

## ALCATEL AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### Note 30 — Main consolidated companies

<u>Company</u>	<u>Country</u>	<u>% control</u>	<u>% interest</u>	<u>Consolidation method</u>
Alcatel <sup>(1)(2)</sup> .....	France	100.0	100.0	Parent company
<b><u>TELECOM SEGMENT</u></b>				
<b><u>Alcatel Participations</u></b> .....	France	100.0	100.0	Full consolidation
Alcatel Australia Limited .....	Australia			
Alcatel Austria A.G. ....	Austria			
Alcatel Bell NV .....	Belgium			
Alcatel Business Systems .....	France			
Alcatel CIT .....	France			
Alcatel Contracting .....	France			
Alcatel España .....	Spain			
Alcatel Indetel S.A. de C.V. <sup>(1)</sup> .....	Mexico			
Alcatel Italia S.p.A. ....	Italy			
Alcatel NV .....	The Netherlands			
Alcatel Polska SA .....	Poland			
Alcatel Portugal SA .....	Portugal			
Alcatel Réseaux d'Entreprise .....	France			
Alcatel Schweiz AG .....	Switzerland			
Alcatel SEL A.G. <sup>(1)</sup> .....	Germany			
Alcatel Space .....	France			
Alcatel Submarine Networks Limited .....	U.K.			
Alcatel Telecom Limited .....	U.K.			
Alcatel Telecom Nederland BV .....	The Netherlands			
Alcatel Telecom Norway A/S <sup>(1)</sup> .....	Norway			
Alcatel Telecomunicacoes SA .....	Brazil			
Alcatel USA Inc .....	USA			
Shanghai Bell Telecommunication Equipment & Mobile Communications .....	P.R.C.	31.65	31.65	Equity
Taiwan International Standard Electronic Ltd (Taisel) .....	Taiwan			
Teletas .....	Turkey			
Thomson-CSF <sup>(1)</sup> .....	France	15.84	15.84	Equity

(1) Publicly traded.

(2) The activities of Alcatel, as the parent company, are included under "Others".

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<u>Company</u>	<u>Country</u>	<u>% control</u>	<u>% interest</u>	<u>Consolidation method</u>
<b><u>CABLES AND COMPONENTS SEGMENT</u></b>				
<b>Alcatel Cable France</b> .....	France	100.0	100.0	Full consolidation
Alcatel Cable Benelux .....	Belgium			
Alcatel Cable Suisse .....	Switzerland			
Alcatel Canada Inc. ....	Canada			
Alcatel Cavi S.p.A. ....	Italy			
Alcatel Cuivre .....	France			
Alcatel Kabel AG & Co. ....	Germany			
Alcatel NA Cable Systems Inc. ....	USA			
Alcatel STK ASA .....	Norway			
Alcatel Maroc <sup>(1)</sup> .....	Morocco			
Lacroix & Kress GmbH .....	Germany			
Saft groupe .....	France			
Société de Coulée Continue de Cuivre .....	France			
<b><u>OTHER SEGMENT<sup>(2)</sup></u></b>				
<b>Energy and Transport</b>				
ALSTOM <sup>(1)</sup> .....	France	24.0	24.0	Equity
<b>Nuclear</b>				
Framatome .....	France	44.1	44.1	Equity
Framatome Connectors International .....	France			
<b>Others</b>				
Locatel .....	France	100.0	100.0	Full consolidation
<b>Financial Holdings</b>				
Compagnie Financière Alcatel .....	France	100.0	100.0	Full consolidation
Cie Immobilière Méridionale .....	France	100.0	100.0	Full consolidation
Civelec .....	France	100.0	100.0	Full consolidation
Générale Occidentale .....	France	100.0	100.0	Full consolidation
Soficim .....	France	100.0	100.0	Full consolidation
SIKL .....	France	100.0	100.0	Full consolidation
<b>Financial Services</b>				
Electro Banque .....	France	100.0	100.0	Full consolidation

(1) Publicly traded.

(2) The activities of Alcatel, as the parent company, are included under "Others".

#### **Note 31 — Summary of differences between accounting principles followed by the Company and U.S. GAAP**

Alcatel's accounting policies comply with generally accepted accounting principles in France (French GAAP). Elements of Alcatel's accounting policies which differ significantly from generally accepted accounting principles in the United States (U.S. GAAP) are described below:

##### **(a) Accounting for long-term contracts**

In 1996, in the Engineering and Systems segment, revenue and margins of long-term contracts were recorded upon completion.

From January 1, 1997, the Engineering and Systems segment recognized revenue and margins of long-term contracts using the percentage of completion method. Consequently, there will be no more adjustments for the purpose of reconciliation to U.S. GAAP. For 1996, income on long-term contracts has been adjusted, using the percentage-of-completion method for material differences. For 1997, the adjustment shown in the income

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statement results from a change in accounting estimates relating to the use of the percentage-of-completion method.

**(b) Accounting for gains on sales of treasury stock**

Alcatel includes gains on its own shares sold by its subsidiaries in the determination of its income. Under U.S. GAAP, such gains are credited directly to equity.

**(c) Amortization of acquisition goodwill**

In France, goodwill is generally amortized over 20 years. Under U.S. GAAP, goodwill must be amortized against income over its estimated life, not to exceed 40 years. The company has concluded that the goodwill has an indeterminate life and, as a result, has used a 40-year life in preparing the U.S. GAAP reconciliation.

**(d) Fair value accounting for the mergers with Compagnie Financière Alcatel, Alsthom and Générale Occidentale**

Alcatel accounted for the mergers with Compagnie Financière Alcatel, Alsthom and Générale Occidentale, paid for with its own newly-issued Shares, on the basis of the historical value of the net assets transferred to the group. Under U.S. GAAP, the net assets acquired by issuing shares are recorded at the fair value of the shares issued using the purchase accounting method. Accordingly, additional goodwill amortization has been reflected in the U.S. GAAP reconciliation.

**(e) Acquisition goodwill charged against shareholders' equity**

A portion of the goodwill related to the acquisition of a majority interest in Telettra (1991), Alcatel SEL (1992), DSC (1998) and of the 30% stake in Alcatel nv. (1992) were directly charged against shareholders' equity. Under U.S. GAAP, acquisition goodwill is classified as an intangible asset. For reconciliation purposes, the Company has amortized acquisition goodwill over a 40-year life (over a 20-year life for DSC).

**(f) Accounting for marketable securities and marketable equity securities**

Alcatel accounts for its investments at the lower of historical cost or fair value, assessed investment by investment. Under U.S. GAAP, certain investments in equity securities are stated at fair value. Changes in fair value related to trading securities are included in net income while those relating to available-for-sale securities are included directly in shareholders' equity.

**(g) Liability recognition for certain employee termination benefit and other costs**

Alcatel accounts for such liabilities when restructuring programs have been finalized and approved by group management. The group has applied EITF 94-3, SFAS 88 and SFAS 112 in preparing the U.S. GAAP reconciliation. Under such requirements, the conditions to be met in order to record a restructuring reserve in the balance sheet are more stringent than under Alcatel's policy.

**(h) Accounting for closing of duplicate facilities of acquiring companies**

Under certain conditions, Alcatel accounted for costs incurred to close duplicate facilities of acquiring companies as part of the cost of acquisition. Under U.S. GAAP, such costs are charged to income.

**(i) Accounting for the acquisition of the 30% stake in Alcatel n. v.**

In connection with this transaction, Alcatel used forward exchange contracts to reduce its foreign currency exposure relative to the cash payments in 1993 and 1994. The premium on these contracts was charged to

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expenses in 1992 net income. Under U.S. GAAP, the premium should be included in net income over the life of the contracts.

In addition, this investment was accounted for at the price contractually agreed upon which did not include any interest factor. Under U.S. GAAP, this investment would be recorded using the present value of the future payments.

#### **(j) Income taxes**

Income taxes have been accounted for in accordance with the Financial Accounting Standard Board's Statement N° 109 "Accounting for Income Taxes" (see Note 32 (c)(3)). From January 1, 1998, Alcatel's accounting policies are in line with the recognition of deferred tax assets under U.S. GAAP. Consequently, there will be no more adjustment for the purpose of reconciliation to U.S. GAAP except for the tax effect of other adjustments and tax on undistributed earnings on equity investment (See Note 1(m)).

#### **(k) Accounting for Thomson-CSF's investment**

The investment in Thomson-CSF's shares has been accounted for as an exchange of a similar line of business and is recorded at carryover basis without impact in the income statement. Under U.S. GAAP, such transactions are recorded at fair value, with recognition of a gain based on the proportion of the business that is "sold."

#### **(l) Accounting for DSC's investment**

The costs identified with research and development activities which have no alternative future use, are not distinguished as part of acquisition cost and has been considered as goodwill. Under U.S. GAAP, such costs are to be allocated to the purchase price and expensed at the date of acquisition if technological feasibility has not been established and no alternative commercial use has been identified.

#### **(m) Presentation of Consolidated Financial Statements**

The classification of certain items in, and the format of, Alcatel's Consolidated Financial Statements vary to some extent from U.S. GAAP.

The most significant reporting and presentation practices followed by Alcatel which differ from U.S. GAAP are described in the following paragraphs:

In its balance sheet, Alcatel reports advance payments on long-term contracts received from customers as a liability. Under U.S. GAAP, advance payments, contract determined by contract, are generally shown as a reduction of unbilled contract costs or, to the extent advance payments exceed unbilled contract costs, as a liability.

Accrued interest, short-term borrowings, bank overdrafts and short-term portion of other debt are included in debt. The long-term portion of debt is specified on the balance sheet. Under U.S. GAAP, the portion of debt maturing within one year would be classified as a current liability (€ 1,787 million at December 31, 1998, € 2,714 million at December 31, 1997 and € 2,905 million at December 31, 1996).

The short-term portion of accrued pensions, retirement obligations, accrued contract costs and other reserves would be shown as current liabilities under U.S. GAAP (€ 3,071 million at December 31, 1998, € 5,372 million at December 31, 1997 and € 4,882 million at December 31, 1996). Additionally, U.S. GAAP would require the long-term portion of other payables to be shown as non-current liabilities (€ 1,456 millions at December 31, 1998, € 473 million at December 31, 1997 and € 526 million at December 31, 1996).

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### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Under U.S. GAAP income statement presentation (see Note 32), other revenues (expenses) detailed in Note 6 have been presented as a deduction from or an addition to operating income, except for gains on sale of shares in subsidiaries which have been presented in a separate line item after operating income.

Profit on the disposal of treasury stock which has been presented in a separate line item has been adjusted for U.S. GAAP reconciliation (see (b) above).

In its statement of cash flows, Alcatel presents the measures “working capital provided by operations” and “net cash flow after investment”. These measures would not be shown under U.S. GAAP statement of cash flows presentation. In addition, a short-term note receivable was included as cash and cash equivalents in the statement of cash flows for 1996. Under U.S. GAAP, this item would not meet the definition of cash equivalents.

In its Consolidated Financial Statements, Alcatel applies the pro-rata consolidation method to account for investment in ALSTOM for 1997 and 1996, which does not comply with U.S. GAAP. Pursuant to the SEC’s rules for foreign registrants, the effect has not been eliminated. From January 1, 1998, ALSTOM is accounted for under the equity method (see Note 2).

Six special purpose leasing activities, within ALSTOM’s group, are accounted for using the equity method under French GAAP for 1997 and 1996. Under U.S. GAAP, these activities would be combined because the Group has substantially all the risks and rewards of ownership. This presentation would increase other financial fixed assets by € 0 million and € 45 million, increase long-term receivables by € 348 million and € 200 million, increase long-term borrowings by € 145 million and € 365 million and increase accrued payables by € 203 million and € (113) million at the years ended December 31, 1996 and 1997, each respectively. Such a difference in the presentation of consolidated financial statements disappears in 1998 due to the use of the equity method for the ALSTOM’s group.

#### **(n) Related parties**

Under U.S. GAAP, information provided for in Note 26 would be presented on the face of the Consolidated Balance Sheets and the Consolidated Income Statements.

#### **(o) Other comprehensive income**

Statement of Financial Accounting Standards N° 130 “Other Comprehensive Income,” effective for financial periods beginning after December 15, 1997, requires retroactive reporting of comprehensive income and its components, displayed as prominently as other financial statements. Comprehensive income may be defined for U.S. GAAP purposes as the change in equity of a business enterprise from transactions and other events and circumstances from non-owner sources. French GAAP does not require separate disclosure of all such changes in equity during a fiscal period.

#### **Note 32 — Reconciliation to U.S. GAAP**

The following is a summary of the estimated adjustments to the Consolidated Income Statements for the years 1998, 1997 and 1996 and Alcatel shareholders’ equity at December 31, 1998, 1997 and 1996, which would be required if U.S. GAAP had been applied instead of French GAAP.

On January 1, 1999, the euro was introduced as the common legal currency of eleven member states of the European Economic and Monetary Union, including France. The Company has adopted the euro as its reporting currency in its Consolidated Financial Statements and translated all French franc amounts at the fixed exchange rate for French francs to euro. Although these statements depict the same trends as would have been shown had they been presented in French francs, they may not be directly comparable to the financial statements of other companies that have also been restated in euro. Prior to the adoption of the euro, the currencies of other countries fluctuated against the French franc, but because the euro did not exist prior to January 1, 1999, historical

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exchange rates for euro are not available. A comparison of the Company's financial statements and those of another company that had historically used a reporting currency other than the French franc that takes into account actual fluctuations in exchange rates could give a much different impression than a comparison of the financial statements and those of another company as translated into euro. Note 1(r) to the Consolidated Financial Statements explains how the amounts in these statements were translated.

**(a) Consolidated Income Statements**

**(1) Net income**

	<u>1998<sup>(a)</sup></u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions)			
<b>Net income as reported in the Consolidated</b>				
<b>Income Statements</b> . . . . .	\$2,427	€2,340	€711	€415
Accounting for long-term contracts . . . . .	—	—	(86)	12
Accounting for gains on sales of treasury stock . . . . .	—	—	(54)	(50)
Amortization of acquisition goodwill . . . . .	159	153	169	63
Fair value accounting for the mergers of Alcatel with subsidiaries (amortization of acquisition goodwill) . . . . .	(12)	(12)	(17)	(17)
Acquisition goodwill charged against shareholders' equity . . . . .	(55)	(53)	(13)	(13)
Accounting for investments in securities . . . . .	2	2	(2)	10
Restructuring plans . . . . .	41	40	(72)	(461)
Accounting for closing of duplicate facilities of acquiring companies . . . . .	—	—	—	—
Accounting for the acquisition on the 30% stake in Alcatel N.V. . . . .	1	1	1	1
Income taxes . . . . .	(341)	(329)	(175)	(131)
Accounting for disposal of Cegelec and Alstom . . . . .	(129)	(124)	—	—
Accounting for Thomson-CSF's investment . . . . .	446	430	—	—
Purchased in process research and development (DSC) . . . . .	(1,137)	(1,096)	—	—
Other adjustments* . . . . .	(220)	(212)	(15)	(7)
Tax effect of the above adjustments . . . . .	<u>40</u>	<u>39</u>	<u>(3)</u>	<u>(5)</u>
<b>Net income according to U.S. GAAP</b> . . . . .	<u>\$1,223</u>	<u>€1,179</u>	<u>€446</u>	<u>€(183)</u>

\*For 1998, concerns mainly retirement benefits and unpaid interest and unamortized premiums on converted bonds (see Note 5(a)).

(a) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 0.9641 = \$1.00 on June 24, 1999.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(2) Summarized U.S. GAAP Consolidated Income Statements**

The Consolidated Income Statements for the years ended December 31, 1998, 1997 and 1996 have been adjusted to reflect the main differences between U.S. GAAP and French GAAP discussed above.

	<u>1998<sup>(a)</sup></u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions)			
<b>Net sales</b> .....	\$22,050	€21,259	€28,335	€24,794
Cost of sales .....	(16,048)	(15,472)	(21,465)	(19,030)
Administrative and selling expenses .....	(3,203)	(3,088)	(3,967)	(3,611)
Research and development expenses .....	(1,876)	(1,809)	(1,775)	(1,679)
Restructuring costs and write down of assets* .....	<u>(373)</u>	<u>(360)</u>	<u>(258)</u>	<u>(528)</u>
<b>Income from operations</b> .....	550	530	870	(54)
Interest expense .....	(638)	(615)	(1,043)	(1,249)
Interest income and other financial .....	520	501	851	1,082
Other operating income (expense), net .....	(1,566)	(1,510)	(243)	(484)
Gain on sale of stock in subsidiaries .....	<u>2,828</u>	<u>2,727</u>	<u>332</u>	<u>635</u>
<b>Income before taxes and minority interests</b> .....	1,694	1,633	767	(70)
Share in net income of equity affiliates .....	188	181	87	151
Provision for income tax .....	(646)	(623)	(386)	(240)
Minority Interests .....	<u>(11)</u>	<u>(11)</u>	<u>(23)</u>	<u>(23)</u>
<b>Net income</b> .....	<u>\$1,223</u>	<u>€1,179</u>	<u>€446</u>	<u>€(183)</u>

The Consolidated Financial Statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

\* Incidental to restructuring plans.

(a) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 0.9641 = \$1.00 on June 24, 1999.

The Consolidated Income Statements include ALSTOM on a proportional consolidation basis for 1997 and 1996.

**(3) Earnings per share under U.S. GAAP:**

Estimated earnings per Share are calculated in accordance with U.S. GAAP (see Note 8).

	<u>1998<sup>(a)</sup></u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
<b>Basic earnings per share:</b>				
Net income (loss) .....	\$7.23	€6.97	€2.84	€(1.17)
<b>Diluted earnings per share:</b>				
Income (loss)* .....	6.88	6.63	2.81	—

The Consolidated Financial Statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

\* Not applicable due to loss position in 1996.

(a) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 0.9641 = \$1.00 on June 24, 1999.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The following tables present a reconciliation of the net income per share and the diluted earnings per share for each year disclosed.

<u>1998</u>	<u>Net income</u>	<u>Number of shares</u>	<u>Per-share amount</u>
Net income per share . . . . .	€1,179	169,142,442	€6.97
Stock option plans . . . . .		1,524,791	
Convertibles bonds . . . . .		<u>7,096,448</u>	
Diluted earnings per share . . . . .	<u>1,179</u>	<u>177,763,681</u>	<u>6.63</u>

At December 31, 1998, certain securities having a potential dilutive effect in the future were not taken into account in the computation of diluted earnings per share because the effect would have been antidilutive:

- 7% DSC convertible bonds (see Note 22(a)(1)).

Consolidated subsidiaries owned 7,419,355 shares and 1,420,840 share equivalents.

<u>1997</u>	<u>Net income</u>	<u>Number of shares</u>	<u>Per-share amount</u>
Net income per share . . . . .	€446	156,937,952	€2.84
Stock option plans . . . . .		1,145,497	
Convertibles bonds . . . . .	<u>1</u>	<u>1,160,639</u>	
Diluted earnings per share . . . . .	<u>447</u>	<u>159,244,088</u>	<u>2.81</u>

At December 31, 1997, certain securities having a potential dilutive effect in the future were not taken into account in the computation of diluted earnings per share because the effect would have been antidilutive:

- 6.5% convertible bonds, due 1990 and 2.5% convertible bonds due 1994 (see Note 22(a)(1)).

Group subsidiaries owned 5,245,510 shares and 2,200,790 shares equivalents.

<u>1996</u>	<u>Net income</u>	<u>Number of shares</u>	<u>Per-share amount</u>
Net income per share . . . . .	<u>€(183)</u>	<u>155,902,458</u>	<u>€(1.17)</u>

The completion of diluted earning per share is not applicable due to loss position. Group subsidiaries owned 5,320,995 shares and 2,200,790 shares equivalents.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(4) Statement of comprehensive income**

Under U.S. GAAP, the following information would be displayed within the consolidated financial statements as either a separate statement or as a component of the consolidated statement of changes in shareholders' equity and minority interests.

	<b>1998<sup>(a)</sup></b>	<b>1998</b>	<b>1997</b>
		(in millions)	
<b>Net income under U.S. GAAP</b> .....	\$1,223	€1,179	€446
Other comprehensive income:			
Foreign currency translation adjustments .....	(149)	(144)	129
Unrealized gains on securities .....	413	398	220
Minimum pension liabilities adjustments .....	80	77	(154)
Tax effect on the above adjustments .....	<u>(131)</u>	<u>(126)</u>	<u>18</u>
<b>Comprehensive income according to U.S. GAAP</b> .....	<u>\$1,435</u>	<u>€1,384</u>	<u>€659</u>

The consolidated income statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

(a) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 0.9641 = \$1.00 on June 24, 1999.

If Alcatel were to present consolidated financial statements in accordance with U.S. GAAP, the accumulated balances for minimum liability adjustment, foreign currency translation adjustments and unrealized gains on available-for-sale securities, respectively, would be disclosed on the face of the consolidated balance sheets, in the statements of changes in shareholders' equity and minority interests, or in the notes to the financial statements. The following table presents the accumulated balances, net of tax, of each classification noted above.

	<b>Minimum liability adjustment</b>	<b>Foreign currency translation adjustment</b>	<b>Unrealized gains on securities</b>	<b>Accumulated other comprehensive income</b>
	(in millions of euros)			
<b>1998</b>				
Balance beginning of the year .....	(90)	(942)	313	(341)
Current period change .....	<u>45</u>	<u>(144)</u>	<u>304</u>	<u>(625)</u>
Balance end of the year .....	<u>(45)</u>	<u>(1,086)</u>	<u>617</u>	<u>(966)</u>
<b>1997</b>				
Balance beginning of the year .....	—	(1,071)	139	(351)
Current period change .....	<u>(90)</u>	<u>129</u>	<u>174</u>	<u>10</u>
Balance end of the year .....	<u>(90)</u>	<u>(942)</u>	<u>313</u>	<u>(341)</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Shareholders' equity

	1998 <sup>(a)</sup>	1998	1997	1996
	(in millions)			
<b>Shareholders' equity as reported in the Consolidated</b>				
<b>Balance Sheets</b> .....	\$10,282	€ 9,913	€6,701	€5,971
Accounting for long-term contracts .....	—	—	—	229
Amortization of acquisition goodwill .....	468	451	299	121
Fair value accounting for the mergers of Alcatel with subsidiaries (acquisition goodwill) .....	552	532	544	561
Acquisition goodwill charged against shareholders' equity ...	2,934	2,829	437	450
Accounting for investments in securities .....	866	835	445	210
Restructuring plans .....	307	296	261	334
Accounting for the acquisition of the 30% stake in Alcatel n.v. ....	(48)	(46)	(47)	(49)
Income taxes .....	(171)	(165)	162	371
Accounting for disposal of Cegelec and ALSTOM .....	(129)	(124)	—	—
Accounting for Thomson-CSF's investment .....	585	564	—	—
Other adjustments .....	(198)	(191)	(179)	(50)
Tax effect of the above adjustments .....	(388)	(374)	(170)	(249)
Minority interests .....	(7)	(7)	(5)	(5)
<b>Shareholders' equity according to U.S. GAAP</b> .....	<u>\$15,054</u>	<u>€14,514</u>	<u>€8,448</u>	<u>€7,895</u>

The Consolidated Financial Statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

(a) Translation of amounts from € into \$ has been made merely for the convenience of the reader at the Noon Buying Rate of € 0.9641 = \$1.00 on June 24, 1999.

(c) Additional U.S. GAAP information

(1) Statement of changes in shareholders' equity

	Capital stock	Additional paid-in capital	Retained earnings	Minimum liability adjustment	Unrealized holding gains/losses	Cumulative translation adjustment	Treasury stock at cost	Shareholders' equity
	(in millions of euros)							
<b>Balance at December 31, 1997 after appropriation</b> .....								
Capital increase .....	995	6,796	1,831	(90)	313	(942)	(456)	8,448
Net change in treasury stock owned by consolidated subsidiaries .....	217	5,478	9				(863)	5,695
Net changes in unrealized holding gains/(losses) .....					304			304
Minimum liability adjustment .....				45				45
Shares issued to employees .....		16						16
Translation adjustment .....						(144)		(144)
Effect of Thomson-CSF's stake in Alcatel Space .....			232					232
Change in Alstom's profit .....			(10)					(10)
Net income .....			<u>1,179</u>					<u>1,179</u>
<b>Balance at December 31, 1998 before appropriation</b> .....								
Proposed appropriation of net income ...	1,212	12,290	3,241	(45)	617	(1,086)	(1,319)	14,911
			(397)					(397)
<b>Balance at December 31, 1998 after appropriation</b> .....								
	<u>1,212</u>	<u>12,290</u>	<u>2,844</u>	<u>(45)</u>	<u>617</u>	<u>(1,086)</u>	<u>(1,319)</u>	<u>14,514</u>

The Consolidated Financial Statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

\* The increase in the minimum liability adjustment between 1996 and 1997 mainly results from changes in assumptions in France regarding seniority on retirement date. This change has involved a high increase in the funded status, which has been offset by actuarial losses.

## ALCATEL AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### (2) Pension and post-retirement benefits other than pension plans

The group sponsors various defined benefit pension plans. In France, all group's employees elect to benefit from the retirement indemnity scheme. In other countries, the employee groups covered and the type of retirement plan depends on local regulations and practices. Plan assets consist principally of governmental and corporate bonds (approximately 50%), equity securities (approximately 30%) and short-term investments (approximately 10%).

In order to comply with U.S. GAAP, the Company applied the Statement of Financial Accounting Standards N° 87 "Employers' Accounting for Pensions" ("SFAS 87") and Statement of Financial Accounting Standards N° 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," starting January 1, 1989 as follows:

- the actuarial method used is the projected unit credit method. However, when the benefit formulas attribute more benefits to senior employees or when the plans are integrated with social security systems or multi-employer plans, the Company has elected to apply the projected unit credit service prorate method to avoid delayed recognition of pension costs;
- the transition obligation or fund excess has been determined at January 1, 1989 as being the difference between the liabilities accounted for under prior years accounting policies and the funded status of the plans resulting from SFAS 87 calculations. That transition obligation or fund excess is amortized using the greater of 15 years and the average residual active life of the population covered by each plan;
- the related market-value is determined using a five-year moving average method; and
- prior service experience and gains and losses in excess of 10% of the liability or asset are amortized over the average residual active life of participants.

In order to comply with U.S. GAAP, the group applied the Statement of Financial Accounting Standard N° 106 "Employers' Accounting for Post-retirement Benefits other than Pensions" with effect from January 1, 1993 for U.S. group subsidiaries and with effect from January 1, 1995 for other group subsidiaries. These post-retirement benefits, primarily life insurance and health care, cover most of U.S. group employees.

ALCATEL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Disclosures, presented for the first time, in accordance with SFAS 132, are as follows:

	Pension benefits		Other benefits	
	1998	1997	1998	1997
	(in millions of euros)			
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year*	3,906	2,884	85	72
Service cost	97	100	2	2
Interest cost	194	228	6	6
Plan participants' contributions	7	6	0	(1)
Amendments	11	1	0	0
Acquisitions	67	584	0	0
Business Combinations	(640)	(2)	—	—
Curtailments	98	(13)	0	(1)
Settlements	(16)	(1)	—	—
Special termination benefits	40	—	—	—
Actuarial loss/gain	54	230	8	1
Benefits paid	(289)	(160)	(5)	(5)
Other (foreign currency translation)	(48)	49	(6)	10
Benefit obligation at end of year*	<u>3,480</u>	<u>3,906</u>	<u>89</u>	<u>85</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	2,624	1,661	—	—
Actual return on plan assets	236	350	—	—
Employers' contribution	(11)	47	—	—
Plan participants' contributions**	7	6	—	—
Acquisitions	0	739	—	—
Business Combinations	(264)	(6)	—	—
Curtailments	3	0	—	—
Settlements	(25)	0	—	—
Special termination benefits	33	—	—	—
Benefits paid	(231)	(113)	—	—
Other (foreign currency translation)	(53)	(60)	—	—
Fair value of plan assets at end of year	<u>2,320</u>	<u>2,624</u>	<u>0</u>	<u>0</u>
Funded status	(1,161)	(1,282)	(89)	(85)
Unrecognized actuarial loss/gain	(18)	141	14	7
Unrecognized transition obligation	1	9	35	40
Unrecognized prior service cost	16	3	0	0
Net amount recognized	<u>(1,162)</u>	<u>(1,128)</u>	<u>(41)</u>	<u>(38)</u>

The consolidated income statements have been prepared in French francs and translated into euros using the fixed exchange rate of € 1.00 = FF 6.55957 applicable since January 1, 1999 (see Note 1(r)).

\* The benefit obligation reported in the table above does not include the amount of the minimum liability adjustment.

\*\* In 1998 the figure includes an asset reversion of € 56 million.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligation in excess of plan assets were € 1,794 million, € 1,686 million and € 582 million, respectively, as of December 31, 1998 and € 1,990 million, € 1,874 million and € 597 million, respectively, as of December 31, 1997.

ALCATEL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Actuarial assumptions have been determined by actuaries on a country by country basis and company by company.

	Pension benefits			Other benefits		
	1998	1997	1996	1998	1997	1996
<b>Weighted-average assumptions as of December 31</b>						
Discount rate . . . . .	5-8%	5-7%	6-7%	6.75-8%	7.75-8%	8%
Rate of compensation increase . . . . .	2-7%	2-7%	3-7%	N/A	N/A	N/A
Expected return on plan assets . . . . .	6-9%	6-8%	6-8%	N/A	N/A	N/A

Regarding the other benefits plans, the assumed increase of health care trend is 8.75% in 1998 grading down to 5.0% in years 2004 and later.

	Pension benefits			Other benefits		
	1998	1997	1996	1998	1997	1996
	(in millions of euros)					
<b>Components of net periodic cost*</b>						
Service cost . . . . .	97	100	86	2	2	2
Interest cost . . . . .	194	228	198	6	6	5
Expected return on plan assets . . . . .	(148)	(167)	(120)	0	0	0
Amortization of transition obligation . . . . .	(3)	0	0	3	3	2
Amortization of prior service cost . . . . .	3	1	0	0	0	0
Amortization of recognized actuarial gain/loss . . . . .	4	4	0	0	0	0
Effect of curtailments . . . . .	113	(64)	(48)	0	1	0
Effect of settlements . . . . .	10	(7)	0	0	0	0
Special termination benefits . . . . .	7	0	0	0	0	0
<b>Net periodic benefit cost</b> . . . . .	<u>277</u>	<u>93</u>	<u>116</u>	<u>12</u>	<u>12</u>	<u>9</u>

\* In 1998, according to SFAS 132, service cost is presented free from plan participants' contributions. 1997 and 1996 have been restated for comparison.

Annual cost under French GAAP for pension benefits plans is € 175 million, € 168 million and € 156 million for the years ended December 31, 1998, 1997 and 1996, respectively. The difference between these amounts and the annual costs under U.S. GAAP stems from differences in timing of amortization of the initial transition liability and of actuarial gains and losses and from the absence of recognition of excess funding by certain companies.

Amounts recognized in the statement of financial position:

	Pension benefits		Other benefits	
	1998	1997	1998	1997
	(in millions of euros)			
Accrued benefit liability (including MLA) . . . . .	(1,316)	(1,449)	(41)	(38)
Prepaid benefit cost . . . . .	79	170	—	—
<b>Net amount accrued for under U.S. GAAP</b> . . . . .	<u>(1,237)</u>	<u>(1,279)</u>	<u>(41)</u>	<u>(38)</u>
Accumulated other comprehensive income (MLA) . . . . .	74	150	0	0
<b>Net amount recognized</b> . . . . .	<u>(1,162)</u>	<u>(1,128)</u>	<u>(41)</u>	<u>(38)</u>

ALCATEL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The net accruals accounted for as of December 31, 1998 and 1997 in the accompanying consolidated balance sheets can be compared with balances determined under U.S. GAAP as follows:

	<u>Pension benefits</u>		<u>Other benefits</u>	
	<u>1998</u>	<u>1997</u>	<u>1998</u>	<u>1997</u>
	(in millions of euros)			
— <b>Net amount accrued for under U.S. GAAP</b> . . . . .	(1,237)	(1,279)	(41)	(38)
Excess funding of plans recognized in income only when paid back to the Company . . . . .	(32)	(108)	—	—
Impacts of transition obligation, of prior service cost and of actuarial gains recognized with a different timing under local regulations . . . . .	(38)	(102)	—	—
Minimum liability adjustments (MLA) . . . . .	<u>74</u>	<u>150</u>	<u>—</u>	<u>—</u>
— <b>Net amount accrued for in consolidated financial statements</b> . . . . .	(1,232)	(1,338)	(41)	(38)
Accrued . . . . .	(1,261)	(1,365)	—	—
Prepaid . . . . .	29	27	—	—

Regarding the other benefit plans, a one-percentage-point change in assumed health care cost trend rates would have the following effects:

	<u>1 Percentage Point increase</u>	<u>1 Percentage Point decrease</u>
Effect on total of service and interest cost components . . . . .	6.3%	(6.5%)
Effect on the post-retirement benefit obligation . . . . .	7.6%	(7.8%)

**(3) Income taxes**

**(a) Deferred tax balances:**

	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions of euros)		
Deferred tax assets . . . . .	3,430	3,854	4,019
Less valuation allowance <sup>(1)</sup> . . . . .	<u>(2,548)</u>	<u>(2,777)</u>	<u>(2,391)</u>
Net deferred tax assets . . . . .	881	1,078	1,628
Deferred tax liabilities . . . . .	<u>(929)</u>	<u>(867)</u>	<u>(1,353)</u>
Net deferred taxes . . . . .	<u>(48)</u>	<u>210</u>	<u>275</u>

(1) Of which € 245 million at December 31, 1998 (€ 246 million at December 31, 1997 and € 293 million at December 31, 1996) will be allocated to reduce goodwill.

ALCATEL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Major temporary differences giving rise to deferred taxes at December 31, 1998, 1997 and at December 31, 1996 are as follows:

	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions of euros)		
Accounting for long-term contracts .....	(21)	(65)	(233)
Depreciation of property, plant and equipment .....	(150)	(215)	(236)
Intangible assets .....	(1)	(0)	(62)
Other .....	<u>(757)</u>	<u>(587)</u>	<u>(822)</u>
<b>Deferred tax liabilities</b> .....	<u>(929)</u>	<u>(867)</u>	<u>(1,353)</u>
Tax losses carried forward .....	525	385	674
Accrued pension and retirement obligation .....	53	93	129
Other reserves .....	199	330	401
Other .....	<u>104</u>	<u>269</u>	<u>423</u>
<b>Net deferred tax assets</b> .....	<u>881</u>	<u>1,078</u>	<u>1,628</u>

Deferred tax balances are analyzed as follows:

<u>At December 31, 1998</u>	<u>Current</u>	<u>Non-current</u>	<u>Total</u>
	(in millions of euros)		
Deferred tax assets (net of valuation allowance) .....	511	370	881
Deferred tax liabilities .....	<u>(161)</u>	<u>(768)</u>	<u>(929)</u>
	<u>350</u>	<u>(398)</u>	<u>(48)</u>

<u>At December 31, 1997</u>	<u>Current</u>	<u>Non-current</u>	<u>Total</u>
	(in millions of euros)		
Deferred tax assets (net of valuation allowance) .....	553	525	1,078
Deferred tax liabilities .....	<u>(366)</u>	<u>(501)</u>	<u>(867)</u>
	<u>186</u>	<u>24</u>	<u>210</u>

<u>At December 31, 1996</u>	<u>Current</u>	<u>Non-current</u>	<u>Total</u>
	(in millions of euros)		
Deferred tax assets (net of valuation allowance) .....	773	855	1,628
Deferred tax liabilities .....	<u>(618)</u>	<u>(735)</u>	<u>(1,353)</u>
	<u>155</u>	<u>120</u>	<u>275</u>

(b) Analysis of provision for income tax:

	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions of euros)		
Current tax expense .....	374	199	84
Tax benefit of operating losses carried forward .....	(162)	(280)	(55)
Net change in valuation allowance .....	(371)	211	135
Other deferred tax expenses (benefits) .....	<u>782</u>	<u>255</u>	<u>75</u>
Provision for income tax .....	<u>623</u>	<u>386</u>	<u>240</u>

ALCATEL AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(c) Effective income tax rate

	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions of euros)		
Income (loss) before taxes, minority interests and extraordinary items . . .	1,633	767	(70)
Average income tax rate . . . . .	<u>42.2%</u>	<u>37.9%</u>	<u>(46.9)%</u>
Expected tax . . . . .	689	291	33
Impact of :			
— reduced taxation of certain revenues . . . . .	(520)	(5)	(281)
— net change in valuation allowance . . . . .	(371)	211	135
— tax credits . . . . .	(37)	(53)	(71)
— other . . . . .	<u>862</u>	<u>(58)</u>	<u>424</u>
Actual provision for income tax . . . . .	<u>623</u>	<u>386</u>	<u>240</u>
Effective tax rate . . . . .	<u>36.5%</u>	<u>50.3%</u>	<u>N.A.</u>

N.A.: not applicable due to loss before taxes in 1996.

(4) Stock-based compensation

In 1996, 1997 and 1998, Alcatel adopted stock option incentive plans (see Note 19). The following information is disclosed according to the Statement of Financial Accounting Standard N° 123 Accounting for Stock-Based Compensation (“SFAS 123”) and relates to the second, the third and fourth plans adopted respectively in 1996, 1997 and 1998:

	<u>1996 Plans</u>		<u>1997 Plans</u>		<u>1998 Plan</u>
	<u>Principal</u>	<u>Complementary</u>	<u>Principal</u>	<u>Complementary</u>	
	(in number of options)				
<b>Outstanding at January 1, 1996 . . . . .</b>	—	—	—	—	—
Granted . . . . .	1,813,900	78,800	—	—	—
Exercised . . . . .	—	—	—	—	—
Forfeited . . . . .	(37,000)	—	—	—	—
Expired . . . . .	—	—	—	—	—
<b>Outstanding at December 31, 1996 . . . .</b>	<u>1,776,900</u>	<u>78,800</u>	<u>—</u>	<u>—</u>	<u>—</u>
Granted . . . . .	—	—	1,639,900	73,400	—
Exercised . . . . .	—	—	—	—	—
Forfeited . . . . .	(79,200)	(1,500)	(23,000)	—	—
Expired . . . . .	—	—	—	—	—
<b>Outstanding at December 31, 1997 . . . .</b>	<u>1,697,700</u>	<u>77,300</u>	<u>1,616,900</u>	<u>73,400</u>	<u>—</u>
Granted . . . . .	—	—	—	—	2,321,500
Exercised . . . . .	(436,790)	(22,800)	—	—	—
Forfeited . . . . .	(2,100)	(1,000)	(9,000)	(1,000)	—
Expired . . . . .	—	—	—	—	—
<b>Outstanding at December 31, 1998 . . . .</b>	<u>1,258,810</u>	<u>53,500</u>	<u>1,607,900</u>	<u>72,400</u>	<u>2,321,500</u>

These options can be exercised from:

- July 1, 1998 through December 31, 2003, each option giving the right to one share at an exercise price of € 64.79 for the 1996 plans.

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

- from May 1st, 2002 through December 31, 2004, each option giving the right to one share at an exercise price of € 96.35, for the 1997 principal plan.
- from December, 2002 through December 31, 2004, each option giving the right to one share at an exercise price of € 104.73, for the 1997 complementary plan.
- from December, 2003 through December 31, 2005, each option giving the right to one share at an exercise price of € 102.60 for the 1998 plan. The shares granted can be acquired only if the group operating income is at least 6.5% of total revenues for fiscal year 2000, or 7.5% of total revenues for fiscal year 2001. If neither objective is reached, the options will not be exercisable

For the 1998 plan which is a performance plan, the valuation does not take into account the fact that the stock options will be available if and only if the operational result of the company exceeds 6.5% of 2000 sales or 7% of 2001 sales, because it is considered as very difficult to evaluate the likelihood of success of such a plan and as rather likely that the performance should be met.

The fair values at grant-date of options granted during the years 1998, 1997 and 1996 have been estimated using the Black Scholes model and the following characteristics:

	<b>1996</b>	<b>1997</b>	<b>1998</b>
Interest rate . . . . .	5.7%	5%	3.68%
Expected life . . . . .	5 years	5 years	5 years
Expected volatility . . . . .	32%	32.5%	35%
Expected dividends . . . . .	2.5%	2.25%	2%

The group continues to apply accounting method prescribed by APB Opinion N° 25 Accounting for Stock Issued to Employees.

The following table discloses the pro-forma net income and earnings per share, as if the fair value-based accounting method had been used to account for stock-based compensation cost:

	<b>1996</b>	<b>1997</b>	<b>1998*</b>
	(in millions of euros except per share data)		
Net income . . . . .	(224)	436	1,179
<b>Primary earnings per share:</b>			
Net income . . . . .	(1.44)	2.77	6.97
<b>Diluted earnings per share:</b>			
Net income . . . . .	N/A	2.74	6.63

\* Net income and earnings per share will be only impacted in 1999 for the options granted at the end of 1998.

**(5) Pro forma information concerning the 1998 acquisition of DSC (unaudited)**

In addition to the information provided in Note 2, U.S. GAAP (APB 16) requires the Company to present certain pro forma information as if the transactions had occurred at the beginning of 1997.

The following unaudited pro forma results of operations for the years 1997 and 1998 include such adjustments as amortization of goodwill and related changes in the number of shares used for the Earnings per Share calculation.

The unaudited pro forma results have been prepared for comparative purposes only and do not purport to indicate the results of operations which would actually have occurred had the combination been in effect on the date indicated or which may occur in the future.

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

	<b>1998</b>	<b>1997</b>
	(in millions of euros except per share data)	
Net sales .....	21,956	29,740
Income before extraordinary items and minority interests .....	978	370
Net income .....	967	347
Earnings per share		
Income .....	5.30	1.97
Diluted income .....	5.06	1.95

**(6) Restructuring**

Under French GAAP, as disclosed in Note 1(l), Alcatel Group records restructuring when the restructuring programs have been finalized and approved by group management and have been announced before approval of the financial statements. Under U.S. GAAP, the Alcatel Group records restructuring as disclosed in Note 31(g).

The impact of U.S. GAAP adjustment is as follows:

	<b>1997</b>	<b>Current year expense</b>	<b>Utilization</b>	<b>CTA and others</b>	<b>1998</b>
	(in millions of euros)				
<b>French GAAP reserve</b> .....	1,303	406	(585)	(210)	914
Cost to relocate employees to another site .....	(15)	(10)	2	1	(22)
Plans not announced at balance sheet date .....	—	(9)	—	(22)	(31)
Moving costs .....	(2)	(14)	—	2	(14)
Other direct cost .....	(67)	4	—	(1)	(64)
Lay off costs in excess of legal obligation .....	<u>(199)</u>	<u>(11)</u>	<u>—</u>	<u>1</u>	<u>(209)</u>
<b>Total U.S. GAAP adjustment</b> .....	(283)	(40)	2	(19)	(340)
<b>Restructuring reserve and assets write down</b> .....	1,020	366	(583)	(229)	574
Write down of assets .....	<u>96</u>	<u>45</u>	<u>(58)</u>	<u>(5)</u>	<u>78</u>
<b>U.S. GAAP restructuring reserve</b> .....	<u><u>924</u></u>	<u><u>321</u></u>	<u><u>(525)</u></u>	<u><u>(224)</u></u>	<u><u>496</u></u>

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The current year expense recorded in 1998 includes the following major actions:

	<u>1998</u> (in millions of euros)
— Restructuring of activity in the U.S. related to acquisition of DSC. Severance plan offered to employees (incentives buyout costs for the former ANS facilities, Incremental pension cost and incentive buyout costs due to lay off, net cost to dispose of former ANS facilities in Richardson) . . . . .	108
— Restructuring of activity at Alcatel Italia (discontinuation of R&D consortium with FIAT at Chieti, end of DIAL BSM activity at BARI, closure of plants at Bodio, Gorgonzola) . . . . .	85
— Retrenchment of 125 employees at Ashburn related to discontinuation of HSS product (severance cost, post retirement medical, pension fund shortfall, cost to providing third parties alternatives to HSS products) . . . . .	26
— Retrenchment of 155 employees at Cossonay for CTD (Switzerland) related to closure of plants . . . . .	21
— Severance plan offered to 142 employees of Alcatel CIT and write-off of assets and impairment losses . . . . .	41
— Closing of plants and reorganization of Alcatel Cable France sales force . . . . .	14
— Retrenchment of 90 employees in Halden and Oslo related to discontinuation of activities (severance costs) . . . . .	10
— Retrenchment of 115 employees at Hanover related to discontinuation of activities (severance costs) . . . . .	15
— Layoff cost in excess of legal obligations related to BELL concerning 1998 and 1999 . . . . .	8
— Updating of plan related to externalisation of ARE activity . . . . .	10
— Severance plan for Telspace . . . . .	9
— Other plans in the World . . . . .	19
<b>Total</b> . . . . .	<u>366</u>

The reserve at the end of 1998 is analysed below:

	<u>1998</u> (in millions of euros)
Employee termination benefits . . . . .	337
Other costs . . . . .	<u>159</u>
<b>Total</b> . . . . .	<u>496</u>

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The remaining € 337 millions reserve for employee termination benefits at December 31, 1998 include approximately 5,577 employees to be terminated including:

	<u>Number of employees</u>
Early retirements for BELL .....	218
Severance plans for Alcatel Telecom in the US related to the former ANS facilities .....	750
Externalization of services for ARE related to 1996 .....	621
Closing of seven work sites and incentive departures for SIETTE REG .....	753
Closure of plants for Alcatel CIT in France .....	333
Reserve for lay off of employees in Russia .....	256
Incentives in Italia .....	220
Transfer from production unit to distribution unit at Zurich for SCHWEIZ .....	200
Closing of Strebnefort factory in Austria .....	167
Early retirements and dismissals for ETCA .....	111
Reorganization of Alcatel Kabel AG & Co. (closing of plant) .....	521
Restructuring of Alcatel Cable France (closing and reorganization) .....	204
Reorganization of Charleroi for Alcatel Cable Benelux .....	100
Reorganization of SAFT .....	400
Others plans in the World (Canada, Netherland, Portugal, Ireland) .....	<u>723</u>
<b>Total</b> .....	<u><u>5,577</u></u>

**(7) ALSTOM financial information**

In accordance with the regulations of the U.S. Securities and Exchange Commission with respect to pro-rata consolidation, summarized financial information has been prepared for the two years ended December 31, 1997 and 1996, during which ALSTOM was consolidated under the pro rata method.

	<u>1997</u>	<u>1996</u>
	<u>(in millions of euros)</u>	
<b>Balance sheet data</b>		
Non-current assets .....	2,588	2,307
Current assets .....	<u>14,720</u>	<u>15,146</u>
Total assets .....	<u>17,308</u>	<u>17,453</u>
Shareholders' equity .....	2,145	2,039
Minority interests .....	100	88
Non current liabilities .....	443	350
Current liabilities .....	<u>14,620</u>	<u>14,975</u>
Total liabilities and shareholders' equity .....	<u>17,308</u>	<u>17,453</u>
<b>Income Statement data</b>		
Net sales .....	10,503	9,122
Cost of sales .....	(8,540)	(7,480)
Income from operations after financing .....	622	584
Net income .....	251	309
<b>Cash flow data</b>		
Cash flow from operating activities .....	(16)	118
Cash flow from investing activities .....	(446)	(458)
Cash flow from financing activities .....	(147)	(238)

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(8) Alcatel USA, Inc. financial information**

The Consolidated Financial Statements for Alcatel USA, Inc. (formerly DSC Communications Corporation), are not being filed separately with the Securities and Exchange Commission because certain securities registered under the Securities Act of 1933, of which Alcatel USA, Inc. is an obligor (thus subjecting them to reporting requirements under Section 13 or 15(d) of the Securities Exchange Act of 1934), are fully and unconditionally guaranteed by Alcatel. Financial information relating to Alcatel USA, Inc. is presented herein in accordance with Staff Accounting Bulletin N° 53 as an addition to the notes to the financial statements of Alcatel. DSC Communications Corporation merged with Alcatel's existing U.S. operations into the entity renamed Alcatel USA, Inc. as of December 31, 1998. The condensed income statement information for the years ended December 31, 1998, 1997 and 1996, and the condensed balance sheet information at December 31, 1997 and 1996 set forth below relate only to DSC Communications Corporation. Condensed balance sheet information at December 31, 1998 relates to the combined operations of DSC Communications Corporation and Alcatel's existing U.S. operations. Summarized financial information for Alcatel USA, Inc. is as follows:

	<b>1998</b>	<b>1997</b>	<b>1996</b>
	(in millions of dollars)		
<b>Condensed income statement information:</b>			
Net sales . . . . .	1,187	1,576	1,381
Cost of sales . . . . .	990	912	926
Administrative and selling expenses . . . . .	138	232	234
Income (loss) from continuing operations before extraordinary items . . . .	(1,544) <sup>(1)</sup>	49	(8)
Net income (loss) . . . . .	(1,544)	49	(8)
<b>Condensed balance sheet information:</b>			
Current assets . . . . .	1,637	1,595	1,203
Non-current assets . . . . .	4,194	845	723
Current liabilities . . . . .	1,293	472	433
Non-current liabilities . . . . .	1,261	751	345
Shareholders' equity . . . . .	3,278	1,216	1,148

(1) Includes \$(1,269) million of charges relating to the write-off of in-process research and development in connection with the acquisition of DSC.

**(9) Use of estimates in the preparation of financial statements**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**(10) Recently issued U.S. Accounting Standards**

In June 1998, the FASB issued Statement of Financial Accounting Standards N° 133, "Accounting for Derivative Instruments and Hedging Activities." ("SFAS 133"). The Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

## ALCATEL AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Statement 133 is effective for fiscal years beginning after June 15, 1999 and cannot be applied retroactively. The Group has not yet quantified the impact that SFAS 133 would have on the consolidated financial statements as presented under U.S. GAAP. However, the Statement could increase volatility in earnings and other comprehensive income as presented under U.S. GAAP.

In March 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued the Statement of Position 98-1 (“SOP 98-1”), “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,” which provides guidance on accounting for the costs of computer software developed or obtained for internal use. SOP 98-1 requires computer software costs that are incurred in the preliminary project stage to be expensed as incurred. Once the capitalization criteria of SOP 98-1 have been met, directly attributable development costs should be capitalized. It also provides guidance on the treatment of upgrade and maintenance expenditures. SOP 98-1 is effective for fiscal years beginning after December 15, 1998. Costs incurred prior to initial application of this SOP, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized had this SOP been in effect when those costs were incurred. The Alcatel group has not determined the impact that this SOP would have under U.S. GAAP on its consolidated financial statements.

In April 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued the Statement of Position 98-5 (“SOP 98-5”), “Reporting on the Costs of Start-up Activities”, which generally requires that costs for start-up activities and organization costs should be expensed as incurred. SOP 98-5 is effective for fiscal years beginning after December 15, 1998 and initial adoption is required to be reflected as a cumulative effect of accounting change. The impact of this SOP in the Group’s consolidated financial statements is not material.

**ALCATEL AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**(11) Other information**

	<u>Balance at beginning of period</u>	<u>Charged to costs and expenses</u>	<u>Other movements</u>	<u>Balance at end of period</u>
	(in millions of euros)			
<b>Valuation and qualifying accounts deducted from the related accounts</b>				
<b>1998</b>				
Other investments and miscellaneous .....	151	(9)	(11)	131
Inventories .....	702	62	(23)	741
Trade receivables and related accounts .....	569	(24)	(63)	483
Other accounts receivable .....	19	(1)	(4)	14
<b>1997</b>				
Other investments and miscellaneous .....	133	24	(6)	151
Inventories .....	701	(42)	43	702
Trade receivables and related accounts .....	515	30	25	569
Other accounts receivable .....	35	1	(17)	19
<b>1996</b>				
Other investments and miscellaneous .....	105	32	(3)	133
Inventories .....	632	61	9	701
Trade receivables and related accounts .....	429	69	16	515
Other accounts receivable .....	33	(2)	3	35
<b>Accrued contract costs and other reserves</b>				
<b>1998</b>				
Accrued pensions and retirement obligations .....	1,338	73	(179)	1,232
Estimated losses on long-term contracts .....	433	44	(162)	315
Costs on completed contracts .....	858	108	(560)	406
Other contract costs .....	2,301	(28)	(953)	1,320
Other reserves .....	1,214	(7)	(118)	1,088
<b>1997</b>				
Accrued pensions and retirement obligations .....	1,289	38	11	1,338
Estimated losses on long-term contracts .....	487	(50)	(4)	433
Costs on completed contracts .....	793	11	55	858
Other contract costs .....	2,045	75	181	2,301
Other reserves .....	1,162	131	(79)	1,214
<b>1996</b>				
Accrued pensions and retirement obligations .....	1,270	156	(137)	1,289
Estimated losses on long-term contracts .....	406	186	(105)	487
Costs on completed contracts .....	742	546	(495)	793
Other contract costs .....	1,915	435	(305)	2,045
Other reserves .....	807	188	167	1,162

**SIGNATURE**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Alcatel**

By:                   /s/  JEAN-PIERRE HALBRON                  

Name: Jean-Pierre Halbron

Title: Senior Executive Vice President

Paris, June 28, 1999