

**SPEECH BY JOHN ROTH, PRESIDENT AND CEO OF NORTEL NETWORKS
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(Verbatim transcription from an audio cassette recording)

Thank you. I was going to talk about things like globalization and e-business and brain drains and taxes. But last Friday when I returned from Europe after meeting with Mr. Schroeder and then some customers, I was a little surprised to find news crews were all over our campus to see if the lights were still on, and helicopters were flying over top to see if the facilities still existed.

So obviously I probably should talk about something a little different. You probably all want to know what's going on at Nortel Networks. I've been told that this crowd is bigger than what Paul Martin commanded I think. And I've got more news media than what I guess Vladimir Putin also attracted but probably I should have his bodyguards.

Let me start off by saying that Nortel in Canada is truly unique. I'll put our revenue in Canadian dollars. We tend to report in U.S. dollars because we do so much of our business around the world but in Canadian dollars last year, our revenue was 45 billion dollars. The largest company in Canada by revenue.

We're probably still, I think, Canada's only meaningful high tech company in the field to telecommunications given the sale of Newbridge to Alcatel. And we still do about 25% of Canada's research and development that's done by the private sector.

Despite what's happened to the stock we're still Canada's most valuable company by far. And I must say that we're the only company that can shut down the T.S.E. any day of the week we want. I would really like to see that fixed, because so many Canadians want to buy Nortel stock and they have to go to New York to do it.

Canadians have a high expectation of Nortel because we are so unique and I think there's a time when people think that Nortel is invincible. We like to think we are pretty good but we're certainly not invincible.

We only have about 5% of our revenues in Canada. 60% of our revenues come from the United States. I might add that we are now the world's leading telecom infrastructure equipment company in the world, having overtaken Lucent during the last year. So that is a distinction that we really have.

But with 60% of our revenue coming from the U.S. market, we are very exposed to what's going on in the U.S. and I think in that regard we're also unique in Canada because

not many other Canadian companies have the degree of exposure that we have to the U.S. market.

The U.S. is going down into the most abrupt down turn it has probably ever, ever experienced. If you think back to the talks that Greenspan gave the last little while -- November 15th, Greenspan was still mostly concerned, after the meeting of the Federal Reserve, about interest rates, about inflation in the U.S. But reassured everybody that, well, he thought it was coming under control. But he was still worried about it but we weren't going to increase interest rates at that point in time. But as recently as November 15th, the Federal Reserve was still concerned about the fact they may have to raise interest rates some more.

On December 19th, the Federal Reserve met again and the mood shifted a little bit. They said, well, we think inflation is under control. We're a little more concerned about the economy. I think we have the right balance. We're not going to do anything.

Just on January 3rd, the Reserve shocked everyone with a half point cut in interest rates. And by January 31st, they've cut interest rates once again by a full percentage point for the month. They had not done that since 1984. And quite honestly the market was disappointed because the market was looking for a three quarter point reduction at the end of the month. They were looking for 1 and $\frac{1}{4}$ % reduction in interest rates for the month which was absolutely unprecedented. ... the market reaction, it had fully priced in a three quarter point reduction and when it didn't happen, the market reacted.

If you listen to Alan Greenspan today, the mood has shifted from one of, this could be something that will be over by the summer to now saying that the entire year will be difficult. And now we've seen that inflation has picked up a full percentage point in the United States and so the ability of the Federal Reserve to engineer a soft landing by using interest rate cuts is diminished somewhat because the fear of inflation is starting to rise in fact. So the ability to engineer a soft landing is more at risk.

Now against this backdrop of a very abrupt and sharp downturn coming in the United States and some people are starting to use the R word quite, quite regularly. Nortel just finished its best year ever. At this time last year, if I'd been meeting with you, if you looked back at the notes, we were talking about a 21% growth for year 2000. We did pretty good in the first quarter and in April we revised the guidance saying, well we think we're going to do a better than 21%. We're talking now about growing close to 30%. And in July we revised it up again and we said we think we can now do 40% for the entire year, 2000.

As you know, we met that guidance, turning in a total year growth of 42%, bringing our revenues from 21 billion dollars U.S. as we left 1999 to finishing last year with revenues of 30.3 billion dollars, tying if you like for the last 12 months, the revenues of the largest

telecom equipment vendor in the world and that's Lucent Technologies who, when I started at Nortel in 1969, was six times our size.

So as you know, we met that guidance and we finished the year not only doing 42% revenue growth but we also finished the year with a very solid fourth quarter, in fact brought in revenues over and above our guidance. And we ended the year with a strong order book.

Now I might add that this upcoming April will mark the fourth anniversary of the board naming me as C.E.O. of this corporation and during that four years, I've enjoyed 15 straight quarters where we met or beat the guidance that we gave to the street. We didn't always meet or beat the expectations of the street and we have not learned the skills of maybe bringing the expectations in line with what we say our people are going to do. But we have met and beaten our guidance for 15 straight quarters.

Unfortunately this is going to be the first quarter that I will not meet the guidance. While we entered this year with good momentum and a strong fourth quarter and a very good book to bill coming out of the year, in fact we started the year with a bunch of orders where customers wanted it early in the year. Where they wanted to get a fast start on the year because they've been managing their budgets for the end of the year. So we entered with the view that we would do pretty good. We also share with our customers what they're looking for from us for the upcoming year and they settled their budgets in the October, November time frame, we had a good perspective of what they wanted to do and what our share would be and that gave us confidence for the forecasts that we put out.

So when we announced our results at the end of the year, on January 18th, we announced that we saw that our business was going to hold pretty well. We pulled down the guidance somewhat, from 30 to 35. We felt now it would be at the low end of that range, more like 30. And that we could probably still meet the numbers for the first quarter.

Now in our business, January is generally a slow month for order input as our customers get back after the Christmas break, digest what they've done over the year-end. But this year, we started to see customers holding budget reviews and they started that around the middle of the month. But we thought that they should get through this fairly quickly, but it carried on. And really the budget reviews were being instigated primarily in the U.S. but to some degree also a little bit in Europe, but mostly in the United States, really looking at whether or not their budgets still made sense for the year.

So it's now four weeks since we made our announcements on January 18th. And we have to say that it's becoming very clear that all of our customers are starting to adjust their budgets to take account of the realities of the very sharp and severe downturn that the U.S. is experiencing.

Customers in the U.S. but to a certain degree everywhere, are taking every opportunity to push out purchases, and add capacity later wherever possible.

Our lead time now in our industry, for at least Nortel, is now down to from four to eight weeks, from receipt of order to when we can ship the materials and invoice the customer. So we're now at the point where we can see that with the order flow really slowed down, that we will not meet the coming quarter because the orders will not be released in that time frame.

Traditionally now, this is quite a surprise for us because traditionally in our industry, our industry follows the economic cycles a little differently than say consumer products. We have had a history in telecommunications of the economic cycle with a time lag of six to nine months. However, we haven't seen a big economic down turn in North America for a decade and we think the last time we saw one of those, our lead times used to be 26 weeks. So it's probably not unsurprising that if you had a lead time of 26 weeks or six months, that we would see quite a lag. Now with lead times in our industry down to four to eight weeks, we're basically following the economic cycles along just a few weeks behind consumer appliances.

So this is a major change for Nortel because we felt that if there was going to be an economic downturn coming, and certainly you can see it on the horizon, that it would come late in the summer. And if Greenspan was able to engineer the recovery as I think we all hoped he would, we might even escape it all together.

So this abrupt downturn has hit us as abruptly as it has the U.S. economy.

Now in the United States, I must say that the news that we got from the United States is that we got second coverage, I think to Dell, because we were just one of many companies who announced similar kinds of results. Dell, Hewlett Packard, Intel, Cisco, Motorola, all the high tech companies are announcing similar kinds of views for the upcoming year and we're now seeing it in the same kind of time frame.

Now so far, as I say, Nortel is unique in Canada. Because I think Canada so far has not really felt the impact of the downturn in the United States. But I would point out that 42% of Canada's G.D.P. is dependant upon exports. And 85% of those exports are to the United States. So that means that 35% of Canada's G.D.P. is directly tied to how well the United States market does. So this is going to have an impact on all of Canada as this continues to move. And we need to get prepared for it.

Now as I said earlier, it's almost four years since I took over the helm of Nortel Networks. And at the time I had the annual general meeting and I gave my speech to the crew and the shareholders, I set my goals of making Nortel the most valued company in the industry. But valued by our customers and valued by our employees. And I said, if I felt I got those

two right that the investors wouldn't do too bad in the long term as the company did well for the customers.

I also saw at that time huge changes coming up in our industry. And the huge changes are really being driven by the fact data traffic on the telephone networks of the world were going to overtake voice traffic as the predominant form of traffic that the world's networks would carry. And this would drive tremendous reengineering and redevelopment of telephone networks around the world.

For Nortel it meant we had to develop a new portfolio. The voice network technology that we've become so good at was still important but day by day it would become less relevant. Today for instance, 70% of the traffic that's carried on the world's telephone networks is in fact data traffic. Much is spoken about the Internet but the Internet still only represents 5% of the total traffic. Data from corporations is the predominant traffic and it's growing at 30% to 40% per year and has done so for 30 years.

For Nortel this meant a brand new portfolio and we set about getting that and we also realized that not only would it require a new portfolio but it would probably require a new way of working with our customers. Our customers had to move fast and that the only way they could move fast would be to work with their vendors in a very different way. The traditional way of building telephone structures that we've evolved over the last 100 years would not move at the speed that the industry needs to move at if the industry is going to serve the demand that's coming from society. So it would mean a new way of partnering with their customers.

We termed the whole change inside Nortel 'the right angle turn' and it was quite a transformation. New portfolio, new way of doing business. I might point out that about 75 customers world-wide represent or account for 85% of Nortel's revenues. So this is a small select group of customers that we can partner with intimately, get to know, build lasting relationships that will carry us through many years.

In many ways, the relationship we have with our customers is almost more valuable to Nortel than the portfolio we carry. Because in today's world of fast-moving technology, products come and go but the relationships last for a long time. So it's that strength that has really helped propel Nortel forward. And the difference in style and attitude towards our customers has been remarked by customers around the world to me and the rest of Nortel staff.

We're now the leading infrastructure company in the world. We have the leading portfolio in the ability to help customers move from the world of voice to data. We spotted the fact that if data traffic was the predominant form of traffic, capacity on backbone networks would become a bottleneck. We moved on that and became the world leader in fibre optic systems that connect our cities together world-wide.

We also identified the fact that wireless was going to go to data as well and we were going to see the phenomenon we referred to as the wireless Internet. We are now the leader throughout Europe in supplying the core networks for the wireless Internet generation of networks that are coming up and that same technology is finding it's way here to North America.

The next big event that's coming up is following fibre optics deeper into the city. Today fibre optics is widely deployed between the major cities of the world. But within the cities the major buildings are not yet hooked up. That's a huge task. So there's huge market opportunity that will open in the coming years and this is the area where Nortel is focusing next.

Now during my past four years, we have doubled our revenues. When I became C.E.O. in 1997 our revenues were 15.7 billion dollars U.S. and we just capped last year at 30.3. Not only did we do that but we improved our rate of return from 4.3% in 1997 to 7.6% this year. So if you took the two together we've almost quadrupled our earnings over that period of time.

Now the job of C.E.O. is really to guide a company so that their company out-performs the market segment that they serve. If you can grow faster than the market, or faster than your peers, or faster than your global competitors, then you're doing your job. We do not really control what the stock markets do and I don't think anyone can invent rational reasons for why P.E. ratios move from 120 to 20 and buy and sell decisions and recommendations are made.

But I must say that what I set out to do four years ago I have largely achieved. Nortel today is the world leader in telecom infrastructure. It is the absolute world leader in moving ahead to help telephone companies around the world make the transition from voice to data. It is the world leader in all the hydro segments and as people look for where they want to invest in terms of long term growth and not be confused with day traders, then Nortel is one of the best positioned companies in the world by far and I dare you to make the comparison to any of our competitors.

That's the long-term position that Nortel has earned for itself and it's well positioned and this is a year that will be difficult. But in difficult times you can even do better improving your market share. But the reality is, there's a downturn in the market place. The market is not going to grow at 20% or 30%. It's growing much lower. Today we've noticed in the aftermath of our announcement, many people coming forward and actually saying, well we think maybe their calls in growth is still too optimistic. They might even be a little lower. So there's a whole wave of people looking to see, well what is the real growth rate of our industry going to be this year.

At this point in time the U.S. downturn is very hard to predict. It is going very quickly. It's going to last longer. And we need to be prepared.

So we felt it was only prudent to take the actions we did last week in terms of making sure that we adjust our workforce, that we can weather the storm properly, put our emphasis on the people and the talent that we need to move the company forward. And that's where Nortel will be. And we'll come out of this down turn even a stronger company than we went into it.