

## 2006: Alcatel-Lucent merger

### Abstract

The 2006 merger between Alcatel and Lucent Technologies will create the world's #1 networking equipment company.

This Enterprise Management Associates (EMA) Impact Brief discusses the implications of the merger on both companies' ongoing initiatives and their joint customer base among the world's leading service providers, from the Americas to EMEA to APAC and beyond. It focuses on the superior network management capabilities the merger will bring together under one roof. Finally, it assesses the impact on the merged entity's major competitors, such as Cisco and Nortel, and places it within the context of the overall network equipment market.

### Event

The new global company to be formed by the merger of Alcatel with Lucent Technologies, officially announced on April 2, 2006, creates the world's revenue leader among network equipment manufacturers and marks the first merger of a major U.S. networking equipment company with an entity headquartered outside the U.S.

It's a move that actually makes sense from both a regional and technological standpoint and will force competitors, from the weakened Nortel to the mighty Cisco, to make moves of their own in an effort to keep pace.

### Context

This merger creates what is now the world's revenue leader among network equipment manufacturers, with a presence in more than 130 countries and combined annual sales of \$25 billion (about 21 billion Euros) that controls approximately 20% of the global network equipment market. The new entity's combined revenues are higher than Cisco's latest FY (\$24.8 billion for FY ending July 30, 2005) and Ericsson's \$19.9 billion.

The move also marks the first merger of a major U.S.-based networking hardware company with one outside the U.S. Some market observers have hyped the formation of a "new trans-Atlantic telecom powerhouse," but the numbers tell a real and more dramatic tale of the tape that shows how these two hardware heavyweights' regional strengths are an ideal complement to each other. Lucent's largest revenue market traditionally has been the U.S., and its long-term success at places like NTT has made APAC another revenue stronghold. Not surprisingly, Alcatel has earned the majority of its revenues in EMEA. The new combined company will come out of the

gate earning the majority of its revenues outside EMEA with a much more balanced revenue picture region-by-region: 35% EMEA, 34% North America, 15% APAC and 16% ROW. In addition to NTT, Lucent's network deployments at service providers outside the Americas include China's Ministry of Posts & Telecommunications (MPT) and Telecom Italia. Alcatel's presence at major carriers outside EMEA includes BellSouth and SBC's Project Lightspeed, which, in light of AT&T Inc.'s \$67 billion bid for BellSouth, places Alcatel at ground zero of U.S. telecom power.

At YE2005, Alcatel and Lucent together had about 88,000 employees, and the new combined organization plans to save \$1.7 billion over three years mainly by laying off 10% of the global workforce.

### Key ramifications

#### Closes Each Company's OSS Gaps

The conventional wisdom is that network equipment manufacturers cannot deliver value in Operations and Business Support Systems (OSS/BSS) because hardware companies create software best (or solely) equipped to manage their own equipment, and even when their reach extends beyond their own gear they approach it strictly on an "aftermarkets" basis as an optional add-on to network equipment contracts.

The conventional wisdom holds true at least to the extent that these companies still focus on OSS not on its own merits but as an offering best seen as complementary/supplementary to networks based on Alcatel and Lucent equipment. Yet Lucent has been delivering OSS value for decades, and while Alcatel lagged the field for much of that time it has now come roaring to the head of the pack partly by bringing sumptuous solutions from third-party OSS providers to its training table.

Lucent critics point to the company's memorable foray into front-office (customer-facing) OSS that just as memorably crashed and burned. Its \$2 billion acquisition of Kenan Systems influenced other big iron players like Nortel Networks to similarly bulk up on software as part of an "end-to-end OSS" strategy, but the strategy failed. Lucent sold the Kenan assets (centered on the KenanFX billing system, formerly Kenan's Arbor BP) to CSG Systems for just \$300 million, and CSG sold those former Kenan assets to Comverse Technology for \$250 million. Nortel sold off its OSS assets, including its Architel business unit, to MetaSolv for \$35 million.

True enough. Yet despite that memorable miss, the OSS hits keep on coming:

- A Lucent (formerly AT&T Network Systems) OSS, Loop Management Operations System (LMOS), was introduced back in 1971 and—much like Trunk Inventory Record Keeping System (TIRKS), a Telcordia (formerly Bellcore) OSS of the same vintage—became one of the most widely-deployed OSSs in the world.
- Other Lucent systems have been hard at work in the PSTN, such as ITM for multivendor SONET management, ActiView for activation, NOC1, NetMinder/NTM for fault monitoring and management, ConnectVu for network provisioning, SARTS and TDIL for testing, and many more.
- Today Lucent has come full circle with its VitalSuite software, which EMA has previously assessed as an effective tool for optimizing VoIP, and VitalQIP, a tool for planning IP address strategy, which is a critical step in the readiness review before enterprises make the leap to VoIP. VitalSuite is deployed in wireline, mobile and converged networks as service providers look to capture the market opportunity for high-demand IP-based services.

VitalSuite network and application performance management solutions address the key network management challenges enterprises face when deploying VoIP. VitalNet, the core platform, collects granular statistics from SNMP-manageable devices and analyzes utilization, availability, and error statistics, validating service levels to ensure appropriately sized WAN circuits and PVCs. VitalART is a Web-based reporting tool that can generate customizable, presentation-quality reports and graphs built from VitalNet data. VitalApps is performance optimization and fault management software that monitors VoIP events and transactions from the desktop to the network/Internet destination server. This module relies on aggregation algorithms developed by Bell Labs, and embedded VitalAgent clients, to merge thousands of transactions into reports on overall system health and potential problems.

VitalQIP helps companies plan IP address strategies, then manage IP addresses for data networks, providing a centralized and automated solution for many IP management tasks associated with deploying VoIP. It also provides insight into the operation of the VoIP network, including cost accounting and asset management.

- Alcatel's ability to pull off a triple play is powered in part by Syndesis, which with its acquisition of CoManage offers triple-threat OSS (automated discovery, provisioning and activation) under one roof. The two companies first demonstrated the IPTV application of Alcatel's triple play OSS/BSS solution at TeleManagement World in 2005 and it is now housed

in the world's largest lab dedicated to triple play and IPTV: Alcatel's Plano, Texas-based OSS Integration Laboratory. More importantly, the companies' collaboration is at the heart of an increasing number of high-profile triple play and IPTV deployments across world regions.

Places Lucent's World-renowned Bench Strength And Systems Integration Prowess Under The Alcatel Umbrella.

- The French giant gains access to the most widely respected telecommunications R&D organization on the planet: Bell Labs. Currently Bell Labs has more than 10,500 employees, most of whom serve in R&D roles, and Alcatel's R&D organization actually has more, 15,600, so the combined R&D juggernaut will be more than 26,000 strong... unless or until those ranks are thinned by the impending layoffs
- Alcatel's strength has been in SONET in the U.S. and SDH in Europe. Similarly, Lucent has long been deployed to support wireline networks, but has moved well ahead of Alcatel in wireless. The ability to integrate the wireline PSTN with wireless networks is becoming a prerequisite for doing business with the world's largest service providers, and this merger will bring at least the potential to do so under one roof.
- Lucent is a formidable integration and outsourcing provider. Alcatel is not. Lucent had already landed one of the largest integration and outsourcing contracts in recorded history—its \$4 billion contract for the MOPTT of the Kingdom of Saudi Arabia—before continuing to power up with its \$3.7 billion acquisition of International Network Services (INS). Merging with Lucent adds full-featured systems integration and professional support organizations and revenue streams to Alcatel's product and financial portfolios.

Turns On The (IP)TV For Lucent.

Although it lags Lucent in several areas, Alcatel enjoys crystal-clear superiority in triple play networking and IPTV. Alcatel's recent IPTV and broadband entertainment network contract wins across North America and Europe include projects for:

- SBC, never one to throw money around without good cause (and better bench testing), which is spending \$1.7B over five years with Alcatel to bring to fruition SBC's Project Lightspeed. The project is intended to deliver integrated IPTV, high-speed broadband, IP voice and wireless services to 18 million households by YE2007.
- SaskTel, which is spending \$35M Canadian (approximately \$32M U.S.) to deploy an Alcatel triple play

solution to enhance Internet and entertainment services across Saskatchewan.

- Swisscom, for which Alcatel is deploying an IP broadband access network across Switzerland based on Alcatel's Intelligent Services Access Manager (ISAM) product family to deliver enhanced IPTV triple play services.
- Sistema Multi Media, which is deploying Alcatel to make IPTV a reality in Russia for the first time.

### Forces The Remaining Networking Giants To Make Similar Moves To Keep Pace.

On the wireless front, Cisco is already working with Nokia and others to drive enterprise adoption of services such as voice over WiFi. In the software arena, Cisco once prided itself on working with a constellation of OSS/network management vendor partners through the Cisco Ecosystem and appeared ready to enter that space in a visible and serious way through acquisitions of a number of those vendors in which it had taken sizable financial stakes. Yet Cisco, which lately has been consumed with expansion into other areas—including (laudably) shipping some of the market's first certified SOA-compatible network devices—has never achieved critical mass in OSS/NM, and has seen other vendors from Visionael to Lucent provide more robust management of “Cisco Powered Networks” than Cisco itself.

Once-mighty Nortel Networks is in disarray, with preliminary unaudited Y2005 losses of \$2.4 billion on revenues of \$10.8 billion. When Lucent “failed at OSS,” it really only lost its way in the front office—customer care and billing—and with VitalSuite and VitalQIP it is once again minting bankable network management solutions in today's currency: IP. When Nortel failed at OSS it dumped those assets lock-stock-and-barrel, leaving it with no software revenue backup plan when hardware sales faltered. Wireless equipment leaders Ericsson, Nokia and Motorola are all in strong financial positions and any of the three could make a move on Nortel to create similar synergy to the Alcatel-Lucent pairing (albeit not as financially viable).

Others, however, have better balance sheets than Nortel to offer a potential wireless suitor, including Juniper, Ciena and Tellabs. Juniper's \$3.4 billion 2004 acquisition of Netscreen gave it entrée into the security market and may make it the cleanest shot in an increasingly target-rich environment.

### EMA's perspective

In one sense, Alcatel's 2006 merger with Lucent Technologies could be viewed as simply more of the same. Virtually every corner of the technology marketplace has been rocked by

consolidation over the past five years, creating an aura of inevitability around the idea that every market will soon be controlled by two or three dominant players. Despite antitrust laws and lip service from the politicians and government agencies charged with enforcing them, the pace of acquisitions has continued unabated.

In reality, the Alcatel-Lucent merger is anything but more of the same. We believe it will have a profound effect on not only the network equipment space, but the entire communications marketplace. The first trans-Atlantic pairing of network equipment giants is a complementary fit that creates the world's #1 networking company with remarkable revenue balance across world regions. The new company will be a formidable competitor in any world region, and it will compete effectively not only in wireline but in high-growth IP and wireless networking.

The new company will be led by current Lucent CEO Patricia Russo, with Alcatel Chairman and CEO Serge Tchuruk becoming non-executive chairman [read: out of the line of power]. This is fitting because Lucent brings a bit more to this party than Alcatel: world-leading technological bench strength in Bell Labs and a vibrant integration and outsourcing business. Lucent's OSS arsenal spans most of the world's existing telephony networks, and its experience in OSS and network management spans the past four decades. With its VitalSuite and VitalQIP products, Lucent is not just riding but managing the market's next wave of rapidly-converging IP-based wireless and wireline broadband services.

That said, Alcatel did not exactly show up empty-handed to this merger. Its effectively-managed triple play/IPTV solutions have left Lucent and the rest of the market in the dust because they offer service providers—many of whom are now clamoring to transform themselves from “telcos” to “communications and entertainment providers”—total network deployment and delivery solutions. It's light-years from the days when network device makers rolled out hardware and element managers and left it largely to the telcos to pay Bellcore and a raft of OSS mini-mites to make sense of it all. Not only does this place Alcatel in the pole position as the world's networking giants race to win each new broadband entertainment network contract, it is also a major contributing factor in the level revenue-by-region performance that results from this pairing, as best exemplified by Alcatel's massive multi-year deal with SBC.

This won't be the last across-the-pond or cross-border marriage of networking giants, and we expect to see similar moves by #2 Cisco and #3 Ericsson within the next 10 months.



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