



The Silver Word

Nortel Networks Corporation

With the global Internet economy forecasted to reach \$2.8 trillion by 2003 and eBusiness expected to achieve an 86% annual growth rate in the US to \$1.3 trillion, Nortel Networks is in the right place at the right time.

The company is a global leader in telephony, data, eBusiness and wireless solutions for the Internet. Nortel offers network solutions for two business groups: Service Provider and Carrier, and Enterprise. Nortel's Service Provider and Carrier Group is the global leader in Internet Protocol, high-speed access, long distance, optical and wireless networking. The enterprise solutions group provides world-class Internet Protocol-based communications solutions that enable interpersonal electronic communications for all kinds of businesses.

Nortel Networks was created when Northern Telecom Limited acquired Bay Networks in August 1998 in a \$6.9 billion transaction. Bay Networks was then merged into a wholly owned subsidiary of the company. In April 1999, the company changed its name to Nortel Networks. Headquartered in Ontario, Canada, Nortel is currently listed on the Toronto and New York Stock Exchanges.

Nortel is at the heart of the Internet revolution. The company is building a new high-performance Internet, based on four critical drivers of technology: Optical Internet, Internet Telephony, Wireless Internet and Internet Services. Through acquisitions, alliances and investments, Nortel is constantly meeting market demand with state-of-the-art products. The company has developed alliances with Hewlett-Packard, Intel, Microsoft and Panasonic, and it invests an enormous amount of resources in research and development. The company's 20,000 engineers are filing an average of three patents daily.

1999 revenues were up 26%, from 1998 to \$22.2 billion. Net income increased from a loss of \$569 million in 1998 to a loss of \$197 million in 1999. Long-term debt remained relatively unchanged at \$1.6 billion, and the long-term debt to equity ratio dropped only 1% from 1998 to 13%. Due to increases in long-term receivables and acquisitions, cash flow from operations dropped significantly from a loss of \$112 million in 1998 to a loss of \$1.4 billion in 1999.

The increase in 1999 revenues was attributable to the strength in optical and high-speed Internet access and wireless technology. Fourth quarter activity was the driving factor for the increase in year-end profits: net income skyrocketed to \$417 million, or, \$0.31 per

share, from virtually no net income and earnings in the third quarter. This was the first quarter in the past two years that the company generated a return on equity ratio.

Nortel is on the acquisition roll as its annual reports and its press releases demonstrate:

- In October 1999, Nortel announced the acquisition of Clarify, a provider of front office eBusiness solutions. Clarify stock holders will receive 1.3 common shares of Nortel for each share of Clarify common stock. Clarify's leadership in eBusiness combined with Nortel's high performance Internet technologies will create powerful applications that can serve both the Carrier and Enterprise customers.
- In January 2000, Nortel announced plans to acquire Promatory Communications, a developer of Digital Subscriber Line platforms for high-speed Internet access. The aggregate purchase price for the common shares of Promatory is roughly \$778 million on a fully diluted basis. In addition, Nortel announced the acquisition of Qtera, a producer of ultra-long-reach optical networking systems.
- In February, the company announced the acquisition of Dimension Enterprises, an engineering and business strategy consulting firm for \$65 million in cash. Dimensions will help Nortel design and engineer Internet data centers which house eBusiness transactions.
- In February, Nortel participated in two collaborative efforts. Nortel teamed up with Hewlett-Packard to facilitate delivery of end-to-end wireless Internet solutions. Motorola and Nortel announced that they are jointly enabling manufactures to develop advanced Internet products.
- In March, Nortel announced its agreement to acquire CoreTek, a pioneer in strategic optical components for \$1.43 billion in Nortel common shares. CoreTek's tunable lasers will further strengthen Nortel's ability to deliver a flexible high-performance optical Internet.
- In April, Nortel and Architel Systems announced an agreement whereby Nortel will acquire all common shares of Architel for an estimated \$395 million in Nortel common shares. Architel is a global leader in software systems that allow service providers to offer Internet and other next generation Internet Protocol services.

Just last week, Barron's suggested that Cisco was overvalued and that the acquisition pace Cisco has been maintaining is not sustainable. I only mention this as Nortel is operating at a similar pace. In addition, over the last two years, Nortel has not had positive net income until the third quarter of 1999. However, revenues and gross margins have remained strong and the net losses, in most cases, were attributed to special charges associated with the company's acquisitions and product expansions. It looks as if Nortel will generate positive earnings – as witnessed in the last quarter and by the fact that first quarter 2000 prospects are bright. Cisco stock dipped on news of the Barron's article, but has since recovered. The market must feel confident about Nortel, as the stock has been on an upward trend for the past five years.