may be banned from participating in government procurement contracts within Taiwan for a certain period and fines or penalties may be imposed on Alcatel, in an amount not to exceed €25,000.

Other allegations made in connection with this matter may still be under ongoing investigation by the Taiwanese authorities.

As a group, Alcatel expects to generate approximately €126 million of revenue from Taiwanese contracts in 2006, of which only a part will be governmental contracts. Based on the amount of revenue expected 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 consolidated 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 or the Group.

Note 21

Remuneration of Directors and members of Senior Management

The value of attendance fees allocated to members of the Board for 2005 remains steady compared with 2004 at €0.6 million euros.

During 2005, the total amount of remunerations paid by Alcatel to the members of Senior Management was €7.5 million, (compared with €3.4 million in 2004). This includes the exceptional items resulting from contractual commitments.

Note 22

Information relating to subsidiaries and associates

(in millions of euros)	Capital stock at year-end	Components of shareholders' equity other than capital stock (1)	Alcatel percentage of ownership (%)
Detailed information relating to subsidiaries and associates with book value in excess of 1% of Alcatel's capital stock			
A – Subsidiaries (at least 50% of capital stock held by Alcatel)			
CFA - Cie Financière Alcatel - 54, rue La Boétie - 75008 Paris	3,162.0	1,247.3	100.0
Coralec - 12, rue de la Baume - 75008 Paris	3,534.6	87.9	100.0
Electro Banque - 12, rue de la Baume - 75008 Paris	106.0	605.0	99.9
Telpart (ex Saft Participations) - 12, rue de la Baume - 75008 Paris	196.8	281.3	100.0
Alcatel Submarine Networks - Route de Nozay - 91625 La Ville-du-Bois Cedex	112.0	48.9	100.0
Alcatel Norway A/S - Ostre Aker vei 33 Oker - 0508 Oslo (Norway)	10.5	28.1	100.0
SIKL - Sté Immobilière Kléber Lauriston - 12, rue de la Baume - 75008 Paris	16.3	30.4	100.0
B – Associates (10% to 50% of capital stock held by Alcatel)			
Alcatel Deutschland - Lorenzstrasse 10 - 70435 Stuttgart (Germany)	101.2	(19.1)	25.0
Information relating to other subsidiaries and associates			
A – Subsidiaries (at least 50% of capital stock held by Alcatel)			
a- French subsidiaries	-	-	-
b- Foreign subsidiaries	-	-	-
B – Associates (10% to 50% of capital stock held by Alcatel)			
a- French subsidiaries	-	-	-
b- Foreign subsidiaries	-	-	-

(1) Before appropriation.
(2) Last financial year.

Gross value of investments held	Net book value of investments held	Outstanding loans and advances	Guarantees given	Net sales (2)	Net income (loss) (2)	Dividends received in 2005 by Alcatel
8,274.0	4,709.7	1,171.2	-	195.3	(1,024.3)	-
8,726.6	1,134.5	272.1	-	-	(2,528.1)	-
581.3	581.3	-	-	32.0	16.7	80.1
539.9	476.3	-	-	-	(1.8)	-
1,282.6	101.0	114.0	-	412.5	(64.1)	-
164.8	68.8	-	-	326.1	(3.8)	-
155.0	46.2	-	-	-	(0.6)	-
262.2	262.2	-	-	-	80.7	21.8
39.9	37.0	-	-	-	-	9.3
-	-	-	-	-	-	-
-	-	-	-	-	-	-
1.7	-	-	-	-	-	-

Investment portfolio at December 31, 2005

		Number of shares held	Net book value (in thousands of euros)	Alcatel percentage of ownership	Alcatel Group percentage of ownership
Investment in subsidiaries and associates					
I - Participations					
Compagnie Financière Alcatel	(TG)	451,711,205	4,709,724	100.0	100.0
Coralec	(TG)	572,428,051	1,134,518	100.0	100.0
Electro Banque	(TG)	10,592,213	581,303	99.9	100.0
Telpart (ex Saft Participations)	(TG)	13,121,159	476,332	100.0	100.0
Alcatel Deutschland		1	262,176	25.0	100.0
Alcatel Submarine Networks	(TG)	35,470,941	101,037	95.0	100.0
Alcatel Norway		8,400,000	68,834	100.0	100.0
SIKL	(TG)	214,630	46,165	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	3,053	100.0	100.0
FIPP		81,044	200	74.6	74.6
Other			250		
II – Other financial investments					
Alcatel		25,343,255	270,919	2.0	4.1
III – Investments in real estate companies			20,820		

(TG) Subsidiary belonging to the French Tax Group.

The French Tax Group also includes:

- Alcatel Participations (subsidiary of Compagnie Financière Alcatel);
- Alcatel Business Systems (subsidiary of Alcatel Participations);
- Alcatel CIT (subsidiary of Alcatel Participations).

Five-year summary of financial data

	2005	2004	2003	2002	2001
Capital stock at year end					
a) Capital stock (in thousands of euros)	2,857,083	2,610,911	2,568,820	2,529,417	2,481,540
b) Number of A shares	1,428,541,640	1,305,455,461	1,284,410,224	1,239,193,498	1,215,254,797
c) Number of O shares	-	-	-	25,515,000	25,515,000
d) Total number of shares after division	1,428,541,640	1,305,455,461	1,284,410,224	1,264,708,498	1,240,769,797
Potential capital					
a) Capital stock (in thousands of euros)	3,232,201	3,222,896	3,170,035	2,974,011	2,688,391
b) Total number of shares	1,616,100,626	1,611,448,098	1,585,017,673	1,487,005,573	1,344,195,736
Results (in thousands of euros)					
a) Revenues from investment portfolio	111,157	73,171	103,101	280,502	393,542
b) Income (loss) before tax, depreciation, amortization and provisions	(175,141)	(388,386)	(8,126,141)	379,442	697,755
c) Income tax	(62,095)	(1,220,747)	165,356	(353,964)	(97,504)
d) Employee profit sharing	-				
e) Income (loss) after tax, depreciation, amortization and provisions	390,524	2,178,214	(3,255,426)	(14,710,546)	(2,966,106)
f) Dividends (including distribution tax)	0.16*	-	-	-	196,993
Earnings per Share (in euros)			-		
a) Income (loss) after tax, but before depreciation, amortization and provisions**	(0.08)	0.64	(6.46)	0.58	0.64
b) Income (loss) after tax, depreciation, amortization and provisions**	0.27	1.67	(2.53)	(11.63)	(2.39)
c) Dividend attributable to each A Share having a nominal value of €2	0.16*	-	-	-	0.16
d) Dividend attributable to each O Share having a nominal value of €2		-	-	-	0.1 0
Personnel			-		
a) Average number of staff employed during the year	4	5	5	4	5
b) Payroll (in thousands of euros)	6,771	5,000	2,911	1,889	3,343
c) Social security and employee benefits (in thousands of euros)	1,430	1,540	1,662	955	779

* *Proposed.*

***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, 2005

(Free translation of a French language original)

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, 2005, 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, 2005 and the results of its operations for the year then ended, in accordance with the accounting rules and principles applicable in France.

II. Justification of our assessments

In accordance with the requirements of article L. 823-9 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 €7,417.10 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 income in particular), to check, if necessary, the fair value of fixed assets.

We have examined the relevance of the methodology outlined in notes 1a) and 4 to the Financial Statements, examined the data and assumptions used in implementing this methodology and assessed the reasonableness of such estimates.

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 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 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, 2006

The Auditors

DELOITTE & ASSOCIES	BARBIER FRINAULT & AUTRES ERNST & YOUNG
Alain Pons Antoine de Riedmatten	Christian Chiarasini

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 users. 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 Statutory 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 audit opinion on the Statutory Financial Statements taken as a whole and not to provide separate assurance on individual account captions or on information taken outside of the Statutory Financial Statements. The report also includes information relating to the specific verification of information in the Directors' 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.

AUDITORS' SPECIAL REPORT ON AGREEMENTS INVOLVING RELATED PARTIES

Year ended December 31, 2005

As statutory auditors of your Company, we are required to report on certain agreements with related parties.

Agreements authorized during the fiscal year

Pursuant to Article L. 225-40 of the French Commercial Code, the following agreements, previously authorized by the Board of Directors of your Company, have been brought to our attention.

The terms of our engagement do not require us to identify such agreements, if any, but to communicate to you, based on information provided to us, the principal terms and conditions of those agreements brought to our attention, without expressing an opinion on their usefulness and appropriateness. It is your responsibility, pursuant to Article 92 of the Decree of March 23, 1967, to assess the interest involved in respect of the conclusion of these agreements for the purpose of approving them.

We conducted our procedures in accordance with professional standards applicable in France; those standards require that we agree the information provided to us with the relevant source documents.

Agreement describing and organizing the termination of the duties of the Group President and Chief Operating Officer

At its April 19, 2005 meeting, the Board of Directors authorized, after the approval of the Appointments and Compensation Committee, the signing of an agreement between Alcatel and Mr. Philippe Germond, describing and organizing the termination of his duties as Group President and Chief Operating Officer.

The main provisions of this agreement, which aim to adjust the contractual commitments due to his resignation during the first half of fiscal year 2005, include (i) determining Mr. Germond's severance pay which was set at €300,000 in the initial agreement when he assumed his duties, (ii) reducing his notice period to 3 months, (iii) setting his bonus with respect to fiscal year 2005, on a time-apportioned basis, i.e. €250,000 (iv) terminating his position as a member of the Group Board of Directors (v) maintaining his rights to Alcatel stock subscription options of which he is a beneficiary in accordance with the terms and conditions of the stock option plans set up by the Board of Directors.

Agreements approved during prior fiscal years that continued in effect during this fiscal year

In accordance with the Decree of March 23, 1967, 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).

Support agreement with subsidiaries regarding research and development and industrial property costs

Although not formally falling within the scope of Article L. 225-38 of the French Commercial Code, the Board of Directors has authorized contributions by Group companies to research and development and industrial property costs. Such amounts are paid in their entirety to Alcatel, which is in turn responsible for distributing such costs among the subsidiaries in accordance with their funding requirements. For fiscal year 2005, the income recorded by Alcatel amounted to €730,593,000. Charges due from Alcatel and its subsidiaries amounted to €752,474,000.

Neuilly-sur-Seine, March 30, 2006

The Statutory Auditors

DELOITTE & ASSOCIES	BARBIER FRINAULT & AUTRES
	ERNST & YOUNG
Alain Pons Antoine de Riedmatten	Christian Chiarasini

This is a free translation of the original text in French for information purposes only.

It should be understood that the agreements reported on are only those provided by the French Commercial Code and that the report does not apply to those related party transactions described in IAS 24 or other equivalent accounting standards.

INFORMATIONS ABOUT THE GROUP

ALCATEL SHARE

Listings

The Alcatel share is listed on several places:

- Premier Marché de la Bourse de Paris (Euronext);
- Euronext financial markets in Amsterdam and Brussels;
- SWX Swiss Exchange (Basle, Geneva, Zurich);
- Francfurt;
- Tokyo;
- SEAQ à Londres.

The security is also listed on the New Stock Exchange 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 on Alcatel ordinary share.

ISIN Code

Since June 2003, all Securities quoted on the Euronext Paris stock market are identified by an International Securities Identification Number (ISIN).

Alcatel ISIN Code: FR0000130007

However, stock exchange markets and news agencies use following tickers:

- CGEP.PA (Euronext Paris);
- ALA.N (NYSE);
- Bloomberg CGE.FP.

Indexes

The Alcatel share is included in the following stock market indexes: CAC 40 and DJ Euro Stoxx 50.

Transactions in Paris and New York for last three years

Transactions in Paris	2005	2004	2003
Highest (in euros)	11.70	14.82	11.89
Lowest (in euros)	8.14	8.77	4.16
Last cotation(in euros)	10.47	11.45	10.21
Capotalisation (in billions of euros)	15	15	13

Number of shares at December 31, 2005: 1,428,541,640

Transactions in New York (ADS)	2005	2004	2003
Highest (in dollars)	15.75	18.32	13.68
Lowest (in dollars)	10.44	10.76	4.60
Last cotation (in dollars)	12.40	15.63	12.85
Capitalisation (in billions of dollars)	16	21	19

Number of shareholders (estimation): 450,000

Five-year summary of dividend per share

					2001	
(in euros)	2005	2004	2003	2002	Action A	Action O
Dividend distributed	0.16*	-	-	-	0.16	0.10
Tax credit	N/a	-	-	-	0.08	0.05
Total dividend	N/a	-	-	-	0.24	0.15

** A resolution will be submitted to the Shareholders' meeting in 2006 to issue a dividend of €0.16 per share for 2005*

At the general meeting of May 20, 2005, the Board announced its objective of resuming a susbtantial and progressive dividend beginning in 2005.

Dividends not claimed within five years are paid to the French Treasury.

INFORMATION ON THE CAPITAL STOCK

Capital stock and voting rights

The capital stock at December 31, 2005 was €2,857,083,280, represented by 1,428,541,640 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 3, 2005 was 1,274,367,832.

Potential capital at January 1, 2006

		Number of shares by option exercise price	
Potential Capital At January 1, 2006	**Total Shares**	**< €15**	**< €21**
Capital at December 31, 2005	1,428,541,640	1,428,541,640	1,428,541,640
Share subscription options*	115,539,007	56,255,433	75,821,838
Bonds redeemable as shares	2,719,130	2,719,130	2,719,130
4.75% OCEANEs June 2003	63,192,019	63,192,019	63,192,019
Potential capital at January 1, 2006	**1,609,991,796**	**1,550,708,222**	**1,570,274,627**
Percentage of dilution	12.70%	8.55%	9.92%

** Total number of options remaining to be exercised at a price between €15 and €21.*

Financial authorizations

To date, the company has been granted the following authorizations by the Shareholders'Meetings of June 4, 2004 and May 20, 2005.

Status of delegations of competence and authorizations at December 31, 2005			AGM Authorization
Issues with preferential rights			
Share issue with preferential subscription rights including increase by incorporation of reserves	Ceiling	26% Of capital	05/20/2005
	Limitation	Global limitations*	
	Uses	None	
	Duration	26 Months	
	Maturity	2007	
Issues without preferential rights			
Share issue without preferential subscription rights	Ceiling	26% Of capital	06/04/2004
	Limitation	Global limitations*	
	Duration	26 Months	
	Maturity	2006	
	Uses	1.4% Of capital	
Issues of securities in the event of contributions in kind	Ceiling	10% Of capital	05/20/2005
	Limitation	Global limitations*	
	Duration	26 Months	
	Maturity	2007	
	Uses	None	
* Global limitations	Shares	€750 Million	05/20/2005 and 06/04/2004
	Settlement	€712 Million	
	Marketable securities	€6 Billion	
	Settlement	€5.8 Billion	
Issues reserved for employees			
Share issue reserved for an employee savings plan	Ceiling	3% Of capital	05/20/2005
	Limitation	Na	
	Duration	26 Months	
	Maturity	2007	
	Uses	None	
Subscription and purchase options price (without discount)	Ceiling	6% Of capital**	05/20/2005
	Duration	38 Months	
	Maturity	2008	
	Uses	0.03%	
Share buyback program			
Share buyback	Ceiling	10% Of capital	05/20/2005
	Duration	18 Months	
	Maturity	2006	
	Uses	None	
Share cancellation	Ceiling	10% Of capital	05/20/2005
	Duration	18 Months	
	Maturity	2006	
	Uses	None	

*** The board has undertaken that the total number of options in circulation does not give entitlement to suscribe for new shares exceeding 12% of the total shares of the company.*

Five-year summary of capital stock

Type of transaction	Number of shares		Capital	Share premiums
	A shares	O shares [1]		
Capital at December 31, 2000	**1,212,210,685**	**16,500,000**	**2,457,421,370**	**21,341,865,096.98**
Stock options exercised	752,186			8,450,266.69
Share issue reserved for employees	91,926			4,412,448.00
Redemption of Deborah Acquisition Ltd bonds				
(acquisition of Kymata Ltd)	2,200,000	9,015,000		72,332,590.00
Capital increase costs				(1,256,615.26)
Capital at 31.12.2001	**1,215,254,797**	**25,515,000**	**2,481,539,594**	**21,425,803,786.43**
Stock options exercised	7,577			89,353.92
Redemption of Coralec bonds:				
- acquisition of Astral Point Communication Inc.	8,783,396			126,568,736.36
- acquisition of Telera Inc.	15,147,728			49,381,593.28
Capital at 31.12.2002	**1,239,193,498**	**25,515,000**	**2,529,416,996**	**21,601,843,469.99**
Stock options exercised	108,632			619,778.80
Redemption of Deborah Acquisition bonds:				
- acquisition of Kymata Ltd		485,000		2,379,410.00
Redemption of Coralec bonds:				
- acquisition of iMagic TV Inc.	3,531,332			19,210,446.08
- acquisition of TiMetra Inc.	15,534,934			94,452,398.72
- acquisition of Astral Point Communications Inc.	40,000			576,400.00
Redemption of Alcatel bonds/7.917%	1,828			6,105.52
Conversion of class O shares to ordinary shares	26,000,000	(26,000,000)		
Capital at 31.12.2003	**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 of Spatial Wireless	17,783,297	-	35,566,594	176,268,039.86
Redemption of Alcatel 7.917% bonds	3,212	-	6,424	10,728.08
Imputation of loss on primes (AG dated June 4, 2004)				(14,156,675,224.11)
Capital at 31.12.2004	**1,305,455,461**	**-**	**2,610,910,922**	**7,757,527,030.92**
Stock options exercised	1,855,913		3,711,826	8,316,745.80
Redemption of Coralec bonds:				
- acquisition of iMagic TV Inc.	50,000		100,000	272,000.00
- acquisition of Spatial Wireless	400,000		800,000	3,964,800.00
Redemption of Alcatel 7.917% bonds	120,780,266		241,560,532	403,406,088.44
Capital at 31.12.2005	**1,428,541,640**		**2,857,083,280**	**8,173,486,665.15**

(1) The shares forming 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.

Breakdown of capital stock and voting rights at December 31, 2005

Capital stock and voting rights situation	Shares	%	Votes	%
Brandes Investment Partners, L.P.*	152,374,018	10.67	152,374,018	10.88
Caisse des dépôts et consignations**	58,867,807	4.12	59,154,757	4.22
Employee Group Investment fund (FCP3A)	27,027,779	1.89	44,039,555	3.14
Société Générale Group	10,672,805	0.75	17,955,310	1.28
Treasury stock	25,343,255	1.77	-	-
Shares held by subsidiaries	33,601,350	2.35	-	-
Public	1,120,654,626	78.45	1,127,102,613	80.47
TOTAL	**1,428,541,640**	**100.00**	**1,400,626,253**	**100.00**

* *Sources Brandes Investment Partners, L.P. dated February 14, 2006.*

** *Source CDC (excluding CDC Ixis Capital Markets).*

At December 31, 2005, a total of 31 million shares were entitled to dual voting rights, representing 2.2% of the voting rights.

To the company's knowledge, no other Shareholder holds more than 5% of the capital stock.

Alcatel has no knowledge of any Shareholder pact or agreement relating to an option on an entity that is a member of the Group, nor any agreement which, if implemented, could, at a later date, cause a change in the control thereof.

During 2005, a number of registered Shareholders and intermediaries acting essentially on behalf of their clients notified the company of declarations that the legal and statutory thresholds had been exceeded:

Declarations of exceeding thresholds	Declaretion	% capital	% voting rights	Declaring company
March 21, 2006	Up	5	5	Fidelity International
February 17, 2006	Down		4	Caisse des dépôts et consignations
February 7, 2006	Down	4		Caisse des dépôts et consignations
October 4, 2005	Down		5	Caisse des dépôts et consignations
September 27, 2005	Down	5		Caisse des dépôts et consignations
August 22, 2005		2.7		Crédit Agricole Asset Management
May 27, 2005		3.3		Crédit Agricole Asset Management
March 2, 2005	Up	5	5	Caisse des dépôts et consignations
May 6, 2005	Up	10	10	Brandes Investment Partners*
March 1, 2005	Down	0.5	0.5	Caisse nationale des Caisses d'épargne et de prévoyance
February 28, 2005	Up	0.5	0.5	Caisse nationale des Caisses d'épargne et de prévoyance
January 10, 2005	Up	0.5	0.5	Caisse nationale des Caisses d'épargne et de prévoyance
July 20, 2005	Up	2	2	FCP3A**
April 29, 2005	Up	1		Groupe Société Générale
April 15, 2005	Up	1		Groupe Société Générale
April 8, 2005	Down	1		Groupe Société Générale
February 25, 2005	Down	1		Groupe Société Générale
February 4, 2005	Down	1.50		Groupe Société Générale
January 28, 2005	Up	1.50		Groupe Société Générale

* *Brandes Investment Partners, L.P. specified in its declaration to the AMF in May 2005 that it held no Alcatel shares on its own account and that none of the clients on whose account it acted as part of a discretionary mandate accounted individually for more than 5% of Alcatel's capital. It also specified that it usually had, under the terms of the agreement binding it to its clients, a right to vote on the Alcatel shares acquired on their account.*

** *On December 31, 2005, the employees and former employees (43,606 holders of interests) held 27 million Alcatel shares representing 1.89% of the capital stock through the Mutual Fund FCP 3A, a fund investing exclusively in Alcatel shares. At that date, 50.78% of the units held in this fund were available, taking account of the legal holding period of five years. Between December 31 2004 and December 31 2005, the FCP 3A increased its holding from 25.4 million to 27 million Alcatel shares, thus breaking through the statutory threshold of 2% of the capital stock on July 20 2005. The FCP 3A's holding fell back below the 2% threshold after the issue of Alcatel shares in payment for the ORANEs in December 2005.*

Three-year shareholding summary

Situation in capital and voting rights (en %)	2005	2004	2003
Brandes Investment Partners	10.67	8.00	7.70
Caisse des dépôts et consignations	4.12	5.22	5.79
Group employee investment fund FCP3A	1.89	1.95	1.94
Groupe Société Générale	0.75	0.89	0.91
Self-owned	1.77	1.94	1.97
Self-control	2.35	2.98	3.22
Public	78.45	79.02	78.47
TOTAL	**100.00**	**100.00**	**100.00**

Trading by the company in its own shares

Alcatel has conducted no transaction under its share buyback program. At December 31, 2005, Alcatel held 25,343,255 shares, representing 1.77% of the capital stock. These shares were registered on December 31, 2005 as a deduction from Shareholders' equity.

The combined Shareholders' Meeting of May 20, 2005, in its seventh resolution, authorized the Board, with a right to subdelegate 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 buyback program was publicized in a prospectus that had received the approval of the French Financial Markets Authority n° 04-435 on May 14, 2004.

Pursuant to the terms of this program, the maximum share purchase price shall not exceed €40 per share while the minimum sale price shall not be less than 2 euros per share.

The Board of Directors, Meeting on March 8, 2006, proposed to cancel the existing authorization and give the Board a new authorization to implement a buyback program.

Pledges of shares

As at March 31, 2006, existing pledges on Alcatel shares registered purely nominally and administered applied to 10,187 shares held by a total of 40 Shareholders.

Issued securities giving rights to the capital

Stock options granted by Alcatel

2005 plans

On March 10, 2005, the Board of Directors approved the grant of stock subscription options to 9,470 Group employees and executives at an exercise price of €10.

The Board also renewed the Chairman's power to grant the stock subscription options, under strictly defined conditions, in order to honor promises made when hiring new staff and to recognize exceptional situations.

Between April 2005 and March 2006, the Chairman, exercising his delegated authority, granted certain Group employees 350,750 options to subscribe for shares that may be exercised at fixed prices based on the value of the shares during the twenty days preceding the Chairman's decision, in this case within a range of €8.80 to €10.20.

During 2005, 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 1,062,000 and these options to subscribe can be exercised at a weighted average price of €10. The total number of options exercised by those senior executives and employees who are not corporate officers, representing the ten largest numbers exercised, in consideration of the exercise of the same number of options, amounted to 214,931 options. These options to subscribe to Alcatel shares were exercised at a weighted average price of €6.24.

2006 plans

On March 8, 2006, the Board of Directors decided to grant 17,009,320 stock subscription options to 8,001 Group employees and executives, giving them the right to subscribe for new Alcatel shares at an exercise price of €11.70, the average share price over 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 (four years for beneficiaries who are employees of a company with its head office in France) and until March 7, 2014.

750,000 options were granted to the members of Senior Management, except for the Chairman and Chief Executive Officer who received no options,) on March 8, 2006, representing 4.4% of all the options granted by the Board on March 8, 2006. These options satisfy the general terms of the annual plan and may be exercised at a price of €11.70.

Summary of the Alcatel plans

At December 31, 2005, 131,953,837 options to subscribe for and purchase shares remained in circulation, each one giving rights to one Alcatel share.

However, because of the expiry, on December 31, 2005, of the exercise period for the stock option plans of December 9, 1998 and September 8, 1999 and the partial expiry of the subscription plans of March 29, 2000, December 13, 2000 and December 19, 2001, 16.4 million options are null and void as at January 1, 2006.

At January 1, 2006, the total number of options in circulation was 115.5 million, representing 8.09% of the company's capital. Including the options plan agreed by the Board in March 2006, the total number of options in circulation is 132.5 million, representing 9.24% of the company's capital.

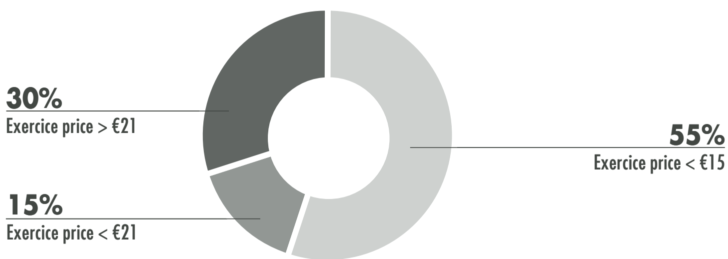
However, because of the change in the share price since the grant of the options, 55% of the total subscription options granted to Group employees had a price lower than the highest price of Alcatel's stock market share price of since January 1, 2006 (€13.49 on March 24, 2006) and therefore offered the potential of a gain for their beneficiaries.

Summary of subscription options still to be exercised at March 8, 2006

				Number of options per exercise price	
Year of grant	**Exercise price**	**Options in circulation**	**Options available***	**< €15**	**< €21**
2000	€48 to €65	11,735,859	100%	NA	NA
2001	€9 to €50	47,883,040	100%	442,905	19,901,730
2002	€3.2 to €17.2	864,578	87%	756,998	864,578
2003	€6.7 to €11.2	21,130,879	63%	21,130,879	21,130,879
2004	€9.8 to €13.2	17,053,121	68%	17,053,121	17,053,121
2005	€8,8 to €11.41	16,871,530	0%	16,871,530	16,871,530
2006	€11.70	17,009,320	0%	17,009,320	17,009,320
Plans total		**132,548,327**	**64%**	**73,264,753**	**92,831,158**
As % of the number of options still to be exercised				55%	70%

** Open exercise period.*

The graph below shows the breakdown of subscription options granted to Group employees between 2000 and 2006 by exercise price:



The principal features of the options granted and outstanding at December 31, 2005 are described below.

Exercise price for all plans has been determined without rebate.

Stock options subscription and purchase plans Situation at December 31, 2005

Creation of the plan Share class	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding: held by all employees and executives	Number of options outstanding: including Senior Management(4)	Option exercise period(1): From	Option exercise period(1): To	Exercise price (in euros)	Options exercised in 2005
STOCK PURCHASE OPTIONS										
12/09/1998	2,025	11,602,500	0	1,717,750	9,884,750	185,000	12/09/2003	12/31/2005	20.52	
09/08/1999	141	545,000	0	123,750	421,250	0	09/08/2004	12/31/2005	28.40	
STOCK SUBSCRIPTION OPTIONS										
03/29/2000	3,887	15,239,250	13,000	2,363,945	12,862,305	380,000	04/01/2003 04/01/2005	12/31/2005 12/31/2007	48.00	
03/29/2000 Plan AL (3)	58,957	3,317,808	40	59,064	3,258,704	1,176	07/01/2005	06/30/2006	48.00	
12/13/2000	478	1,235,500	0	231,650	1,003,850	15,000	12/13/2003 12/13/2005	12/31/2005 12/31/2007	65.00	
12/13/2000(2)(5)	340	306,700	0	109,200	197,500	0	12/13/2001 12/13/2004	12/12/2008 12/12/2008	64.00	
03/07/2001(2)	30,790	37,668,588	0	10,547,218	27,121,370	356,000	03/07/2002 03/07/2005	03/06/2009 03/06/2009	50.00	
03/07/2001 Plan AL(3)	2,024	275,778	0	198,228	77,550	300	07/01/2005	06/30/2006	50.00	
04/02/2001(2)	13	48,850	0	36,600	12,250	0	04/02/2002	04/01/2009	41.00	
04/02/2001(2)(5)	1	2,500	0	0	2,500	0	04/02/2002	04/01/2009	39.00	
06/15/2001(2)	627	977,410	0	209,770	767,640	0	06/15/2002 06/15/2005	06/14/2009 06/14/2009	32.00	
09/03/2001(2)	58	138,200	0	34,400	103,800	0	09/03/2002 09/03/2005	09/02/2009 09/02/2009	19.00	
11/15/2001(2)(5)	16	162,000	3,000	53,000	106,000	0	11/15/2002	11/14/2009	9.00	
12/19/2001(2)	25,192	27,871,925	0	8,888,560	18,983,365	525,000	12/19/2002 12/19/2005	12/18/2009 12/18/2009	20.80	
12/19/2001 Plan AL	45,575	935,660	0	41,670	893,990	200	01/01/2005 01/01/2006	12/31/2005 12/31/2006	20.80	
12/19/2001(2)(5)	521	565,800	109,518	119,377	336,905	0	12/19/2002 12/19/2005	12/18/2009 12/18/2009	9.30	2,500
02/15/2002	37	123,620	0	50,790	72,830	15,000	02/15/2003 02/15/2006	02/14/2010 02/14/2010	17.20	
04/02/2002	24	55,750	0	21,000	34,750	0	04/02/2003	04/01/2010	16.90	
05/13/2002	23	54,300	0	13,000	41,300	0	05/13/2003 05/13/2006	05/12/2010 05/12/2010	14.40	
06/03/2002	176	281,000	0	49,021	231,979	0	06/03/2003 06/03/2006	06/02/2010 06/02/2010	13.30	
09/02/2002	226	1,181,050	464,774	305,875	410,401	0	09/02/2003	09/01/2010	5.20	228,445
10/07/2002	16	30,500	7,018	13,023	10,459	0	10/07/2003	10/06/2010	3.20	3,000
11/14/2002	26	111,750	50,086	10,440	51,224	0	11/14/2003	11/13/2010	4.60	25,873
12/02/2002	16	54,050	19,247	23,168	11,635	0	12/02/2003	12/01/2010	5.40	15,685
03/07/2003	23,650	25,626,865	2,796,041	3,203,669	19,627,155	570,626	03/07/2004 03/07/2007	03/06/2011 03/06/2011	6.70	1,566,542
03/07/2003 Plan AL	31,600	827,348	286	18,265	808,797	0	07/01/2006 07/01/2007	06/30/2007 06/30/2008	6.70	147
06/18/2003	193	338,200	17,690	42,032	278,478	2,188	06/18/2004 06/18/2007	06/17/2011 06/17/2011	7.60	10,746

Creation of the plan Share class	Number of beneficiaries	Number of options issued	Number of options exercised	Number of options cancelled	Number of options outstanding: held by all employees and executives	Number of options outstanding: including Senior Management[4]	Option exercise period[1]: From	Option exercise period[1]: To	Exercise price (in euros)	Options exercised in 2005
07/01/2003	19	53,950	2,315	29,385	22,250	0	07/01/2004	06/30/2011	8.10	1,842
09/01/2003	77	149,400	2,436	9,035	137,929	50,000	09/01/2004 09/01/2007	08/31/2011 08/31/2011	9.30	833
10/01/2003	37	101,350	0	39,667	61,683	0	10/01/2004 10/01/2007	09/30/2011 09/30/2011	10.90	
11/14/2003	9	63,600	0	3,500	60,100	0	11/14/2004 11/14/2007	11/13/2011 11/13/2011	11.20	
12/01/2003	64	201,850	562	66,801	134,487	0	12/01/2004 12/01/2007	11/30/2011 11/30/2011	11.10	
03/10/2004	14,810	18,094,315	0	1,741,802	16,352,513	755,000	03/10/2005 03/10/2008	03/09/2012 03/09/2012	13.20	
04/01/2004	19	48,100	0	18,642	29,458	0	04/01/2005 04/01/2008	03/31/2012 03/31/2012	13.10	
05/17/2004	26	65,100	0	8,600	56,500	0	05/17/2005 05/17/2008	05/16/2012 05/16/2012	12.80	
07/01/2004	187	313,450	0	35,950	277,500	0	07/01/2005 07/01/2008	06/300/2012 06/30/2012	11.70	
09/01/2004	21	38,450	0	1,300	37,150	0	09/01/2005	08/31/2012	9.90	
10/01/2004	85	221,300	300	27,700	193,300	0	10/01/2005 10/01/2008	09/30/2012 09/30/2012	9.80	300
11/12/2004	20	69,600	0	800	68,800	0	11/12/2005 11/12/2008	11/11/2012 11/11/2012	11.20	
12/01/2004	11	42,900	0	5,000	37,900	0	12/01/2005 12/01/2008	11/30/2012 11/30/2012	11.90	
01/03/2005	183	497,500	0	17,400	480,100	0	01/03/2006	01/02/2013	11.41	
03/10/2005	9,470	16,756,690	0	707,210	16,049,480	720,000	03/10/2006 03/10/2009	03/09/2013 03/09/2013	10.00	
06/01/2005	96	223,900	0	8,800	215,100	0	06/01/2006 06/01/2009	053/1/2013 05/31/2013	8.80	
09/01/2005	39	72,150	0	0	72,150	0	09/01/2006 09/01/2009	05/31/2013 05/31/2013	9.80	
11/14/2005	23	54,700	0	0	54,700	0	11/14/2006 11/14/2009	11/13/2013 11/13/2013	10.20	
TOTAL	**251,828**	**166,646,207**	**3,486,313**	**31,206,057**	**131,953,837**	**3,575,490**				**1,855,913**

(1) Four-year vesting period for employee beneficiaries of a company with registered offices in France (five years for options granted before April 27 2000).

(2) New vesting rules: rights are vested in successive tranches over four years at the level of 25% after one year from the date of the Board Meeting and 1/48 at the end of each month thereafter.

(3) Options created in a capital increase reserved for employees.

(4) Members of the executive committee in post during 2005, excluding corporate agents or attorneys, that is a total of nine people.

(5) Options to subscribe to Class O shares which become ordinary shares.

Stock options granted by foreign subsidiaries

Options were granted by Alcatel USA Inc., to managers of the American and Canadian companies allowing them to purchase Alcatel ADS. Under these plans, 10,058,615 options were still not exercised at December 31, 2005.

The options plans granted by the foreign companies acquired by Alcatel provide entitlement to the grant of Alcatel shares or ADS in a number defined by applying the swap ratio used at the time of the acquisition to the number of shares of the company acquired to which the options gave entitlement.

The following table gives the details, for the American and Canadian companies issuing these plans, of the number of options that existed and could be exercised at the close on December 31, 2005, their average price and the exercise period.

		Options outstanding			Options that may be exercised	
Issuing company	**Exercise price**	**Number outstanding at 12/31/2005**	**Weighted residual exercise period** (N° of years)	**Weighted average exercise price**	**Number of options at 12/31/2005**	**Weighted average exercise price**
Packet Engines	USD 0.29-USD 0.86	10,372	2.10	0.59	10,372	0.59
Xylan	USD 0.05-USD 18.14	1,393,928	2.21	9.08	1,393,928	9.08
Internet Devices Inc.	USD 0.26-USD 1.17	23,980	2.88	0.92	23,980	0.92
DSC	USD 16.57-USD 44.02	45,690	1.25	20.40	45,690	20.40
Genesys	USD 0.01-USD 41.16	3,018,403	3.25	20.70	3,018,403	20.70
Newbridge	USD 11.72-USD 52.48	4,253	2.40	12.73	4,253	12.73
Astral Point	EUR 0.29-EUR 58.71	74,510	4.29	16.57	74,510	16.57
Telera	EUR 0.43-EUR 6.36	136,161	4.88	5.15	135,759	5.14
iMagic TV	EUR 2.84-EUR 64.68	78,506	1.74	18.69	78,069	18.77
TiMetra	EUR 0.53-EUR 7.97	1,703,423	4.96	5.91	1,152,000	5.10
Spatial Wireless	EUR 0.24-EUR 9.10	858,123	8.24	2.97	248,177	2.99
TOTAL NUMBER OF OPTIONS		**7,347,349**			**6,185,141**	

In total, the stock options plans granted in the United States and Canada that constitute a commitment by Alcatel USA Inc. to the beneficiaries involve 17,405,964 options not yet exercised at December 31, 2005. 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 Astral Point, Telera, iMagic TV, TiMetra and Spatial Wireless.

Bonds redeemable for shares

Issues to finance acquisitions

During 2004, Alcatel authorized a debt issue through its subsidiary Coralec, represented by bonds redeemable for Alcatel shares (ORA) to allow the acquisition of Spatial Wireless (United States).

As part of this acquisition, 18,988,334 bonds redeemable for Alcatel ordinary shares were issued at the unit price of €11.912 and resulted, between January 1 and December 31, 2005, in the issue of 400 000 shares with a par value of €2 thus taking the number of shares issued since they were created as redemption for these bonds to 18 183 297 Alcatel shares.

During 2003, Alcatel authorized two debt issues through its subsidiary Coralec, represented by bonds redeemable for Alcatel shares to allow the acquisition of iMagic TV Inc. (Canada) and TiMetra Ltd (United States).

In the acquisition of iMagic TV Inc., 3 717 254 bonds redeemable for Alcatel ordinary shares were issued at a unit price of €7.44 and resulted, between January 1 and December 31, 2005, in the issue of 50,000 shares with a par value of €2 thus bringing the number of shares issued since the date of creation as payment for these bonds to 3,631,332 Alcatel shares.

In the acquisition of TiMetra Ltd, 17,979,738 bonds redeemable for Alcatel ordinary shares were issued at the unit price of €8.08. No redemption was recorded between January 1 and December 31, 2005. The number of shares issued since the date of creation as repayment for these bonds is 16,534,934 Alcatel shares.

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).

In the acquisition of Astral Point Communications Inc., 9,506,763 bonds redeemable for Alcatel ordinary shares were issued at the unit price of €16.41. No redemption was recorded between January 1 and December 31, 2005. The number of shares issued since the date of creation as repayment for these bonds is 9,123,396 Alcatel shares.

As of December 31, 2004, a total of 2,719,130 bonds redeemable for Alcatel shares were outstanding. These bonds are not listed on any market.

Issues as part of financing activities

ORANE December 2002

As authorized by the Alcatel combined general Shareholders' Meeting of April 18, 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, 2005, all the bonds had been redeemed and resulted in the creation of 10,307 shares during 2005 and 120,769,959 shares on maturity on December 23, 2005 on the basis of one share per bond.

The bonds were for three years maturing in December 2005 and carried interest at an annual rate of 7.917%. The interest was paid in full to the bond holders on January 2, 2003.

OCEANE June 2003

As authorized by the Alcatel combined annual Shareholders' Meeting of April 7, 2003, Alcatel issued debt 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.

The bonds have a term of seven and a half years and bear interest at an annual rate of 4.75%.

The proceeds of 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 book building for institutional investors followed by a fixed price offer from private investors. At the close of the offer, Alcatel bought back bonds for a nominal value of €342 million.

On December 31 2005, a total of 63,192,019 Océanes, listed on Euronext Paris, were outstanding.

Warrants (giving right to existing securities)

As part of certain company acquisitions specified above and financed by issuing bonds redeemable for Alcatel shares, a certain number of these bonds redeemable for Alcatel shares were issued to cover the commitments of the target company with respect to options or warrants issued. At December 31, 2005, 10,870 warrants issued by Spatial Wireless giving rights to Alcatel shares were outstanding.

Securities not representing capital stock

These securities are ordinary bond issues: the balance of these issues was €1,960 million at December 31, 2005.

Four of these issues are listed on Euronext Paris:

- 5.625% bond issued in 1997;
- zero coupon bond issued in 1998 (matures in June 2006);
- 4.375% bond issued in 1999;
- 4.375% fixed rate bond issued in 2001.

Two of these bonds are listed on the Luxembourg stock exchange:

- the 7% fixed rate bond (maturing December 2006), issued during 2001 as part of the Euro Medium Term Notes program put in place on July 27, 2001;
- the 6.375% fixed rate bond issued in 2004.

Since 2003, Alcatel has been managing its bonded debt in the form of a public buyback offer (2003), a public buyback swap (2004) and buybacks on the secondary market.

The decision made at the General Shareholders' Meeting of June 3, 2004 authorizes the company to issue bonds of a maximum nominal value of €10 billion over a 26-month period. This authorization expires at the next general Meeting and will be renewed.

LEGAL INFORMATION

Identity of the company

Company name and headquarters

Alcatel

54, rue La Boétie - 75008 Paris.

Legal form and applicable legislation

A French 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 study, 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 on 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 general and special Shareholders' Meeting of June 20, 1989).

All shares are registered until they are fully paid up.

Fully paid-up shares are registered or bearer at the Shareholders' discretion, subject to the provisions of subparagraph 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 come to own a number of shares in the company equal to or greater than:

- 2% of the total number of shares, must, within five stock market trading days after this percentage interest is exceeded, inform the company by letter or fax of the total number of shares it possesses. This declaration must be made every time a new threshold of 1.5% is exceeded.
- 3% of the total number of shares must, within five stock market 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 1% 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 Article L. 233-7 of the Commercial Code.

In each declaration described above, the declarer shall certify that the declaration he is making includes all securities held or owned as defined in the preceding paragraph. He shall also indicate the date or dates of acquisition.

If the Shareholder fails to comply with the provisions of paragraphs 1 and 2 above, 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 subparagraphs 1 and 2 above shall also inform the company within the same period of five stock market 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 according to the applicable law and regulations.

If the parties are not exempt from these formalities under the applicable legislation, the company may require that the signing of declarations or transfer orders or transfers be certified as defined by the applicable laws and regulations.

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 general Meeting of May 3, 2001)

1 - General or special Shareholders' Meetings are called and meet under the conditions specified by law.

The duly constituted Annual General Meeting represents all Shareholders.

Its decisions are binding on all Shareholders, including those who are absent or dissenters.

2 - The Meeting is held at the corporate headquarters or any other location specified in the notice of Meeting.

3 - All Shareholders may participate in the Meetings in person, through an agent, or by mail, with proof of identity and ownership of securities, either by registering the shares or 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 the regulations and with the procedures previously defined by the Board of Directors, Shareholders may participate and vote in all general and special Meetings by videoconference or any other telecommunications means that allow them to be identified.

4 - Shareholders may, under the conditions set by law, send their proxy or mail voting forms for all General 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 email.

To be counted, all votes by mail or proxy must be received at the company's headquarters or the location cited 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 applicable regulations.

5 - The proceedings of the Meeting may be broadcast by videoconference and/or telecast. If so, this shall be announced in the notice of Meeting and the invitation.

6 - Any Shareholder who has announced his intention to attend the General Meeting, has sent in a mail vote, or given a proxy by producing a certificate of non-transferability issued by the custodian of the shares, may, however, transfer some or all of the shares in connection with which he has announced plans to attend the Meeting, or 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 the law and regulations.

7 - The Meeting is chaired either by the Chairman or one of the Vice-Chairmen of the Board, or by a director appointed by the Board or by the Chairman.

The Meeting shall name officers consisting of the Meeting Chairman, two tellers and a secretary.

The duties of tellers are performed by the two members of the Meeting who represent the largest number of votes and, if they do not agree to do so, by the members with the next largest number of votes, and so on until the duties are accepted.

8 - Copies or excerpts of the Meeting minutes shall be validly certified either by the Chairman of the Board, the Meeting secretary or the director appointed to chair the Meeting.

The Ordinary General Meeting may deliberate on the first calling of the meeting only if the shareholders present or represented hold at least a fifth of the shares with voting rights. On the second calling of the meeting, no quorum is required.

The Extraordinary General Meeting may deliberate on the first calling of the meeting only if the shareholders present or represented have at least a quarter of the shares with voting rights and a fifth of the shares with voting rights on the second calling of the meeting.

Voting rights (Article 22 of the bylaws, amended by the combined general Meeting of June 20, 1989)

Subject to the provisions below, every member of every Meeting is entitled to as many votes as the number of shares he owns or represents.

However, dual voting rights are attached to all registered, fully paid-up shares that have been registered in the name of the same owner for at least three years*.

Dual voting rights automatically end for any share that is converted to bearer form or transferred to another owner. However, any transfer from named holder to named holder of registered shares as the result of inheritance, whether or not intestate, or of the division of property held in common by spouses or as a gift during life to a spouse or heirs, shall not interrupt the time period defined above and the shares shall retain all acquired rights.

Regardless of the number of shares owned directly and/or indirectly, a Shareholder or proxy may not exercise single voting rights at a General 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 dual 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 takeover or swap affecting 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 procedure.

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 General or Special Shareholders' Meetings.

Appropriation of earnings (Article 24 of the bylaws, amended at the Combined Shareholders' Meeting of April 7, 2003, which approved the elimination of special rights for class O shares)

The profit and loss for the year is the difference between income and expenditure for the year, after provisions. 5% is deducted from the profit, minus any prior losses, to form the statutory reserve. This deduction ceases to be mandatory when the statutory 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's 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 items from which the sums are taken. However, dividends shall be paid first from distributable earnings for the fiscal year.

The Ordinary Meeting may allow each Shareholder to choose between payment of the dividend or interim dividend in cash or in shares for all or part of the distributed dividend or interim dividend.

For an interim dividend, the Shareholders' Meeting or the Board of Directors shall determine the date of the dividend payment.

**Pursuant to Article L. 225-99, para 2 of the Commercial Code, the removal of the dual voting right stems from an Extraordinary General Meeting decision taken with the authorization of a special meeting of the holders of these rights.*

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:

Statutory auditors	Appointment*	Renewal**	Expiration
Deloitte & Associés, représenté par M. Alain Pons 185, avenue Charles de Gaulle 92203 Neuilly-sur-Seine Cedex	18/06/1998	05/16/2000	06/01/2006**
Barbier Frinault et Autres (Ernst & Young), représenté par M. Christian Chiarasin 41, rue Ybry 92576 Neuilly-sur-Seine Cedex	06/23/1994	05/16/2000	06/01/2006**
Alternates			
M. Olivier Azières, 185, avenue Charles de Gaulle 92203 Neuilly-sur-Seine Cedex	18/06/1998	16/05/2000	01/06/2006
M. Philippe Peuch-Lestrade, 41, rue Ybry 92576 Neuilly-sur-Seine Cedex	23/06/1994	16/05/2000	01/06/2006

* *Date of the Annual Shareholders' Meeting.*

** *Renewal of auditors' mandate will be proposed during the General Meeting in 2006.*

FEES RECEIVED - FISCAL YEAR 2005

	2005				**2004**			
	Deloitte (Deloitte Touche Tohmatsu Network)		**Barbier Frinault & Autres (Ernst & Young Network)**		**Deloitte (Deloitte Touche Tohmatsu Network)**		**Barbier Frinault & Autres (Ernst & Young Network)**	
	K€	**%**	**K€**	**%**	**K€**	**%**	**K€**	**%**
1- Audit								
Statutory audits, certification, reveiw of Company consolidated financial statements	6,875	87.3	4,454	88.4	5,162	70.4	3,506	58.3
Fees directly in relation with Auditors' mission	689	8.8	525	10.4	1,041	14.2	2,090	34.7
Sub-total	**7,564**	**96.1**	**4,979**	**98.8**	**6,203**	**84.5**	**5,596**	**93.0**
2- Other services								
Tax	303	3.8	35	0.7	967	13.2	342	5.7
Information technologies								
Other	7	0.1	26	0.5	167	2.3	77	1.3
Sub-total	**310**	3.9	**61**	1.2	**1,134**	15.5	**419**	7.0
TOTAL	**7,874**	**100.0**	**5,040**	**100.0**	**7,337**	**100.0**	**6,015**	**100.0**

STATEMENT OF THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

After taking all reasonable measures, I state that the information contained in this reference document complies, to my knowledge, with the material facts and contains no omissions likely to impair its meaning.

I have obtained from the Statutory Auditors, Deloitte & Associés et Barbier Frinault & Autres, a letter of completion of work in which they indicate that they have verified the information relating to the financial situation and Financial Statements given in this reference document and have read the whole reference document.

The historical financial information presented or included for reference in the reference document has been the subject of reports by the Statutory Auditors appearing on pages 146 and 174 for 2005 and included for reference in this document for 2003 and 2004. These reports have been issued without reservation and contain observations relating to 2004.

Paris, March 31, 2006

Serge Tchuruk,

Chairman and Chief Executive Officer

The reference document contains all the management report items required by law.

The draft resolutions submitted to the next general meeting, called to approve the Financial Statements for the year ending December 31, 2005 will be published later in the Bulletin des Annonces Légales Obligatoires.

TABLE OF CORRESPONDENCE

In concordance with Annex 1 of Regulation (EU) n°809/2004 established by the Commission on April 29, 2004.

INVESTOR RELATIONS

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