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AGERE SYSTEMS INC

Form S-1

January 30, 2002

As filed with the Securities and Exchange Commission on January 30, 2002

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER THE SECURITIES ACT OF 1933

AGERE SYSTEMS INC.

(Exact name of registrant as specified in its charter)

| | | |
|---|---|--|
| Delaware | 3674 | 22-3746606 |
| (State or other jurisdiction of incorporation or organization) | (Primary Standard Industrial Classification Code Number) | (I.R.S. Employer Identification Number) |

555 Union Boulevard
Allentown, Pennsylvania 18109
(610) 712-4323

(Address, including zip code, and telephone number, including area code, of
registrant's principal executive offices)

Jean F. Rankin, Esq.
Senior Vice President and General Counsel
Agere Systems Inc.
555 Union Boulevard
Allentown, Pennsylvania 18109
(610) 712-4323

(Name, address, including zip code, and telephone number,
including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as
practicable after the effective date of this registration statement.

If any of the securities being registered on this Form are to be
offered on a delayed or continuous basis pursuant to Rule 415 under the
Securities Act of 1933, check the following box. []

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

CALCULATION OF REGISTRATION FEE

| Title of Each Class of Securities to be Registered | Proposed Maximum Aggregate Offering Price(1) | Amount of Registration F |
|--|--|--------------------------|
| Investment Units Consisting of % Senior Subordinated Notes due 2007 and Put Rights | \$200,000,000 | \$18,400 |

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 45

The registrant hereby amends this registration statement on such date or dates as may be determined until the registrant shall file a further amendment which specifically states that this registration statement become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement becomes effective on such date as the Securities and Exchange Commission, acting pursuant to said Section

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED JANUARY 30, 2002

PROSPECTUS

[logo]

400,000 Investment Units

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Consisting of
\$200,000,000 Principal Amount of
% Senior Subordinated Notes due 2007
and
Put Rights

Agere Systems Inc. is offering 400,000 investment units at a price of \$ per investment unit. Each investment unit consists of a % senior subordinated note in the principal amount of \$500 and put rights.

The notes will bear interest at the rate of % per year. Interest on the notes is payable on January 15 and July 15 of each year, beginning on July 15, 2002. The notes will mature on July 15, 2007. We may redeem the notes in whole but not in part at any time pursuant to a make-whole provision described under "Description of Notes--Optional Redemption."

The notes and the put rights will be unsecured senior subordinated obligations and will be subordinated in right of payment to all our existing and future senior debt, including our bank debt.

On July 15, 2007, or on an earlier date if accelerated, Agere Systems Inc. will pay the holder of a put right the amount, if any, by which \$ exceeds the average closing or sale price of a share of Agere common stock during the 20-trading day period preceding such date.

Investing in the investment units involves risks. See "Risk Factors" beginning on page 13.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

| | Per Investment Unit | Total |
|--------------------------------|---------------------|-------|
| Public Offering Price | \$ | \$ |
| Purchaser Discount | \$ | \$ |
| Proceeds to Agere Systems Inc. | \$ | \$ |

Interest on the notes will accrue from , 2002 to date of delivery.

We expect to deliver the investment units to the purchaser on or about , 2002.

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this

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prospectus.

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This prospectus contains trademarks, service marks and registered marks of Agere Systems Inc.

"SHARCS" is a service mark of Salomon Smith Barney Inc.

INDUSTRY DATA

In this document, we rely on and refer to information regarding the semiconductor market and its segments and competitors from Gartner Dataquest Alert: Communications Semiconductor and Optical Component Market Share in 2000, issued on June 11, 2001, analyst reports and other publicly available sources. Gartner Dataquest is not aware of and has not consented to being named in this document. Although we believe that this information is reliable, we have not independently verified the accuracy and completeness of this information.

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FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about the industry in which we operate, management's beliefs and assumptions made by management. Such statements include, in particular, statements about our plans, strategies and prospects under the headings "Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations", "Business" and "Recent Developments." Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. We do not have any intention or obligation to update publicly any forward-looking statements after we distribute this prospectus, whether as a result of new information, future events or otherwise.

The assumptions underlying the information on our market segments and product areas have been derived from information currently available to us. If any one or more of these assumptions are incorrect, actual market results may differ from those we expect. While we do not know what impact any such differences may have on our businesses, our future results of operations and financial condition may be materially adversely affected. In addition, we generally cannot assure you that the forward-looking information regarding our market segments and product areas will be achieved, whether or not the assumptions are correct. Conditions in our industry change rapidly and such information must be continually evaluated in light of then current conditions. For a description of recent changes in conditions in our industry, please see "Risk Factors--Risks Related to Our Business--The demand for products in our industry has recently declined, and we cannot predict the duration or extent of this trend."

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SUMMARY

The following is a summary of some of the information contained in this prospectus. In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in our notes discussed under "Risk Factors" and our combined and consolidated financial statements and notes to our combined and consolidated financial statements included elsewhere in this prospectus.

We describe in this prospectus the businesses contributed to us by Lucent Technologies Inc. as part of our separation from Lucent as if they were our businesses for all historical periods prior to Lucent's contribution to us of the assets and liabilities related to those businesses, which began on February 1, 2001. Please see "Arrangements Between Lucent and Our Company" for a description of this separation. Our historical financial results as part of Lucent contained in this prospectus may not reflect our financial results in the future as a stand-alone company or what our financial results would have been had we been a stand-alone company during the periods presented. Our fiscal year ends on September 30.

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AGERE SYSTEMS

Our Company

Agere Systems designs, develops and manufactures integrated circuits for use in a broad range of communications and computer systems and optoelectronic components for communications networks. We are the world leader in sales of communications components, which include both integrated circuits and optoelectronic components. Communications components are basic building blocks of electronic and photonic products and systems for terrestrial and submarine, or undersea, communications networks and for communications equipment. We had revenue of \$4,080 million and EBITDA, on an adjusted basis, of \$(96) million in fiscal 2001. EBITDA equals operating income (loss) plus depreciation and amortization expense. Adjusted EBITDA equals EBITDA plus purchased in-process research and development, restructuring and separation charges and impairment of goodwill and other acquired intangibles. EBITDA is not intended to represent cash flow or any other measure of performance or liquidity in accordance with generally accepted accounting principles. EBITDA is included here because we believe that you may find it to be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly-titled figures for other companies. As of September 30, 2001, we employed approximately 14,400 people worldwide. We have major research and development and manufacturing sites in the United States, Mexico, Singapore and Thailand.

We sell integrated circuits for use in a broad range of communications networks and computer equipment. Integrated circuits, or chips, are made using semiconductor wafers imprinted with a network of electronic components. They are designed to perform various functions such as processing electronic signals, controlling electronic system functions and processing and storing data. In fiscal 2001, we derived \$2,869 million, or 70% of our revenue, from sales of our integrated circuits segment.

We also sell active optoelectronic components to manufacturers of communications equipment. Optoelectronic components transmit, process, change, amplify and receive light that carries data and voice traffic over optical networks. Optical networks transmit information as pulses of light, or optical signals, through optical fibers, which are hair-thin glass strands. An optical network utilizes a number of interdependent active optoelectronic and passive optical components. An active component is a device that has both optical and electronic properties. A passive component is a device that functions only in the optical domain. In addition to our broad portfolio of active optoelectronic components, we have started to sell some passive components. In fiscal 2001, we derived \$1,211 million, or 30% of our revenue, from sales of our optoelectronic components.

Competitive Strengths

Integrated Circuits

Our integrated circuits combine a number of functions into a single unit or chip. Because of this integration, we have the ability to deliver products that interact more effectively and enhance performance. This allows our customers to meet the requirements of their end customers faster and more cost effectively than if they purchase a number of separate integrated circuits.

We have dedicated engineering groups that develop core manufacturing technology, common design methodology and commonly used integrated circuit design elements for use across our Integrated Circuits segment. By using common core technologies, we simplify our design methods, create reusable intellectual

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property and achieve manufacturing efficiencies.

We believe the primary considerations for customers selecting integrated circuit products are:

- o design capabilities, including the ability to deliver integrated solutions;

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- o performance, as measured by speed, power requirements and reliability;
- o feature set;
- o price;
- o flexibility, which refers to the ability to design products using the manufacturer's own intellectual property, the manufacturer's customers' intellectual property or a combination of both; and
- o compatibility with other products and communications standards used in communications networks.

We focus our product development and sales efforts to address the customer considerations listed above. The relative importance of these factors may vary depending on the product group or the particular customer's requirements. For example, price may be one of the most important considerations for a customer selecting many of our client access and network connectivity integrated circuits because these integrated circuits are used in price sensitive products sold to consumers. On the other hand, a customer selecting our network communications integrated circuits typically will be more focused on design and performance rather than price because these customers often have specialized demands that require customized solutions.

Optoelectronic Components

Our optoelectronic components are engineered to work together in an optical network. We sell integrated solutions that combine multiple components into a single product. We believe our integrated solutions allow our customers to reduce the size and costs of their optical network equipment and reduce their time to develop new products. We also believe these solutions allow our customers to rely on a smaller number of suppliers and improve the performance of their products.

We believe the primary considerations for customers selecting optoelectronic components are:

- o performance, as measured by speed, power requirements and reliability;
- o price;
- o breadth of product line and ability to offer integrated solutions;
- o quality and automation of manufacturing processes;

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- o manufacturing capacity, as measured by ability to satisfy orders; and
- o compatibility of products with other products and communications standards used in communications networks.

We focus our product development and sales efforts to address the customer considerations listed above. The relative importance of these factors may vary depending on the product group or the particular customer's requirements.

Our Strategy

We intend to maintain and enhance our position as the leading global provider of communications components. To accomplish this goal, we are pursuing the major strategies described below.

- o Focus on Future Growth and Profit Opportunities within the Communications Components Industry. We are focusing resources on segments of the market for integrated circuits and optoelectronics where we can leverage our existing technical skills, manufacturing capabilities and customer relationships, and where we believe there is long-term market growth and profit potential. We will particularly focus on the markets for network communications equipment and wireless local area networking products.
- o Expand and Develop New Customer Relationships. We seek to capitalize on our status as a stand-alone company to increase our sales by being selected to develop and supply components for our customers' new products. We seek to expand our engagements with existing and potential customers who have been reluctant to buy from us because they are competitors of Lucent.
- o Execute on Management Realignment and Restructuring. We have realigned our management structure to focus on the communications infrastructure and client systems markets. We will continue to implement a series of announced restructuring initiatives focused on improving gross profit, reducing expenses and streamlining operations within these segments.

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- o Extend Product and Technical Leadership. We are building on our product and technical leadership by continuing to work closely with our customers and making appropriate investments in research and development. Specific initiatives include:
 1. Integrated Solutions. We will continue to leverage our extensive communications systems experience and extensive product portfolio to provide integrated solutions for our customers. Our integrated solutions will provide customers with components and software for entire functions and subsystems so that customers can design and market higher performance products more quickly. We also support customers with technical product and systems understanding to help them use our products effectively.

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2. Combined Integrated Circuit and Optoelectronic Solutions. We believe that customers will increasingly demand combined integrated circuit and optoelectronic solutions in order to reduce the time and expense necessary to develop communications equipment. We will take advantage of our extensive experience, systems understanding and broad product portfolio in both integrated circuits and optoelectronics to capitalize on this market opportunity.

Our Relationship with Lucent

Agere was formed as part of Lucent Technologies' plan to spin-off to its stockholders its microelectronics business, including its integrated circuits and optoelectronics divisions. Our Class A common stock began trading on the New York Stock Exchange following our initial public offering in April 2001. The separation of our business from Lucent's other businesses was substantially completed, including the transfer of all assets and liabilities related to these divisions (other than pension and postretirement plan assets and liabilities, which have yet to be transferred) when we completed our initial public offering. As of December 1, 2001, Lucent owned 100% of our outstanding Class B common stock and 37 million shares of our Class A common stock, which together represented approximately 84.2% of the combined voting power of both classes of our voting stock with respect to the election and removal of directors and approximately 57.8% of the voting power of our outstanding common stock with respect to all other matters. Lucent has announced that it continues to move forward with its intention to distribute all shares of our common stock that it owns to its stockholders in a tax-free distribution. However, Lucent's credit facilities include conditions that must be satisfied before Lucent can distribute its Agere stock to its stockholders, and, even if the conditions were met, we cannot assure you that Lucent will complete the spin-off by a particular date or at all. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Overview--Separation from Lucent" and "Arrangements Between Lucent and Our Company" for further information about our spin-off as a fully independent company.

RECENT DEVELOPMENTS

Earnings

On January 23, 2002, we reported that revenues for the first quarter of fiscal 2002, ending December 31, 2001, were \$537 million, down approximately 10% from the September quarter. Reported net loss for the December quarter was \$375 million, or \$0.23 per share. Reported net loss for the September quarter was \$3,354 million, or \$2.05 per share, which included \$2,735 million in impairment of goodwill and other acquired intangibles.

Facility Consolidation

On January 23, 2002, we announced a number of initiatives to accelerate the implementation of our operating model. First, we announced our intention to sell our Orlando, Florida wafer fabrication facility. Second, we announced plans to consolidate nine existing manufacturing, research and development, business management and administrative facilities in Pennsylvania

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and New Jersey into our Allentown, Pennsylvania campus and one new R&D facility in central New Jersey. The Pennsylvania and New Jersey plans include the consolidation of:

- o all integrated circuit and optoelectronic wafer fabrication activities (currently located in Allentown, Breinigsville and Reading, Pennsylvania and Murray Hill, New Jersey) into our Allentown campus;
- o the majority of integrated circuit and optoelectronic assembly and test operations (currently located in Allentown, Breinigsville and Reading) to our facilities in Bangkok, Thailand; Matamoros, Mexico; and Singapore; all remaining assembly and test operations, primarily development operations, will be consolidated into our Allentown campus;
- o all research and development functions currently located in Pennsylvania into our Allentown campus; approximately one quarter of all research and development functions currently located in New Jersey will also be consolidated into our Allentown campus with the remaining New Jersey functions being consolidated into a new research and development facility in central New Jersey; and
- o all sales, administrative and other functions currently located in Pennsylvania and New Jersey into our Allentown campus.

The consolidation is expected to be completed in 12 to 18 months. When completed, the Pennsylvania and New Jersey consolidation actions will reduce floor space in the region by 50%, or approximately 2.0 million square feet, saving approximately \$100 million annually in cash. Total cash required for the consolidation actions is estimated to be between \$250 million and \$350 million. Non-cash charges associated with these activities have not yet been determined. Operations at our owned facilities in Breinigsville and Reading will be terminated and those facilities closed, and we will seek buyers for those properties. Five leased facilities will be vacated.

FPGA Sale

On January 18, 2002, we completed the sale of our Field-Programmable Gate Array, or FPGA, business to Lattice Semiconductor Corporation for \$250 million in cash. The transaction included our general-purpose ORCA(R) FPGA product portfolio, our field programmable system chip, or FPSC, product portfolio and all related software design tools. As part of the transaction, approximately 100 of our product development, marketing and technical sales employees joined Lattice.

Accounts Receivable Securitization

On January 24, 2002, we and certain of our subsidiaries entered into a securitization transaction relating to certain of our and their accounts receivable. As part of the transaction, we and certain of our subsidiaries transfer accounts receivable on a daily basis to a wholly-owned, bankruptcy-remote special purpose subsidiary which will be consolidated in our results. The special purpose subsidiary has entered into a loan agreement with certain financial institutions, pursuant to which the financial institutions agreed to make loans to the special purpose subsidiary secured by the accounts receivable. The financial institutions have commitments under the loan agreement of up to \$200 million; however the amount that we can actually borrow at any time depends on the amount and nature of the accounts receivable that we have transferred to the special purpose subsidiary. The loan agreement expires on January 21, 2003.

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Realignment

Effective October 1, 2001, we realigned our business operations into two market-focused groups, Infrastructure Systems and Client Systems, that target the network equipment and consumer communications markets, respectively. Each of these two groups is a reportable operating segment.

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The Infrastructure Systems segment is comprised of our former optoelectronics segment and portions of our former integrated circuits segment and facilitates the convergence of products from these businesses as we address markets in high-speed communications systems. We have consolidated research and development, as well as marketing, for optoelectronic and integrated circuit devices sold for use in communications systems. This more effectively allows us to design, develop and deliver complete, interoperable solutions to equipment manufacturers for advanced enterprise, access, metropolitan, long-haul and undersea applications.

The Client Systems segment consists of the remainder of our former integrated circuits segment and includes our wireless data, computer communications, storage and wireless terminal solutions products. This segment delivers semiconductor solutions for a variety of end-user applications such as modems, Internet-enabled cellular terminals and hard-disk drives for computers as well as software, systems and wireless local area network solutions through the ORiNOCO(TM) product family.

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THE OFFERING

We are offering 400,000 investment units at a price of \$ _____ per investment unit. Each investment unit consists of a % senior subordinated note in the principal amount of \$500 and put rights.

| | |
|----------------|--|
| Issuer..... | Agere Systems Inc. |
| Purchaser..... | SHARCS Trust I, a newly created Delaware trust that: <ul style="list-style-type: none">o it will also purchase shares of our common stock in private transactions or in the open market;o it will issue "SHARCS(sm) (Shared Appreciation Convertible Securities)," which are securities of the Company. |

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represent all of the beneficial interest

o holders of SHARCS will have the right
 certain events to exchange their SHARCS
 of the notes for the underlying notes and

This prospectus is not an offer to sell
 filed a registration statement with the
 Commission relating to the SHARCS.

Notes:

Notes offered..... \$200 million aggregate principal amount
 Subordinated Notes due 2007.

Maturity..... July 15, 2007.

Interest payment dates..... January 15 and July 15 of each year, commencing

Optional Redemption..... The notes will be redeemable in cash, at
 whole, but not in part, at a price equal to

o 100% of their principal amount plus accrued
 of redemption; and

o the sum of the present values of the remaining
 payments of principal and interest thereon on an
 annual basis, at the treasury rate plus accrued
 accrued interest to the date of redemption.

Ranking..... The notes will be our unsecured senior subordinated debt.
 The notes will rank:

o subordinate in right of payment to all existing and
 indebtedness, including our credit facilities;

o equal with any future senior subordinated debt;

o senior to any future junior subordinated debt.

Assuming we had completed this offering and the net proceeds
 applied the net proceeds as described in the prospectus,
 the notes would have been subordinated to approximately \$ million of senior indebtedness.

The notes will also be effectively subordinated to all existing and
 indebtedness and other liabilities of our company and our
 subsidiaries. The total balance sheet liabilities of our company and our
 subsidiaries were \$ million at , 2002.

Change of Control..... If a change of control occurs, we will be

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repurchase the notes at a repurchase price equal to the principal amount of the notes, plus accrued interest, if any, to the date of repurchase. A holder may exercise the right to require us to repurchase the notes if a change of control must first exchange its common stock for the notes and common stock are distributed to the holder will surrender all rights under the notes corresponding to such exchanged SHARCS, if any, previously accelerated. See "Description of Securities."

Material covenants.....

We will issue the notes under an indenture for the benefit of the holder or holders. Among other things, limit our ability to incur debt of restricted subsidiaries to:

- o incur additional debt;
- o pay dividends on stock, repurchase stock, or incur debt;
- o make investments;
- o create liens on the collateral;
- o sell assets;
- o sell capital stock of subsidiaries;
- o guarantee other indebtedness;
- o enter into agreements that restrict dividends of subsidiaries;
- o merge or consolidate or sell all or substantially all of our assets and liabilities and those of our subsidiaries;
- o enter into transactions with affiliates.

These covenants are subject to a number of exceptions and qualifications. See "Description of Securities - Covenants."

U.S. federal income tax considerations.....

The notes will be issued with original issue discount for federal income tax purposes. See "Certain Tax Consequences."

Absence of an established market for the notes.....

The notes are new securities and there is no established market for them. Initially, they will be owned by the issuer. We intend to apply for a listing of the notes on a national securities exchange and an automated dealer quotation system. According to you that a liquid market will develop for the notes if you who exchange their SHARCS early.

Trustee for the notes.....

Put Rights:

Put Rights.....

On July 15, 2007, we will pay to the trustee the amount, if any, by which the market price or sale price of a share of our common stock for the 10-day period preceding such date.

The trust may not transfer the put right
event that any SHARCS are exchanged earl

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of our common stock covered by the put o
us and the trust will be reduced by the
upon such exchange (without payment by e
occurrence of certain events, the put ri
"Description of Put Rights."

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RISK FACTORS

See "Risk Factors," which begins on page 13, for a discussion of
certain factors that you should consider in evaluating an investment in the
investment units.

Our principal executive offices are located at 555 Union Boulevard,
Allentown, Pennsylvania 18109. Our telephone number is (610) 712-4323. Our
World Wide Web site address is www.agere.com. Information contained in our
website is not incorporated by reference in this prospectus and, therefore, is
not part of this prospectus.

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SUMMARY HISTORICAL FINANCIAL INFORMATION

The following table sets forth our summary historical financial
information derived from our audited consolidated and combined financial
statements for the fiscal years ended September 30, 2001, 2000 and 1999
included elsewhere in this prospectus. This summary financial information may
not be indicative of our future performance as a stand-alone company. You
should read the summary financial information in conjunction with
"Management's Discussion and Analysis of Financial Condition and Results of
Operations," our consolidated and combined financial statements and the notes

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to our consolidated and combined financial statements included elsewhere in this prospectus.

| | ----- 2001 ----- (dollars in millions) |
|---|---|
| Statement of operations information: | |
| Revenue: | |
| Integrated circuits..... | \$ 2,869 |
| Optoelectronics..... | 1,211 |
| Total revenue..... | 4,080 |
| Costs..... | 3,084 |
| Gross profit..... | 996 |
| Operating expenses: | |
| Selling, general and administrative..... | 597 |
| Research and development..... | 951 |
| Purchased in-process research and development..... | -- |
| Amortization of goodwill and other acquired intangibles..... | 415 |
| Restructuring and separation..... | 662 |
| Impairment of goodwill and other acquired intangibles..... | 2,762 |
| Total operating expenses..... | 5,387 |
| Operating income (loss)..... | (4,391) |
| Cumulative effect of accounting change (net of provision (benefit) for income taxes)..... | (4) |
| Net income (loss)..... | (4,616) |
| Other financial data: | |
| Ratio of earnings to fixed charges(1)..... | n/a |
| Deficiency(1)..... | \$ 4,553 |
| Supplemental financial data: | |
| EBITDA(2)..... | \$ (3,520) |
| Adjusted EBITDA(3)..... | (96) |

The "as adjusted" information is derived from data contained in our historical financial statements. The adjustments are necessary to give pro forma effect to (1) the amendment of the credit facility, and the repayment of \$1,000 million of the credit facility, on October 4, 2001 and (2) the issuance and sale of the investment units and the proceeds therefrom as described under "Use of Proceeds" as if such transactions had occurred as of September 30, 2001.

| | September 30, 2001 | |
|---------------------------------|---|--|
| | ----- Historical ----- (dollars in millions) | As adjusted ----- ----- ----- |
| Balance sheet information: | | |
| Cash..... | \$ 3,152 | \$ |
| Working capital..... | 156 | |
| Total assets..... | 6,562 | |
| Short-term debt..... | 2,516 | |
| Long-term debt..... | 33 | |
| Total stockholders' equity..... | 2,461 | |

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- (1) For purposes of determining the ratio of earnings to fixed charges, "earnings" are defined as income (loss) from continuing operations before income taxes less undistributed earnings of equity investments plus fixed charges less interest capitalized during the period. "Fixed charges" consist of interest expense on all indebtedness and that portion of operating lease rental expense that is representative of the interest factor. "Deficiency" is the amount by which fixed charges exceeded earnings in fiscal 2001.

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- (2) EBITDA equals operating income (loss) plus depreciation and amortization expense. EBITDA is not intended to represent cash flow or any other measure of performance or liquidity in accordance with generally accepted accounting principles. EBITDA is included here because we believe that you may find it to be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly- titled figures for other companies.
- (3) The calculation of adjusted EBITDA is shown below:

| | Historical Year Ended September 30, | | |
|--|---|---------|--------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| | (dollars in millions) | | |
| EBITDA..... | \$(3,520) | \$ 822 | \$ 877 |
| Purchased in-process research and development..... | -- | 446 | 17 |
| Restructuring and separation..... | 662 | -- | -- |
| Impairment of goodwill and other acquired intangibles. | 2,762 | -- | -- |
| | ----- | ----- | ----- |
| Adjusted EBITDA..... | \$ (96) | \$1,268 | \$ 894 |
| | ===== | ===== | ===== |

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RISK FACTORS

An investment in the investment units is subject to a number of risks. You should carefully consider the following risk factors and all the other information contained in this prospectus before investing in our investment units.

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RISKS RELATED TO OUR SEPARATION FROM LUCENT

WE WILL BE CONTROLLED BY LUCENT AS LONG AS IT OWNS A MAJORITY OF OUR COMMON STOCK, AND OUR OTHER STOCKHOLDERS WILL BE UNABLE TO AFFECT THE OUTCOME OF STOCKHOLDER VOTING DURING THAT TIME.

Lucent is our controlling stockholder because it owns a majority of our common stock. Because Lucent's interests may differ from ours, actions Lucent takes with respect to us, as our controlling stockholder, may not be favorable to us.

Lucent's interests may not be the same as, or may conflict with, the interests of our other stockholders. Our other stockholders will not be able to affect the outcome of any stockholder vote so long as Lucent owns a majority of our common stock.

Lucent is generally not prohibited from selling a controlling interest in us to a third party. Because we have elected not to be subject to Section 203 of the General Corporation Law of the State of Delaware, Lucent, as a controlling stockholder, may find it easier to sell its controlling interest to a third party than if we were subject to Section 203.

THE TIMING AND MANNER OF OUR SEPARATION FROM LUCENT ARE UNCLEAR AND MAY NOT OCCUR, AND WE MAY NOT ACHIEVE MANY OF THE EXPECTED BENEFITS OF OUR SEPARATION, SO WE MAY LOSE MANY OF OUR EMPLOYEES AND OUR BUSINESS MAY SUFFER.

We believe that the announcement of our separation from Lucent led to an increased interest in doing business with us from some of our existing and potential customers. If the distribution of all shares of our common stock that Lucent owns to its stockholders does not occur, then these customers may not increase or commence purchases of our products. Many of our existing employees are anticipating our spin-off from Lucent and may be more susceptible to competitive job offers if the distribution does not occur or is delayed. We also may not obtain some of the other benefits we expect as a result of this distribution, including greater strategic focus and increased agility and speed. Further, even if the distribution occurs, we may not achieve the benefits of our separation. In addition, until the distribution occurs, the risks relating to Lucent's control of us and the potential business conflicts of interest between Lucent and us will continue to be relevant to our stockholders.

WE MAY HAVE POTENTIAL BUSINESS CONFLICTS OF INTEREST WITH LUCENT WITH RESPECT TO OUR PAST AND ONGOING RELATIONSHIPS AND, BECAUSE OF LUCENT'S CONTROLLING OWNERSHIP, THE RESOLUTION OF THESE CONFLICTS MAY NOT BE ON THE MOST FAVORABLE TERMS TO US.

Prior to the distribution, a resolution of any potential conflicts of interest between Lucent and us may be less favorable to us than if we were dealing with an unaffiliated party. Conflicts of interest may arise between Lucent and us in a number of areas relating to our past and ongoing relationships, including:

- o the nature, quantity, quality, time of delivery and pricing of products we supply to each other under, and other issues arising under, our product purchase agreements with Lucent;
- o labor, tax, employee benefit, indemnification and other matters arising from our separation from Lucent;
- o intellectual property matters;
- o employee recruiting and retention;

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- o sales or distributions by Lucent of all or any portion of its ownership interest in us, which could be to one of our competitors; and
- o business opportunities that may be attractive to both Lucent and us.

We and Lucent have entered into several agreements in connection with our separation, as described in "Arrangements Between Lucent and Our Company." While we are controlled by Lucent, it is possible for Lucent to cause us to amend these agreements on terms that may be less favorable to us than the current terms of the agreements.

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OUR HISTORICAL FINANCIAL INFORMATION PRIOR TO THE FEBRUARY 1, 2001 CONTRIBUTION TO US OF OUR BUSINESS FROM LUCENT MAY NOT BE REPRESENTATIVE OF OUR RESULTS AS A STAND-ALONE COMPANY AND, THEREFORE, MAY NOT BE RELIABLE AS AN INDICATOR OF OUR HISTORICAL OR FUTURE RESULTS.

Our historical consolidated and combined financial statements may not be indicative of our future performance as a stand-alone company. This is primarily a result of the three factors described below.

- o First, our historical consolidated and combined financial statements reflect allocations, primarily with respect to general corporate expenses, research expense and interest expense, which may be less than the expenses we will incur in the future as a stand-alone company.
- o Second, the information does not reflect significant changes that we expect to occur in the future as a result of our separation from Lucent, including changes in how we fund our operations, conduct research and handle tax and employee matters.
- o Third, our historical consolidated and combined financial statements include substantial revenue from sales to Lucent. This revenue may not reflect the pricing, volume or percentage of our sales we would have derived from Lucent if we were a stand-alone company.

BECAUSE LUCENT'S BELL LABORATORIES' CENTRAL RESEARCH ORGANIZATION HISTORICALLY PERFORMED IMPORTANT RESEARCH FOR US, WE MUST CONTINUE TO DEVELOP OUR OWN CORE RESEARCH CAPABILITY. WE MAY NOT BE SUCCESSFUL, WHICH COULD MATERIALLY HARM OUR PROSPECTS AND ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

If our separate research efforts are not as successful as when we were part of Lucent, we may not be able to keep pace with the rapid technological change in our industry and our prospects may be harmed. Many of our products use technology and manufacturing processes derived from innovations developed by Lucent's Bell Laboratories central research organization. After the contribution to us of our business in February 2001, Lucent has no obligation to provide research and development for us except as agreed to in the development project agreement and joint design center operating agreement described under "Arrangements Between Lucent and Our Company." We cannot assure you that our independent research efforts will be as successful as the efforts of Bell Laboratories have been historically or that our efforts will not require us to increase our expenditures for the same services over the amounts in our

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historical combined and consolidated financial statements. A significant increase in our expenditures for the same services may adversely affect our results of operations. We may not be able to recruit engineers and other research and development employees as effectively as Bell Laboratories was able to because of its history, name recognition and size.

MANY OF OUR EXECUTIVE OFFICERS AND SOME OF OUR DIRECTORS MAY HAVE CONFLICTS OF INTEREST BECAUSE OF THEIR OWNERSHIP OF LUCENT COMMON STOCK AND OTHER TIES TO LUCENT.

Many of our executive officers and some of our directors, including the Lucent-representative directors who we expect will resign at the time of the distribution, have a substantial amount of their personal financial portfolios in Lucent common stock and options to purchase Lucent common stock. Ownership of Lucent common stock or options to purchase Lucent common stock by our directors and officers could create, or appear to create, potential conflicts of interest when directors and officers are faced with decisions that could have different implications for Lucent and us.

WE COULD INCUR SIGNIFICANT TAX LIABILITY IF LUCENT FAILS TO PAY THE TAX LIABILITIES ATTRIBUTABLE TO LUCENT UNDER OUR TAX SHARING AGREEMENT, WHICH COULD REQUIRE US TO PAY A SUBSTANTIAL AMOUNT OF MONEY.

We and Lucent have entered into a tax sharing agreement that allocates responsibility for tax liabilities between us and them. For a discussion of this agreement, please see "Arrangements Between Lucent and Our Company--Tax Sharing Agreement." Under U.S. federal income tax laws, we and Lucent are jointly and severally liable for Lucent's federal income taxes attributable to periods prior to and including the most recent taxable year of Lucent, which ended on September 30, 2001. This means that if Lucent fails to pay the taxes attributable to it under the tax sharing agreement for those periods, we may be liable for any part of, including the whole amount of, these liabilities.

BECAUSE THE DIVISION OF ENFORCEMENT OF THE SECURITIES AND EXCHANGE COMMISSION IS INVESTIGATING MATTERS BROUGHT TO ITS ATTENTION BY LUCENT, OUR BUSINESS MAY BE AFFECTED IN A MANNER WE CANNOT FORESEE AT THIS TIME.

On November 21, 2000, and again on December 21, 2000, Lucent brought to the attention of the staff of the Securities and Exchange Commission matters relating to its recognition of revenue. Lucent also publicly disclosed these matters in press releases on those dates. Although Lucent has informed us that it has no reason to believe that this investigation by the Division of Enforcement of the Securities and Exchange Commission into these matters concerns our business and we are not aware of any reason why the investigation would affect us, it is possible that the results of the investigation may have an impact on us. Although the investigation could result in no action being taken by the Securities and Exchange Commission, if an action is taken and the investigation is found to concern our business, the action could result in monetary fines or changes in some of our financial and other practices and procedures that we are unable to foresee

at this time.

RISKS RELATED TO OUR BUSINESS

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THE DEMAND FOR PRODUCTS IN OUR INDUSTRY HAS RECENTLY DECLINED, AND WE CANNOT PREDICT THE DURATION OR EXTENT OF THIS TREND. SALES OF OUR INTEGRATED CIRCUITS AND OPTOELECTRONIC COMPONENTS ARE DEPENDENT ON THE GROWTH OF COMMUNICATIONS NETWORKS.

We derive, and expect to continue to derive, a significant amount of revenue from the sale of integrated circuits and optoelectronic components used in optical, wired and wireless communications networks. The current economic downturn has resulted in reduced purchasing in many of the markets we serve worldwide. In particular, the communications equipment industry is currently in a cycle characterized by diminished product demand, excess manufacturing capacity and the erosion of average selling prices. If the long-term growth in demand for communications networks does not occur as we expect, the demand for many of our integrated circuits and optoelectronic components may decline or grow more slowly than we expect. As a result, we may not be able to grow our business and our revenue may decline from current levels.

BECAUSE WE EXPECT TO CONTINUE TO DERIVE A MAJORITY OF OUR REVENUE FROM INTEGRATED CIRCUITS AND THE INTEGRATED CIRCUITS INDUSTRY IS HIGHLY CYCLICAL, OUR REVENUE MAY FLUCTUATE.

We expect to continue to derive a majority of our revenue from integrated circuits products. Because the integrated circuits market segment is highly cyclical, we may have declines in our revenue that are primarily related to industry conditions and not our products. This market segment has experienced significant downturns, often in connection with, or in anticipation of, excess manufacturing capacity worldwide, maturing product cycles and declines in general economic conditions, and we are currently experiencing such a downturn.

IF WE DO NOT COMPLETE OUR ANNOUNCED WORKFORCE REDUCTIONS AND OTHER RESTRUCTURING AND CONSOLIDATION ACTIVITIES AS EXPECTED OR EVEN IF WE DO SO, WE MAY NOT ACHIEVE ALL OF THE EXPENSE REDUCTIONS WE ANTICIPATE.

Our business has been experiencing lower revenues due to decreased and canceled customer orders. Revenue has declined over the past five quarters. During calendar 2001 and the first quarter of fiscal 2002, we announced a series of restructuring initiatives to align Agere with current market conditions. These initiatives are focused on improving gross profit, reducing expenses and streamlining operations. These restructuring initiatives include a worldwide workforce reduction, rationalization of manufacturing capacity and other restructuring initiatives. In addition, we recently announced our intention to consolidate our operations at a number of facilities. If we do not complete these workforce reductions and other restructuring and consolidation activities as expected or even if we do so, we may not achieve all of the expense reductions we anticipate.

OUR QUARTERLY REVENUE AND OPERATING RESULTS MAY VARY SIGNIFICANTLY IN FUTURE PERIODS DUE TO THE NATURE OF OUR BUSINESS.

Our quarterly revenue and income (loss) from operations may vary significantly from quarter to quarter because of the nature of our revenue and planned product introductions. For example, because of our lengthy sales and design processes, the effects of failing to be selected by a customer to provide a product may result in significantly lower revenue later, as compared to prior periods with more revenue from earlier design wins. In addition, sales of our products for specific customer projects often begin and end abruptly, so revenue may increase rapidly and later decrease just as quickly. The relative timing of the beginning and end of our sales and design processes can make our revenues less predictable.

IF WE FAIL TO KEEP PACE WITH TECHNOLOGICAL ADVANCES IN OUR INDUSTRY OR IF WE PURSUE TECHNOLOGIES THAT DO NOT BECOME COMMERCIALY ACCEPTED, CUSTOMERS MAY NOT

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BUY OUR PRODUCTS AND OUR REVENUE MAY DECLINE.

The demand for our products can change quickly and in ways we may not anticipate because our industry is generally characterized by:

- o rapid, and sometimes disruptive, technological developments;
- o evolving industry standards;
- o changes in customer requirements;
- o limited ability to accurately forecast future customer orders;
- o frequent new product introductions and enhancements; and
- o short product life cycles with declining prices over the life cycle of the product.

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If we fail to make sufficient investments in research and development programs in order to develop new and enhanced products and solutions, or if we focus on technologies that do not become widely adopted, new technologies could render our current and planned products obsolete, resulting in the need to change the focus of our research and development and product strategies and disrupting our business significantly.

BECAUSE MANY OF OUR CURRENT AND PLANNED PRODUCTS ARE HIGHLY COMPLEX, THEY MAY CONTAIN DEFECTS OR ERRORS THAT ARE DETECTED ONLY AFTER DEPLOYMENT IN COMMERCIAL COMMUNICATIONS NETWORKS AND IF THIS OCCURS, IT COULD HARM OUR REPUTATION AND RESULT IN INCREASED EXPENSE.

Our products are highly complex and may contain undetected defects, errors or failures. These products can only be fully tested when deployed in commercial communications networks and other equipment. Consequently, our customers may discover errors after the products have been deployed. The occurrence of any defects, errors or failures could result in:

- o cancelation of orders;
- o product returns, repairs or replacements;
- o diversion of our resources;
- o legal actions by our customers or our customers' end-users;
- o increased insurance costs; and
- o other losses to us or to our customers or end users.

Any of these occurrences could also result in the loss of or delay in market acceptance of our products and loss of sales, which would harm our business and adversely affect our revenue and results of operations. We have from time to time experienced defects and expect to experience defects in the future. Because the trend in our industry is moving toward even more complex products in the future, this risk will intensify over time.

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OUR PRODUCTS AND TECHNOLOGIES TYPICALLY HAVE LENGTHY DESIGN AND DEVELOPMENT CYCLES. A CUSTOMER MAY DECIDE TO CANCEL OR CHANGE ITS PRODUCT PLANS, WHICH COULD CAUSE US TO GENERATE NO REVENUE FROM A PRODUCT AND ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

We may never generate any revenue from our products after incurring significant design and development expenditures. A delay or cancelation of a customer's plans could significantly adversely affect our financial results. Unlike some of our competitors, we primarily focus on winning competitive selection processes to develop products for use in our customers' equipment. These selection processes can be lengthy. After winning and beginning a product design for a customer, that customer may not begin volume production of their equipment for a period of up to two years, if at all. Due to this lengthy design and development cycle, we may experience delays from the time we begin incurring expenses until the time we generate revenue from our products. We have no assurances that our customers will ultimately market and sell their equipment or that such efforts by our customers will be successful.

BECAUSE OUR SALES ARE CONCENTRATED ON LUCENT AND A FEW OTHER CUSTOMERS, OUR REVENUE MAY MATERIALLY DECLINE IF ONE OR MORE OF OUR KEY CUSTOMERS DO NOT CONTINUE TO PURCHASE OUR EXISTING AND NEW PRODUCTS IN SIGNIFICANT QUANTITIES.

Our customer base is highly concentrated. Our top ten end customers accounted for approximately 53% of our revenue in fiscal 2001. If any one of our key customers decides to purchase significantly less from us or to terminate its relationship with us, our revenue may materially decline. Because our strategy has generally been to develop long-term relationships with a few key customers in the product areas in which we focus and we have a long product design and development cycle for most of our products, we may be unable to replace these customers quickly or at all. We could lose our key customers or significant sales to our key customers because of factors beyond our control, such as a significant disruption in our customers' businesses generally or in a specific product line.

In particular, we depend on Lucent as a key customer. We derived 14.9% of our revenue from sales to Lucent in fiscal 2001. We expect to continue to be dependent on Lucent for a significant percentage of our revenue.

IF WE FAIL TO ATTRACT, HIRE AND RETAIN QUALIFIED PERSONNEL, WE MAY NOT BE ABLE TO DEVELOP, MARKET OR SELL OUR PRODUCTS OR SUCCESSFULLY MANAGE OUR BUSINESS.

In some fields, there are only a limited number of people in the job market with the requisite skills, particularly people with optoelectronic technology expertise. We have in the past experienced difficulty in identifying and hiring qualified engineers in many areas of our business as well as in retaining our current employees. The loss of the services of any key personnel or our inability to hire new personnel with the requisite skills could restrict our ability to develop new products or enhance existing products in a timely manner, sell products to our customers or manage our business effectively.

BECAUSE WE ARE SUBJECT TO ORDER AND SHIPMENT UNCERTAINTIES, ANY SIGNIFICANT CANCELLATIONS OR DEFERRALS COULD CAUSE OUR REVENUE TO DECLINE OR FLUCTUATE.

We generally sell products pursuant to purchase orders that customers

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may cancel or defer on short notice without incurring a significant penalty. Cancellations or deferrals could cause us to hold excess inventory, which could adversely affect our results of operations and restrict our ability to fund our operations. If a customer cancels or defers product shipments, we may incur unanticipated reductions or delays in our revenue. If a customer refuses to accept shipped products or does not timely pay for these products, we could incur significant charges against our income, which could materially and adversely affect our operating results.

WE DEPEND ON SOME SINGLE SOURCES OF SUPPLY, PARTICULARLY FOR OUR OPTOELECTRONIC COMPONENTS, AND INTERRUPTIONS AFFECTING THESE AND OTHER SUPPLIERS COULD DISRUPT OUR PRODUCTION, COMPROMISE OUR PRODUCT QUALITY AND CAUSE OUR REVENUE TO DECLINE.

We depend on a single source supplier for several different parts used to make some of our optoelectronic components. Some of these single source suppliers also are competitors of ours. In some of these cases, there is no qualified alternative supplier for these parts or processes and qualifying new suppliers could require a substantial lead time. The loss of any of these or other significant suppliers or the inability of a supplier to meet performance and quality specifications or delivery schedules could cause our revenue to significantly decline.

IF WE DO NOT ACHIEVE ADEQUATE MANUFACTURING UTILIZATION, YIELDS, VOLUMES OR SUFFICIENT PRODUCT RELIABILITY, OUR GROSS MARGINS WILL BE REDUCED.

Because the majority of our manufacturing costs are relatively fixed, efficient utilization of manufacturing facilities and manufacturing yields are critical to our results of operations. Some of our manufacturing facilities have been underutilized, which has reduced our gross margins. Lower than expected manufacturing yields could impair our gross margins and delay product shipments.

In the event of an increase in demand, failure to increase our manufacturing volumes to meet our customers' increasing needs and satisfy customer demand will have a significant effect on our gross margins. In some cases, existing manufacturing capacity may be insufficient to achieve the volume or cost targets of our customers.

The manufacture of our products involves highly complex and precise processes, requiring production in highly controlled and clean environments. Changes in our manufacturing processes or those of our suppliers or contractors, or their inadvertent use of defective or contaminated materials, could significantly reduce our manufacturing yields and product reliability.

WE HAVE RELATIVELY HIGH GROSS MARGIN ON THE REVENUE WE DERIVE FROM THE LICENSING OF OUR INTELLECTUAL PROPERTY, AND A DECLINE IN THIS REVENUE WOULD HAVE A GREATER IMPACT ON OUR NET INCOME THAN A DECLINE IN REVENUE FROM OUR INTEGRATED CIRCUITS AND OPTOELECTRONIC PRODUCTS.

The revenue we generate from the licensing of our intellectual property has a high gross margin compared to the revenue we generate from our integrated circuits and optoelectronic products. A decline in this licensing revenue would have a greater impact on our profitability than a similar decline in revenues from our integrated circuits and optoelectronic products.

WE DEPEND ON JOINT VENTURES OR OTHER THIRD-PARTY STRATEGIC RELATIONSHIPS FOR THE MANUFACTURE OF SOME OF OUR PRODUCTS, ESPECIALLY INTEGRATED CIRCUITS. IF THESE MANUFACTURERS ARE UNABLE TO FILL OUR ORDERS ON A TIMELY AND RELIABLE BASIS, OUR REVENUE MAY DECLINE.

We currently manufacture our integrated circuits and optoelectronic components through a combination of internal capability, joint ventures and external sourcing with contract manufacturers. To the extent we rely on joint

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ventures and third-party manufacturing relationships, especially with respect to integrated circuits, we face the following risks:

- o their inability to develop manufacturing methods appropriate for our products;
- o that the manufacturing costs will be higher than planned;
- o that the reliability of our products will decline;
- o their unwillingness to devote adequate capacity to produce our products;
- o their inability to maintain continuing relationships with our suppliers; and
- o the reduction of our control over delivery schedules and costs of our products.

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If any of these risks is realized, we could experience an interruption in supply or an increase in costs, which could delay or decrease our revenue or adversely affect our results of operations.

IF OUR CUSTOMERS DO NOT QUALIFY OUR MANUFACTURING LINES FOR VOLUME SHIPMENTS, OUR REVENUE MAY BE DELAYED OR REDUCED.

Customers will not purchase any of our products, other than limited numbers of evaluation units, prior to qualification of the manufacturing line for the product. We may not always be able to satisfy the qualifications. Delays in qualification can cause a customer to discontinue use of the product and result in a significant loss of revenue.

BECAUSE INTEGRATED CIRCUIT AND OPTOELECTRONIC COMPONENT AVERAGE SELLING PRICES IN PARTICULAR PRODUCT AREAS ARE DECLINING AND SOME OF OUR OLDER PRODUCTS ARE BECOMING OBSOLETE, OUR RESULTS OF OPERATIONS MAY BE ADVERSELY AFFECTED.

We have in the past, and will in the future, experience declines in the average selling prices for some of our integrated circuits and optoelectronic components. For our products, the declines are due to, among other things, downturns in the semiconductor and communications industries, increased competition, lower costs of producing products and greater unit volumes. In addition, because our industry is characterized by rapid technological change and short product life cycles, in any given year we may have a substantial amount of revenue from products that are becoming obsolete. We may experience substantial decreases in sales of these products in subsequent years.

If we do not offset these decreases by increases in our sales of other products, including new products, that can be sold at higher prices, our revenue will decline, which will have a material adverse effect on our results of operations.

WE CONDUCT A SIGNIFICANT AMOUNT OF OUR SALES ACTIVITY AND MANUFACTURING EFFORTS OUTSIDE THE UNITED STATES, WHICH SUBJECTS US TO ADDITIONAL BUSINESS RISKS AND MAY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS DUE TO INCREASED COSTS.

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In fiscal 2001, we derived 55% of our revenue from sales of our products shipped to locations outside the United States. We also manufacture a significant portion of our products outside the United States and are dependent on international suppliers for many of our parts. We intend to continue to pursue growth opportunities in both sales and manufacturing internationally. International operations are subject to a number of risks and potential costs, which could adversely affect our revenue and results of operations, including:

- o our new brand will not be locally recognized, which will cause us to spend significant amounts of time and money to build a brand identity;
- o unexpected changes in regulatory requirements;
- o inadequate protection of intellectual property in some countries outside of the United States;
- o currency exchange rate fluctuations; and
- o political and economic instability.

WE ARE SUBJECT TO ENVIRONMENTAL, HEALTH AND SAFETY LAWS, WHICH COULD INCREASE OUR COSTS AND RESTRICT OUR OPERATIONS IN THE FUTURE.

We are subject to a variety of laws relating to the use, disposal, clean-up of, and human exposure to, hazardous chemicals. Any failure by us to comply with present and future environmental, health and safety requirements could subject us to future liabilities or the suspension of production. In addition, compliance with these or future laws could restrict our ability to expand our facilities or require us to acquire costly pollution control equipment, incur other significant expenses or modify our manufacturing processes. In the event of the discovery of additional contaminants or the imposition of additional cleanup obligations at these or other sites, we could be adversely affected.

THE COMMUNICATIONS COMPONENT INDUSTRY IS INTENSELY COMPETITIVE, AND OUR FAILURE TO COMPETE EFFECTIVELY COULD HURT OUR REVENUE.

The market segments for optoelectronic components and integrated circuits are intensely competitive and subject to rapid and disruptive technological change. We expect the intensity of competition to continue to increase in the future as existing competitors enhance and expand their product offerings and as new participants enter the market. Increased competition may result in price reductions, reduced gross margins and loss of market share. We cannot assure you that we will be able to compete successfully against existing or future competitors, which may hurt our revenue.

WE MAY BE SUBJECT TO INTELLECTUAL PROPERTY LITIGATION AND INFRINGEMENT CLAIMS, WHICH COULD CAUSE US TO INCUR SIGNIFICANT EXPENSES OR PREVENT US FROM SELLING OUR PRODUCTS. IF WE ARE UNABLE TO PROTECT OUR INTELLECTUAL PROPERTY RIGHTS, OUR BUSINESSES AND PROSPECTS MAY BE HARMED.

Like other companies in the semiconductor industry, we experience

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frequent litigation regarding patent and other intellectual property rights. From time to time, we receive notices from third parties of potential infringement and receive claims of potential infringement when we attempt to license our intellectual property to others. Defending these claims could be costly and time consuming and would divert the attention of management and key personnel from other business issues. The complexity of the technology involved and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement also might require us to enter into costly royalty or license agreements. However, we may be unable to obtain royalty or license agreements on terms acceptable to us or at all. In addition, third parties may attempt to appropriate the confidential information and proprietary technologies and processes used in our business, which we may be unable to prevent and would harm our businesses and prospects.

IF WE CANNOT MAINTAIN OUR STRATEGIC RELATIONSHIPS OR IF OUR STRATEGIC RELATIONSHIPS FAIL TO MEET THEIR GOALS OF DEVELOPING TECHNOLOGIES OR PROCESSES, WE WILL LOSE OUR INVESTMENT AND MAY FAIL TO KEEP PACE WITH THE RAPID TECHNOLOGICAL DEVELOPMENTS IN OUR INDUSTRY.

In the past, we have entered into strategic relationships to develop technologies and manufacturing processes. If any of our strategic relationships do not accomplish our intended goals or do not develop the technology or processes sought, we will not realize a return on our investment.

WE MAY NOT HAVE FINANCING FOR FUTURE STRATEGIC INITIATIVES, WHICH MAY PREVENT US FROM ADDRESSING GAPS IN OUR PRODUCT OFFERINGS, IMPROVING OUR TECHNOLOGY OR INCREASING OUR MANUFACTURING CAPACITY.

If we are unable to incur additional debt or issue equity for future strategic initiatives, we may fail to address gaps in our product offerings, improve our technology or increase our manufacturing capacity. We cannot assure you that such financing will be available to us on acceptable terms or at all. Also, in connection with our spin-off from Lucent, we are significantly restricted in our ability to issue stock in order to raise capital.

IF WE ARE UNABLE TO EXTEND OR REFINANCE OUR CREDIT FACILITY WHEN IT MATURES ON SEPTEMBER 30, 2002, WE MAY NOT HAVE SUFFICIENT CASH AVAILABLE TO REPAY THAT FACILITY, TO FUND OUR OPERATIONS OR TO SERVICE OUR DEBT.

We cannot assure you that we will be able to extend or refinance our credit facility before it matures on September 30, 2002. While we currently have sufficient cash on hand to repay amounts outstanding under the credit facility when it matures, we cannot assure you that we will have sufficient cash to repay those amounts when due. In recent periods, we have incurred substantial losses and used cash on hand to fund our operations and other cash needs, and we expect these conditions to continue in the near future. If we are required to repay our credit facility, and we are unable to obtain alternate sources of financing, we may not be able to fund our operations, make capital expenditures or service our debt. Under these circumstances, we would consider actions such as eliminating employee bonuses, accelerating already planned expense reductions, limiting capital spending and selling assets to enable us to meet our cash requirements. However, we cannot assure you that these actions will be feasible at the time or prove adequate. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources."

RISKS RELATED TO THE OFFERING

WE HAVE A SIGNIFICANT AMOUNT OF DEBT, WHICH SUBJECTS US TO VARIOUS RESTRICTIONS AND INTEREST COSTS, AND WE MAY SUBSTANTIALLY INCREASE OUR DEBT IN THE FUTURE.

Because Lucent historically provided financing to us and incurred debt at the parent level, our historical combined balance sheets prior to

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completion of our initial public offering do not include debt. On April 2, 2001, upon completion of our initial public offering, we assumed \$2,500 million of short-term debt that Lucent had borrowed under a credit facility. We did not receive any of the proceeds from the credit facility. Lucent was relieved of all obligations related to this short-term debt. As of January 24, 2002, \$1,103 million was outstanding under our credit facility. See "Certain Indebtedness" for a description of the credit facility. We will use approximately 50% of the net proceeds from the investment units to further repay this short-term debt. After giving pro forma effect to the issuance and sale of the investment units and the application of the net proceeds therefrom as described under "Use of Proceeds," as of , 2002, our total outstanding debt would have been \$ million. Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for additional details about our credit facility, including certain repayments of the facility.

The credit facility is secured by our principal domestic assets other than the proceeds of our initial public offering and, while Lucent remains a majority stockholder, real estate. The maturity date of the facility has been extended from February 22, 2002 to September 30, 2002. In addition, if we raise at least \$500 million in equity or debt capital markets transactions before September 30, 2002, or \$ million after giving effect to this offering, the maturity date of the facility will be extended to September 30, 2004, with the facility required to be reduced to \$750 million on September 30, 2002 and \$500 million on September 30, 2003. The credit facility imposes, and future indebtedness may impose, various restrictions and covenants on us which could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business opportunities. Our interest expense may be materially different as a

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stand-alone company than the interest expense reflected in our historical combined statement of operations for periods prior to completion of our initial public offering. Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations--Overview" for details about our historical interest expense and interest expense under, and the other terms of, the debt we assumed from Lucent.

We may substantially increase our debt in the future. If our cash flow from operations is less than we expect, we will require more financing. We will from time to time issue additional debt, borrow funds under revolving credit facilities or issue other long- or short-term debt.

RESTRICTIONS IN THE NOTES INDENTURE AND OUR CREDIT FACILITY MAY LIMIT OUR ACTIVITIES.

The notes indenture and our credit facility contain restrictions on our activities, including covenants limiting our ability to:

- o incur indebtedness at the subsidiary or parent level;
- o incur or permit to exist liens or security interests on our assets;
- o merge or consolidate with another entity or sell all or substantially all of our assets;

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- o make investments in non-affiliates and certain of our subsidiaries;
- o make or declare dividends on our capital stock;
- o consummate certain transactions with our affiliates; and
- o consummate certain sale and leaseback or collateralized mortgage obligation transactions.

We also are required to satisfy specified financial covenants under the terms of our credit facility. These restrictions may make it difficult for us to successfully execute our business strategy or to compete in the worldwide integrated circuits and optoelectronic components industries with companies not similarly restricted.

IN THE EVENT OF OUR BANKRUPTCY OR LIQUIDATION, OUR ASSETS WILL NOT BE AVAILABLE TO MAKE ANY PAYMENTS TO THE HOLDERS OF THE NOTES UNTIL WE HAVE MADE ALL PAYMENTS TO HOLDERS OF SENIOR INDEBTEDNESS.

The notes will be general unsecured obligations, subordinate in right of payment to all of our existing and future senior indebtedness, including all indebtedness under our credit facility. In the event of insolvency, liquidation, reorganization or a similar proceeding, our senior indebtedness must be paid in full before the principal of, and premium, if any, and interest on the notes may be paid. In the event of a bankruptcy, liquidation or reorganization, holders of the notes will participate ratably (based upon respective amounts owed to each holder or creditor) with all holders of subordinated indebtedness that is deemed to be of the same class as the notes in the remaining assets. If any of these events occur, we cannot assure you that there would be sufficient assets to pay amounts due on the notes. After giving pro forma effect to the issuance and sale of the investment units and the application of the net proceeds therefrom as described under "Use of Proceeds," as of , 2002, we would have had approximately \$ million of senior indebtedness outstanding.

In addition, the indenture provides that, except under certain circumstances, no payment with respect to the notes may be made during the occurrence of a payment default with respect to senior indebtedness. Moreover, the indenture provides that, under certain circumstances, no payment with respect to the notes may be made if certain non-payment defaults occur with respect to certain designated senior indebtedness, including indebtedness under our credit facility.

YOUR RIGHT TO RECEIVE PAYMENTS ON THE NOTES IS UNSECURED AND WILL BE EFFECTIVELY SUBORDINATED TO OUR AND OUR SUBSIDIARIES' EXISTING AND FUTURE SECURED INDEBTEDNESS.

The notes will be general unsecured senior subordinated obligations, effectively junior to any secured debt that we and our subsidiaries have and may have in the future to the extent of the value of the assets securing that debt. Our borrowings under our credit facility are secured. After giving pro forma effect to the issuance and sale of the investment units and the application of the net proceeds therefrom as described under "Use of Proceeds," as of , 2002, we would have had \$ million of secured indebtedness outstanding.

In the event of liquidation, dissolution, reorganization, bankruptcy or any similar proceeding, whether voluntarily or involuntarily instituted, the holders of our secured debt will be entitled to be paid from our or our subsidiaries' assets, as applicable, before any payment may be made with respect to the notes. If any of the foregoing events occurs, we cannot assure you that we will have sufficient assets to pay amounts due on our secured debt and the

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notes. As a result, the holders of the notes may receive less, ratably, than the holders of secured debt in the event of our liquidation, dissolution, reorganization, bankruptcy or other similar occurrence.

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SOME SIGNIFICANT RESTRUCTURING TRANSACTIONS MAY NOT CONSTITUTE A CHANGE OF CONTROL, IN WHICH CASE WE WOULD NOT BE OBLIGATED TO OFFER TO REPURCHASE THE NOTES. EVEN IF A TRANSACTION DOES TRIGGER THAT OBLIGATION, WE MAY NOT BE ABLE TO REPURCHASE THE NOTES.

Upon the occurrence of certain specific kinds of change of control events, we will be required to offer to repurchase all outstanding notes. However, certain important corporate events, such as leveraged recapitalizations that would increase the level of our indebtedness, would not constitute a change of control under the indenture. Moreover, even if a transaction triggers a repurchase obligation, it is possible that we will not have sufficient funds at the time of the change of control to make the required repurchase of notes. In addition, restrictions in our credit facility will not allow such repurchases. See "Description of Notes--Change of Control."

HOLDERS OF NOTES WILL BE TAXED ON ORIGINAL ISSUE DISCOUNT.

The notes will be deemed to be issued at a discount from their principal amount. Consequently, holders of the notes generally will be required to include amounts in gross income for U.S. federal income tax purposes in advance of receipt of the cash payments to which this income is attributable. For a more detailed discussion of the U.S. federal income tax consequences from the purchase, ownership and disposition of the notes, see "Certain Federal Income Tax Consequences."

THERE IS NO ESTABLISHED TRADING MARKET FOR THE NOTES, AND ANY MARKET FOR THE NOTES MAY BE ILLIQUID.

We do not intend to apply for a listing of the notes on a securities exchange. There is currently no established market for the notes, and we cannot assure you of any of the following:

- o the liquidity of any market that may develop for the notes;
- o your ability to sell the notes; or
- o the price at which you will be able to sell the notes.

Although the underwriters of the SHARCS have advised us that they currently intend to make a market for the notes, the underwriters are not obligated to do so and any such market making would not commence until the notes have been distributed by the trust. Any underwriters that make a market in the notes may discontinue their market making at any time at their discretion without notice to the holders of the notes. In addition, market-making activity by the underwriters will be subject to the limits imposed by the Securities Act of 1933 and the Securities Exchange Act of 1934. As a result, we cannot assure you that any market in the notes will develop or, if one does develop, that it will be maintained. If a market for the notes does develop, prevailing interest rates, the markets for similar securities and other factors could cause the notes to trade at prices lower than their purchase price or reduce the liquidity

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of the notes.

WE MIGHT NOT HAVE SUFFICIENT FUNDS TO SATISFY OUR OBLIGATIONS UNDER THE PUT RIGHTS.

If the average closing price or average sale price, as applicable, of a share of our Class A common stock for the 20 trading days prior to maturity is less than the strike price of the put rights, we will be obligated under the put rights to pay to the trust an amount of cash equal to the product of (x) the number of shares subject to outstanding put rights and (y) the difference between the strike price of the put rights and such average closing price or sale price, as applicable. For example, assuming all the put rights will be outstanding at maturity, a 10% decline in the price of our common stock would result in an obligation to pay \$ million. We cannot assure you that we will have sufficient funds to satisfy this obligation.

IN A BANKRUPTCY OR SIMILAR PROCEEDING INVOLVING US, YOUR RIGHT TO RECEIVE PAYMENT UNDER THE PUT RIGHT WOULD LIKELY BE TREATED AS AN EQUITY CLAIM SUBORDINATED TO ALL OF OUR EXISTING AND FUTURE DEBT OBLIGATIONS AND COULD BE FOUND TO BE UNENFORCEABLE.

The put rights will by their terms be general unsecured senior subordinated obligations, subordinate in right of payment to all of our existing and future senior indebtedness, including all indebtedness under our credit facility. If we become the subject of a liquidation, dissolution, reorganization, bankruptcy or similar proceeding, whether voluntarily or involuntarily instituted, our obligations under the put rights will likely be treated as an equity claim. As a result, a claim under the put right would be subordinated to all of our existing and future debt obligations. If any of the foregoing events occur, we cannot assure you that the amounts that you receive with respect to your claim, if any, will have a value equal to the amounts due on the put rights. Moreover, in such a proceeding, a court may treat the put option agreement as an agreement to acquire our own securities that is impermissible under Delaware law and may disallow the put rights in their entirety. In that case, you will not receive anything under your put rights.

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USE OF PROCEEDS

We estimate that the net proceeds of the offering will be approximately \$ million after deduction of expenses and commissions. We intend to use approximately 50% of the net proceeds to repay short-term debt under our credit facility and the balance for general corporate purposes. The \$2,500 million credit facility that we assumed from Lucent at the time of our initial public offering was a 364-day facility that was to mature on February 21, 2002. On October 4, 2001, this credit facility was amended. The maturity date of the facility was extended from February 22, 2002 to September 30, 2002. In addition, if we raise at least \$500 million in equity or debt capital markets transactions before September 30, 2002, or approximately \$ million after giving effect to this offering, the maturity date of the facility will be extended to September 30, 2004, with the facility required to be reduced to \$750 million on September 30, 2002 and \$500 million on September 30, 2003. The interest rates applicable to borrowings under the facility are based on a scale indexed to our credit rating. Based upon our current credit ratings of BB-- from Standard & Poor's and Ba3 from Moody's, the interest rate under the facility is currently the applicable LIBOR rate plus 475 basis points. In addition, until we

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permanently reduce the size of the facility to \$1,000 million, the applicable interest rate will increase by an additional 25 basis points every ninety days, with the next increase taking effect on February 17, 2002. The weighted average interest rate at September 30, 2001 was 7.11%. If we permanently reduce the size of the facility to \$1,000 million the interest rate for borrowings under the facility, assuming our credit ratings remain the same, would drop to the applicable LIBOR rate plus 400 basis points. The only periodic debt service obligation under the amended credit facility is to make quarterly interest payments.

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CAPITALIZATION

The following table sets forth our consolidated capitalization as of September 30, 2001, on an actual basis and on an as adjusted basis to give effect to the amendment of the credit facility and the related repayment of \$1,000 million of short-term debt under the credit facility, this offering and the use of approximately 50% of the net proceeds to repay additional short-term debt outstanding under the credit facility.

The table below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," our combined and consolidated financial statements and the notes to our combined and consolidated financial statements included elsewhere in this prospectus.

| | Sept ----- Historical ((dolla |
|---|--|
| Cash and cash equivalents..... | \$ 3 ===== |
| Put rights liability..... | \$ ===== |
| Debt | |
| Credit facility..... | \$ 2 |
| % Senior Subordinated Notes due 2007..... | |
| Capitalized lease obligation..... | |
| Total debt..... | \$ 2 ===== |
| Stockholders' equity: | |
| Class A common stock, par value \$0.01 per share, 5,000,000,000 shares authorized and 727,000,107 shares issued and outstanding..... | |
| Class B common stock, par value \$0.01 per share, 5,000,000,000 shares authorized and 908,100,000 shares issued and outstanding..... | 6 |
| Additional paid in capital..... | (4, |
| Accumulated deficit..... | |
| Accumulated other comprehensive loss..... | |
| | ----- |

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| | |
|---------------------------------|------|
| Total stockholders' equity..... | 2 |
| Total capitalization..... | \$ 5 |

Our ability to issue additional equity is constrained because our issuance of additional common stock may cause the distribution of our shares by Lucent to its stockholders to be taxable to Lucent under Section 355(e) or be taxable to both Lucent and its stockholders because of a failure of Lucent to distribute "control" of us as defined in Section 368(c) of the Internal Revenue Code, and under the tax sharing agreement we would be required to indemnify Lucent against that tax. In particular, due to Section 355(e), we are significantly limited in our ability to issue shares of our common stock. For a discussion of Section 355(e) and Section 368(c), please see "Arrangements Between Lucent and Our Company--Tax Limitations on Additional Issuance of Our Stock."

SELECTED FINANCIAL INFORMATION
(dollars in millions)

The following table sets forth our selected financial information. The financial information for the years ended September 30, 2001, 2000 and 1999 and as of September 30, 2001 and 2000 has been derived from our audited consolidated and combined financial statements included elsewhere in this prospectus. The financial information for the year ended September 30, 1998 and as of September 30, 1999 has been derived from our audited combined financial statements not included in this prospectus. The financial information for the year ended September 30, 1997 and as of September 30, 1998 and 1997 has been derived from the company's unaudited combined financial statements not included in this prospectus. The historical selected financial information may not be indicative of our future performance as a stand-alone company and should be read in conjunction with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated and combined financial statements and the related notes included elsewhere in this prospectus.

| | Year Ended Se | | |
|--------------------------------------|---------------------------|----------|------|
| | 2001 (1) | 2000 (2) | 1 |
| | (Dollars in millions, exc | | |
| Statement of operations information: | | | |
| Revenue..... | \$ 4,080 | \$ 4,708 | \$ 3 |
| Gross profit..... | 996 | 2,153 | 1 |

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| | | | |
|---|------------|----------|----|
| Purchased in-process research and development..... | -- | 446 | |
| Amortization of goodwill and other acquired intangibles..... | 415 | 189 | |
| Restructuring and separation..... | 662 | -- | |
| Impairment of goodwill and other acquired intangibles..... | 2,762 | -- | |
| Income (loss) before cumulative effect of accounting change..... | (4,612) | (76) | |
| Cumulative effect of accounting change (net of provision (benefit) for income taxes of \$(2) in 2001 and \$21 in 1999) (3)..... | (4) | -- | |
| Net income (loss)..... | \$ (4,616) | \$ (76) | \$ |
| Basic and diluted earnings (loss) per share:(4) | | | |
| Income (loss) before cumulative effect of accounting change..... | \$ (3.46) | \$ (.07) | \$ |
| Cumulative effect of accounting change(3)..... | -- | - | |
| Net income (loss)..... | \$ (3.46) | \$ (.07) | \$ |
| Weighted average shares outstanding - basic and diluted (millions)... | 1,334 | 1,035 | 1 |
| Other Financial Data: | | | |
| Ratio of earnings to fixed charges (5)..... | n/a | 2.4 | |
| Deficiency(5)..... | \$ 4,553 | n/a | |
| Supplemental Financial Data: | | | |
| EBITDA(6)..... | \$ (3,520) | \$ 822 | \$ |
| Adjusted EBITDA(7)..... | (96) | 1,268 | |

At September

| 2001 | 2000 | 1999 |
|-------|-------|-------|
| ----- | ----- | ----- |

(Dollars)

Balance sheet information:

| | | | |
|---|--------|--------|----|
| Working capital..... | \$ 156 | \$ 428 | \$ |
| Total assets..... | 6,562 | 7,067 | 3 |
| Short-term debt..... | 2,516 | 14 | |
| Long-term debt..... | 33 | 46 | |
| Stockholders' equity/invested equity..... | 2,461 | 5,781 | 1 |

(1) During fiscal 2001 we received approximately \$3,400 million of net proceeds from our initial \$2,762 million impairment of goodwill and other acquired intangibles related to our acquisition of Herrmann Technology, Inc., Agere, Inc. and Enable Semiconductor, Inc. We also assumed \$2,500 million of short-term debt from Herrmann Technologies Inc., consisting of short-term borrowings under a credit facility provided by us. We will not receive any of the proceeds of this short-term debt.

(2) During fiscal 2000 goodwill and other acquired intangibles increased by \$3,400 million due to the acquisition of VTC Corporation, Herrmann Technology, Inc., Agere, Inc. and substantially all the assets of VTC are included from their respective dates of acquisition.

(3) Effective October 1, 2000, we adopted Statement of Financial Accounting Standards No. 133, "Derivative Instruments and Hedging Activities," as amended.

Effective October 1, 1998, we changed our method for calculating the market-related value of the expected return-on-asset component of annual net pension and postretirement benefit costs.

(4) Basic and diluted earnings (loss) per common share are calculated by dividing income (loss) by the number of common shares outstanding during the period. The weighted average number of common shares outstanding includes the retroactive recognition to October 1, 1996 of the 1,035,000,000 shares owned by us since our public offering.

(5) For purposes of determining the ratio of earnings and to fixed charges, "earnings" are defined as operating operations before income taxes less undistributed earnings of equity investments plus fixed

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during the period. "Fixed charges" consist of interest expense on all indebtedness and that expense that is representative of the interest factor. "Deficiency" is the amount by which fiscal 2001.

- (6) EBITDA equals operating income (loss) plus depreciation and amortization expense. EBITDA is or any other measure of performance or liquidity in accordance with generally accepted accounting principles included here because we believe that you may find it to

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be a useful analytical tool. Other companies may calculate EBITDA differently, and we cannot assure you that our figures are comparable with similarly-titled figures for other companies.

- (7) The calculation of adjusted EBITDA is shown below:

| | Year Ended September 30, | | |
|--|--------------------------|---------|--------|
| | 2001 | 2000 | 1999 |
| | (Dollars in millions) | | |
| EBITDA..... | \$ (3,520) | \$ 822 | \$ 877 |
| Purchased in-process research and development..... | -- | 446 | 17 |
| Restructuring and separation..... | 662 | -- | -- |
| Impairment of goodwill and other acquired intangibles..... | 2,762 | -- | -- |
| Adjusted EBITDA..... | \$ (96) | \$1,268 | \$ 894 |

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MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated and combined financial statements and the notes thereto. This discussion contains forward-looking statements. Please see "Forward-Looking Statements" and "Risk

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Factors" for a discussion of the uncertainties, risks and assumptions associated with these statements.

OVERVIEW

We are the world leader in sales of communication components, which include integrated circuits and optical components. Communication components are the basic building blocks of electronic and photonic products and systems for terrestrial and submarine, or undersea, communications networks and for communications equipment. We sell our integrated circuits and optoelectronic components globally to manufacturers of communications and computer equipment.

We report our operations in two segments: Integrated Circuits and Optoelectronics. Integrated circuits, or chips, are made using semiconductor wafers imprinted with a network of electronic components. They are designed to perform various functions such as processing electronic signals, controlling electronic system functions and processing and storing data. The Integrated Circuits segment includes our wireless local area networking products, which facilitate the transmission of data and voice signals within a localized area without cables or wires. The Optoelectronics segment represents our optoelectronic components operations, including both our active optoelectronic and our passive optical components. Optoelectronic components transmit, process, change, amplify and receive light that carries data and voice traffic over optical networks. The Integrated Circuits and Optoelectronics segments each include revenue from the licensing of intellectual property related to that segment.

REORGANIZATION

Effective October 1, 2001, we have aligned our products under two new market-focused groups, Infrastructure Systems and Client Systems, that target the network equipment and consumer communications markets respectively. The Infrastructure Systems group includes our optoelectronics components business and portions of our integrated circuits business and will facilitate the convergence of products from both businesses as we address markets in high-speed communications systems. The Client Systems group includes our wireless data, computer communications, storage and wireless terminal solutions products that address end-user applications markets.

SEPARATION FROM LUCENT

We were incorporated under the laws of the State of Delaware on August 1, 2000, as a wholly owned subsidiary of Lucent. We had no material assets or activities as a separate corporate entity until the contribution to us by Lucent of its integrated circuits and optoelectronic components businesses. Lucent conducted these businesses through various divisions and subsidiaries. On February 1, 2001, Lucent began the separation of our company by transferring to us the assets and liabilities related to these businesses. The separation was substantially completed, including the transfer of all assets and liabilities other than prepaid pension costs and postretirement liabilities, which have yet to be transferred, when we completed our initial public offering in April 2001. As of December 1, 2001, Lucent owned 100% of our outstanding Class B common stock and 37 million shares of our outstanding Class A common stock, which represented approximately 57.8% of the total outstanding common stock and approximately 84.2% of the combined voting power of both classes of our common stock with respect to the election and removal of directors.

Lucent originally announced its intention to distribute all shares of our common stock it then owned to its stockholders in a tax-free distribution by September 30, 2001. On August 16, 2001, Lucent amended its credit facilities. The amended credit facilities modified the conditions that must be met before Lucent can distribute its Agere stock to its stockholders. Lucent has announced

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that the distribution of Agere stock can occur at Lucent's request if all the following terms and conditions as defined under its credit facilities are met:

- o no event of default exists under the credit facilities;
- o Lucent has generated positive EBITDA for the fiscal quarter immediately preceding the distribution;
- o Lucent meets a minimum current asset ratio;
- o Lucent has received \$5,000 million in cash from certain non-operating sources; and
- o Lucent's 364-day \$2,000 million credit facility has been terminated and its \$2,000 million credit facility, expiring in February 2003, has been reduced to \$1,750 million or less.

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Lucent has announced that it remains committed to completing the process of separating Agere from Lucent, and that it intends to move forward with the distribution of the Agere stock it held in a tax-free spin-off to its stockholders. Because Lucent must meet a number of conditions before it can complete the spin-off and because Lucent alone will make the decision about whether to complete the spin-off, even if the conditions were met, we cannot assure you that Lucent will complete the spin-off by a particular date or at all.

In connection with our separation from Lucent, we entered into several agreements with Lucent regarding, among other things, interim services, intellectual property and product supply. The interim services agreement sets forth charges generally intended to allow the providing company to fully recover the allocated direct costs of providing the services, plus all out-of-pocket costs and expenses. For more information, see note 19 to our financial statements included elsewhere in this prospectus.

Lucent is our largest customer with purchases in fiscal 2001, 2000 and 1999 representing 14.9%, 21.3% and 25.7%, respectively, of our revenue. We expect Lucent will continue to represent a significant percentage of our revenue in the foreseeable future.

Our financial statements include amounts prior to February 1, 2001 that have been derived from the financial statements and accounting records of Lucent using the historical results of operations and historical basis of the assets and liabilities of our businesses. We believe the assumptions underlying our financial statements are reasonable. However, our financial statements for periods prior to February 1, 2001 may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had we been a stand-alone company during the periods presented. Because a direct ownership relationship did not exist among all the various units comprising Agere, Lucent's net investment in us is shown in lieu of stockholders' equity in our financial statements for periods prior to February 1, 2001. For periods prior to February 1, 2001, our financial statements include allocations of Lucent's expenses, assets and liabilities, including allocations for general corporate expenses, basic research, interest expense,

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pension and postretirement costs, income taxes and cash and receivables, which are discussed in note 1 to our financial statements included elsewhere in this prospectus.

ACQUISITIONS

During fiscal 1999 and 2000 we completed the acquisitions described below as part of our efforts to broaden our portfolio of product offerings. We did not have any significant acquisitions during fiscal 2001.

In June 2000, we acquired Herrmann, a developer and manufacturer of passive optical filters that can be used in conjunction with active optoelectronic components in products such as amplifiers. The purchase price was \$432 million in Lucent common stock and options. In connection with this acquisition, certain former stockholders of Herrmann are entitled to receive up to a total of 677,019 additional shares of Lucent common stock based on retention and the achievement of specified milestones, which require the production of two products at improved manufacturing yields within the three-year period following the acquisition. As of September 30, 2001, 200,000 shares of Lucent common stock had been released based on the achievement of milestones, resulting in additional goodwill related to the acquisition. The achievement of additional milestones may also result in additional goodwill.

In April 2000, we acquired Ortel, a developer and manufacturer of semiconductor optoelectronic components used in fiber optic systems for cable television and data communications networks. The purchase price was \$2,998 million in Lucent common stock and options.

In April 2000, we acquired Agere, Inc., a developer and supplier of network processor integrated circuits. Network processors control how data is sent over a network. The purchase price was \$377 million in Lucent common stock and options.

In March 2000, we acquired substantially all the assets of VTC, a supplier of integrated circuits to computer hard disk drive manufacturers. The purchase price was \$104 million in cash. In connection with this acquisition, stockholders of VTC are entitled to receive additional cash consideration of up to \$50 million contingent on the delivery of product at specified manufacturing yields and the transfer and qualification of process technology to our manufacturing facilities. As of September 30, 2001, \$30 million of the additional cash consideration had been paid, resulting in additional goodwill related to the acquisition. Any future contingent cash consideration paid will also be recorded as additional goodwill.

In March 1999, we acquired Enable, a developer of integrated circuits for local area network equipment. The purchase price was \$51 million in cash.

In February 1999, we acquired Sybarus Technologies ULC, a developer of integrated circuits for communications networks. The purchase price was \$41 million in cash.

During fiscal 2001, we performed impairment evaluations of the goodwill and other acquired intangibles from

recent acquisitions. The assessments were performed in accordance with Statement

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of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," as a result of weakening economic conditions and decreased current and expected future demand for products in the markets in which we operate. We determined the fair value of the acquired entities using a discounted cash flow model based on growth rates and margins reflective of the current decrease in demand for our products, as well as anticipated future demand. Discount rates used were based upon our weighted average cost of capital adjusted for business risks. These assumptions were based on management's best estimate of future results. As a result of the assessments, we determined that an other than temporary impairment of goodwill and other acquired intangibles existed. We recorded a charge to reduce goodwill and other acquired intangibles of \$2,762 million during fiscal 2001, consisting of \$2,220 million, \$275 million, \$240 million and \$27 million related to Ortel, Herrmann, Agere, Inc. and Enable, respectively.

OPERATING TRENDS

Order levels and revenues declined significantly in the latter half of fiscal 2001 and are expected to remain at lower levels in the near-term. We believe the decreases are due to weakness in our customers' markets and excess inventory held by our customers. We experienced a higher than normal level of order cancellations and reschedules during the second half of fiscal 2001. Although the level of customer order changes has decreased in recent months, our order backlog is lower than we have experienced in the past. Because of this reduced backlog and the potential for additional order changes by customers, our ability to forecast future results is limited.

Our costs consist primarily of manufacturing overhead, materials and labor. Similar to many semiconductor manufacturers, we have relatively high fixed costs associated with our wafer manufacturing. As a result, our ability to reduce costs quickly in times of decreased demand is limited, which has an adverse effect on margins. Because we anticipated higher revenues as we entered fiscal 2001, our cost structure reflected manufacturing capacity and resources greater than those actually required. In light of the lower revenues we have experienced in recent quarters, we have taken a number of steps to reduce our cost structure, including restructuring activities and reductions in capital spending.

RESTRUCTURING AND SEPARATION EXPENSES AND INVENTORY PROVISION

In fiscal 2001, we announced a series of restructuring initiatives to reduce our cost structure in light of declining revenues. We recorded a restructuring charge of \$563 million in fiscal 2001 classified within restructuring and separation expenses. These restructuring initiatives include a worldwide workforce reduction, rationalization of manufacturing capacity and other activities.

The restructuring initiatives announced in fiscal 2001 will result in a workforce reduction of approximately 6,000 employees across various business functions, operating units and geographic regions, and includes both management and occupational employees. We recorded a restructuring charge of \$177 million in fiscal 2001 related to approximately 5,500 employees, of which approximately 4,300 employees had been taken off-roll as of September 30, 2001, and expect to record a restructuring charge of approximately \$20 million related to the additional 500 employees by the end of the first quarter of fiscal 2002. Of the \$177 million charge, \$28 million represents termination benefits to U.S. management employees that will be funded through Lucent's pension assets. Severance costs and other exit costs noted above were determined in accordance with Emerging Issues Task Force No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." In addition, on December 5, 2001, we announced our intention to further reduce our workforce by approximately 950 positions. See note 22 to our financial statements included

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elsewhere in this prospectus for further information about this reduction.

We recorded a restructuring charge of \$386 million in fiscal 2001 relating to the rationalization of under-utilized manufacturing facilities and other restructuring-related activities. We have discontinued manufacturing operations at our chip fabrication plant in Madrid, Spain and have agreed to sell the facility. We are also rationalizing under-utilized manufacturing capacity at our facilities in Orlando, Florida, and in Allentown, Breinigsville and Reading, Pennsylvania. In addition, we are consolidating several satellite-manufacturing sites, as well as leased corporate offices. The restructuring charge for fiscal 2001 includes \$37 million related to facility closings, primarily for lease terminations, non-cancelable leases and related costs. It also includes an asset impairment charge of \$287 million related to property, plant and equipment associated with the consolidation of manufacturing and other corporate facilities. This charge was recognized in accordance with the guidance on impairment of assets in Statement 121. The remaining restructuring charge of \$62 million relates primarily to contract terminations.

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A summary of restructuring charges is outlined as follows:

| Year Ended September 30, 2001 | | |
|----------------------------------|---------------------|------------------|
| Total Charges | Non Cash Charges | Cash Payments |
| ----- | ----- | -- |