

CHIEF EXECUTIVE OFFICER'S MESSAGE

To our Shareholders:

As I write this first letter to you as President and CEO of Nortel, I am aware of the impact that the continuing global transformation of the telecommunications industry and the work to complete our financial restatement has had on our efforts to advance Nortel's growth and leadership position. It has been challenging; we strove in 2003 and continued over the past several months to reshape Nortel to be better positioned for a stronger future within the highly competitive and dynamic global telecom market and to regain our reputation as one of the world's most trusted corporate leaders.

I am very encouraged that the challenges of the past few years and our subsequent response is resulting in a global company that is becoming more focused, agile and better positioned to exploit the opportunities that lie ahead as our industry continues to consolidate, innovate and advance as a key influencer on global markets, industry sectors and citizens worldwide.

I am particularly proud to be part of this team of dedicated professionals who have given so much to our Company. My personal gratitude goes also to our customers who have continued to demonstrate their support for us and solidarity with our vision for both the industry and Nortel.

Turning the Page

The restatement of our 2003 financials is now complete. While the restatement process has been arduous, we were absolutely focused on ensuring it was done to the best of our abilities and that we could move forward with total confidence in our financial reporting. On behalf of the entire leadership team, let me reinforce that we are committed to achieving the highest standards of transparency and integrity and regaining the complete confidence and trust of all stakeholders. In 2005 this will continue to be one of our highest priorities. Let me highlight some of the initiatives currently underway to meet that goal.

- The executive compensation program has been revisited and financial accountability is now one of the primary performance criteria.
- As part of the overall plan to review, assess and enhance our finance organization and financial systems, including financial processes, procedures, training programs and organizational systems, Nortel has engaged Accenture.

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They will assist us in becoming a “best practices” organization including the introduction of SAP as the foundation of a new finance and operations system globally. While this will take 18-24 months to realize full potential, we will see incremental benefits throughout 2005.

- A Chief Ethics and Compliance Officer has been appointed and will report to the Chairman, Board of Directors and the President and CEO. An organization model and charter has been established and a “best practices” benchmarking study has been initiated to ensure that our activities in this area lead our industry.
- The Company has put in place a formal program to support compliance with Sarbanes-Oxley under the direction of the new position Vice President, Sarbanes-Oxley. The position is responsible for the documentation of internal control systems and processes over financial reporting, identification of key controls in these systems and processes, testing the performance of the key controls, evaluating the results of the testing including any weaknesses discovered, and establishment of remediation plans and implementation.
- The Company has introduced an ongoing training program for finance personnel globally led by our global finance governance team. The group’s activities are supported by our “U.S. GAAP Guidelines and Interpretations” intranet site launched in August 2004.
- The mandate of the Internal Audit function has also been modified to place a greater emphasis on the adequacy of, and compliance with procedures relating to internal control over financial reporting. An expert external advisor has been engaged to conduct a strategic review of the internal audit function with the objective of ensuring that this function continues to meet professional standards and moves towards audit best practices.

We are committed to achieving the highest standards of transparency and integrity.

Continued Technology Leadership

During the challenges of the past few years, we continued to foster our global innovation leadership because we believed that was the right decision for the Company’s future. 2003 saw that choice vindicated as Nortel was again recognized internationally for its leadership in Voice Over Packet, Multimedia Services and Applications, Wireless Data and Broadband Networking. These technologies

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work to transform our customers' networks, converging multiple networks into a robust, secure broadband network that is more efficient to operate and capable of supporting voice, data, multimedia wireline and wireless communications.

Nortel professionals were continually meeting with Enterprise and Service Provider customers in their own environments to more fully understand their challenges and how we could be a better listener and partner. Our vision of network transformation and the supporting technologies, resonated, resulting in new and strategically important key account wins and deeper relationships with existing customers globally.

Because of our heritage and technology leadership today we recognize that converged networks are the natural evolution from network transformation. Nortel was one of the industry's first players to describe network transformation, meaning private and public networks being transformed; becoming more powerful with a multipurpose infrastructure to deliver rich new network services and manage escalating traffic due to the dramatic increase in the past years in data communications. We saw network transformation unfolding as smarter, more intuitive private and public networks that are always on, accessible from anywhere and providing rich, multimedia offerings.

Network convergence takes this one step further as traditional network channels converge to allow enterprise users even greater mobility, productivity and cost efficiencies. For carriers it offers a whole new series of possibilities to introduce new revenue generating services to their customers and in turn enhance their own operating models. In both cases these networks are underpinned by high security and reliability. These characteristics have always been fundamental requirements for service provider networks and they are increasingly important to governments, defense interests and enterprises around the world. Nortel's strong heritage of managing networks and ensuring their reliability and security provides us with a particular advantage in meeting the demands of converged networks.

An Industry in Global Transition

Through 2003, the global telecommunications industry continued to react to what had been an unprecedented down cycle. Traditional industry business models were in transition with both private and public networks under pressure as network traffic increased dramatically without a proportional increase in revenue. At the same time historical voice communications services were challenged to generate sufficient revenues for reinvestment in upgrading and enhancing existing

networks. These technologies allow enterprises to invest in communications to deliver a profound productivity dividend without a corresponding increase in human labour input.

Globally, carriers then and today continue to face increasing volumes of traffic and mounting operating costs without commensurate revenue growth. Their challenge is to manage investment and drive out operating costs. Enterprises facing increasing growth in their traffic need to see distinct productivity improvements from the network capabilities they are deploying in order to drive substantial new network investment. Consequently, both Service Providers and Enterprises are seeking and will continue to seek new and creative approaches to increasing their networks' utility and value.

Network convergence is quickly becoming a reality as data, voice and multimedia come together on one network. These technological advances are challenging government regulators worldwide but we are encouraged by the intensity of interest and industry consultation that is taking place in many jurisdictions regarding the appropriate regulatory response to these exciting and disruptive technologies. At the same time, four years into the 21st century, the true benefit of communications is still unavailable to many in the world, particularly in the areas of healthcare, education and economic development. Consequently, I am emboldened and motivated by the responsibility that we have to help address these issues through our leadership in solutions innovation and engagement in helping to advise its many critical stakeholders.

In 2003, we also began to see the high growth of telecom services in markets such as India, Korea, China and Russia. Communications advances allowed these economies to literally leapfrog traditional industry cycles, delivering profound social, economic and political impact. These markets are not burdened by legacy network investments, meaning they are moving quickly to deploy highly affordable state of the art technologies which may not be adopted so readily elsewhere. For example, without the same access to universal broadband, communities in rural North America may over time find themselves on the wrong side of the digital divide.

We are confident that significant opportunities for growth exist across the marketplace but particularly in emerging markets as these customers evolve their current networks to high performance, converged networks. This global transformation also means that new powerful competitors are beginning to emerge, particularly from Asia, placing additional pressures on Nortel's operational cost structure.

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Fundamentally today's global communications industry is a very different one than it was only four years ago. We recognize our existing business model is not achieving the targeted operating or cost performance required within this aggressive environment and we are taking action.

Playing to Win

Today we are again in the process of reinventing Nortel. With the foundation of opportunity, passionate employees and consistently superior technologies, we have moved to introduce a strategic road map designed to focus on execution and performance and emphasize four areas in which to better serve both our enterprise and carrier customers. "Cash, cost and revenues" is a strategic imperative dedicated to driving the business forward with better cost management and cash generation. We intend to be well-positioned to exploit growth opportunities and maximize earnings. We cannot stand still.

**"Cash, costs and revenue"
is a strategic imperative.**

Operational Excellence – We have initiated a comprehensive review of our research and development function to ensure that we are receiving the maximum return on this critical investment. We have also targeted an overall significant further reduction of costs through tighter supply chain management, building on our earlier decision to divest the majority of our manufacturing operations to Flextronics so we can focus on our core competency of solutions innovation.

Work is also progressing well on completing Nortel's restructuring program that is designed to reduce costs and address current weaknesses in operating cost performance. This initiative alone has a target of \$500 million in savings.

Agility – We are focused on streamlining the organization to be more responsive to our customers' present and future priorities. Our customers don't think of their networks in segments so why should we? We've combined our optical, wireless and wireline businesses into one operation called carrier networks to take greater advantage of specific industry growth opportunities and better reflect our customers' organizational alignment, while at the same time improving our profit margins and enhancing cost efficiency. We've also realigned our research and development portfolio in a similar way so that our priorities are consistent with our customers. We are focusing on the needs of secure, converged networks meaning converged core capabilities, continued packetization of voice and multimedia IP services, the powerful services edge capability to realize simplification of customer network operations and broadband technologies including wireless and wireline. Around all of this we've wrapped security as a technological imperative.

Stronger Emphasis on Enterprise – We’ve also intensified our focus on solutions for our Enterprise customers in voice, data applications and convergence, as well as solutions and technology leadership in session initiated protocol (SIP) and voice and data IP.

Stronger Emphasis on Government Sector Globally – Modern networks are helping governments provide security, livelihood and welfare for their citizens. We see distinct opportunities for Nortel to provide the latest in network technology to meet these worldwide demands that citizens are placing on their governments. Secure and reliable voice, video and data communications are key for national and homeland defense, commerce, education, and health care. Nortel’s network technology leadership is well positioned globally to help governments meet their goals.

Renewed Professional Service Emphasis – Because of our heritage and long time relationships, our customers look to us not only as an equipment provider but also as an overall network expert. We believe there is a greater opportunity for us to deliver a distinct services offering to the marketplace and a team is currently dedicated to developing a work plan to bring an enhanced and distinct offering to market.

Best Brains – Nortel cannot achieve alone what needs to be accomplished in this highly complex and global industry as it has done in the past. We intend to aggressively seek out distinct partnerships and acquisitions that allow us to exploit opportunities with greater velocity and a stronger return on investment than we could achieve alone. Important work is being done in this area and the next several months should offer some exciting announcements.

Elevation of Corporate Marketing – We are the acknowledged industry leader in solutions innovation; however we need to support that strength with stronger marketing. The industry has been clear with me that that has been a weakness. It is one I am committed to addressing and you can look forward to seeing a confident and more dynamic expression of Nortel in the marketplace. As an early initiative, we recently launched a new branding campaign “This is the Way. This is Nortel” intended to capture the Company’s prominence and critical contribution to many aspects of business, government and society. It reinforces three main themes; the Company’s role in enhancing the human experience, igniting and powering global commerce and helping to secure and protect the world’s most critical information.

Finally, we recognize the profound impact our technologies are having around the world. We are committed to participating more actively through dialogue and direct initiatives with citizens, countries and other partners to ensure that

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telecommunications, and our solutions particularly, can be an authentic tool for societal transformation. I look forward to sharing more of this exciting new direction with you in the future.

Nortel is on the offense again. Competition will remain fierce; however the only way for Nortel to grow meaningfully is to build our market share at a greater speed than overall market growth. We are committed to taking the steps necessary to achieve this goal and improve our profitability and cash generation. Our plan is clear and we are focused on the future.

Nortel is poised for growth and renewed success, supported by a compelling vision already endorsed by customers worldwide.

A handwritten signature in black ink that reads "Bill Owens". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Bill Owens

President and Chief Executive Officer