Case Study - Corporate Action
Alcatel-Lucent Merger

Foreword

Large and complex merger and acquisition transactions are critical events for a number of parties: the Board of Directors of the acquirer and the target companies; shareholders of the respective transacting companies; and other market participants looking to optimize economic benefits from the transaction.

The Depositary Receipt (DR) Division at The Bank of New York Mellon has a dedicated Global Corporate Actions Team (GCAT) that processes all corporate actions on behalf of our DR clients. GCAT approaches each corporate action with a perspective that goes beyond flawless execution of the transaction to working with clients to analyze the strategic aspects and impacts of the transaction on their DR program.

We are pleased to present a detailed case study which examines certain characteristics of merger and acquisition transactions where DRs are used by the acquiring company as acquisition currency. We undertake a granular analysis of the impact that a cross-border transaction has during the merger period, and after, on DR trading volume, supply/demand preferences for DRs, impact on the stock price in the U.S. and local market. We also offer insights into factors that affect the reactions of institutional investors to the transaction.

We intend the case study to be of benefit to financial and investor relations professionals of DR clients who have responsibility for structuring, executing, and monitoring the impact of merger and acquisition transactions.

Michael Finck
Managing Director
The Bank of New York Mellon
Email: Michael.Finck@bnymellon.com
Phone: +1 212 815 2190

June 2008
INTRODUCTION

On November 30, 2006, Alcatel and Lucent Technologies (“Lucent”), respectively French and U.S. communication solution providers, announced the completion of their $11 billion merger transaction (the “Merger”), forming one of the world’s leading communication solutions providers. In connection with the Merger, the newly formed French company Alcatel-Lucent issued approximately 878 million DRs to the former holders of Lucent common stock. Each outstanding share of Lucent common stock was converted into 0.1952 of an Alcatel-Lucent DR with each DR representing one ordinary share.

The Bank of New York Mellon was ideally suited to assist these world-renowned companies with their Merger. The Bank has been Alcatel's depositary since 1997 and acted as Lucent Technologies’ transfer agent since 1996. In this transaction, the Bank acted as an exchange agent for the mandatory exchange of Lucent stock and provided Lucent shareholders with new Alcatel-Lucent DRs.

The Alcatel-Lucent Merger was one of the largest DR corporate actions handled by The Bank of New York Mellon DR Division. The transaction was atypical in terms of the number of DRs issued, the number of registered holders, and the flow-back reaction.

The first part of this case study illustrates the followings aspects of the Alcatel-Lucent Merger:

- the number of DRs issued
- the impact on liquidity
- the impact on stock price
- the flow-back and DR Ownership
- the Direct Registration System implementation (DRS)
- the changes in ownership

The second part of this study provides an analysis explaining the varying reactions of the market following a merger or acquisition and compares the Alcatel-Lucent Merger with other M&A transactions using DRs.
DESCRIPTION OF THE MERGER

Number of DRs Issued

On November 30, 2006 Alcatel-Lucent issued approximately 878 million DRs to the former holders of Lucent common stock completing their $11 billion Merger transaction.

Prior to the Merger, the Alcatel DR program represented 9% of the total Alcatel shares outstanding (140 million DRs outstanding).

As a result of this corporate action and the issuance of 878 million DRs, the Alcatel-Lucent DR program has become the largest program in France in terms of DRs outstanding with more than one billion ADRs representing 45% of the global market capitalization (“market cap”) of the new company as of the date of the Merger.

Liquidity Impact

The announcement of the Merger between Lucent and Alcatel in April 2006, had a significant impact on the trading volume of Alcatel’s DRs. In fact, the announcement caused the trading volume to double from its prior volume of 1.5 million DRs to approximately 3 million DRs per day.

Despite quarterly fluctuations in trading volume, the percentage of DR trading remained relatively constant. Indeed, between September 2006 and December 2007, an average of 34% of the overall trading activity was executed in the U.S. (see below).

During the first four months after the closing of the Merger on November 30, 2006, the trading volume of the new company increased to an average of 12 million DRs traded per day, or an increase of 900% of the prior year’s monthly average.

In 2Q07, the number of DRs traded per day decreased to an average of 8 million, or 32% of the global trading volume. Later in 3Q07, the trading volumes increased again to an average of 13.4 million DRs per day.

In 4Q07, 10 million DRs were traded daily on the NYSE, representing 33% of the global trading volume, in line with the average over the full year 2007.

The graph above describes the Alcatel-Lucent DR trading activity over 16 months, including daily trading volume and percentage of global trading volume (NYSE plus Euronext).

Source: The Bank of New York Mellon, ADR Inform
With the exception of the period between December 2006 and 1Q07, the liquidity fluctuation on NYSE has been remarkably consistent with that of Euronext (see graph below).

The fact that Euronext liquidity did not show the same pattern as NYSE liquidity in 1Q07 illustrates the disconnection between NYSE and Euronext investors. The rise in trading volume on the NYSE reflected increased sale activity, in line with the flowback that occurred in the DR program.

Stock Price Impact
As you can see in the Bloomberg snapshot below (price as of end of day), the DR price and the ordinary stock price were not in parity from mid November to mid January.

Source: The Bank of New York Mellon, ADR Inform and Bloomberg

Source: Bloomberg as of June 11, 2007
In December 2006, the price of Alcatel-Lucent shares continued their upward momentum which had begun the prior summer, while Alcatel-Lucent DRs were traded with a constant “discount” during the same timeframe.

In December 2006 and January 2007, investors were willing to trade Alcatel-Lucent DRs up to 1% (or $0.15) less than the ordinary share price. The increase in trading volume on page 3 relates to the sale of DRs, which also correlated to the DR cancellation activity.

In February and March, the graph indicates high peaks in premium up to 3.3% (or $0.40) illustrating a high demand for DRs, while the Alcatel-Lucent share price was falling. In April, the company stock price started to grow again, in line with increased DRs issuance activity.

**Flow-back and Ownership Increase**

From December 1, 2006 to February 23, 2008 approximately 140 million DRs have been cancelled. February 23, 2008 is the lowest point of Alcatel-Lucent DRs outstanding (873,501,530 DRs). This flow-back represented 16% of the DRs issued on November 30, 2007 and 14% of the total number of DRs outstanding as of the same date.

Since this low point, issuance activity increased bringing the DRs outstanding on October 10, 2007 to a high of 936 million DRs or 40.4% of the global market cap. On the first anniversary date of the Merger, 934 million DRs were outstanding, accounting for 40.3% of the company market cap.

The size of the transaction vastly changed the shape and the composition of the former Alcatel DR program ownership.

Prior to the Merger, public filings identified that 140 million DRs in Alcatel’s program (out of 170 million ADRs outstanding) were held by 150 institutional investors and 105,000 retail holders.

As of September 30, 2007, Alcatel-Lucent’s DR program accounted for 932 million DRs outstanding, and, according to public filings as of September 30, 2007, there were more than 407 institutional investors holding Alcatel-Lucent DRs and more than 3.2 million retail holders.

**Direct Registration System Implementation**

In connection with the transaction, more than 1.2 million Lucent registered shareholders were exchanged into registered holders of the new company.

The Bank of New York Mellon utilized a Direct Registration System, or DRS, which is a non-certificated, book-entry, statement-based method of holding DRs registered directly on the records of the depositary to facilitate the end of Lucent stock. DRS, a securities industry initiative supported by the SEC, is intended to improve the efficiency of clearing/settlement of securities transactions in the Capital Markets. Alcatel-Lucent is among the first DR programs to completely utilize this electronic shareholder recordkeeping program.

The Bank of New York Mellon’s involvement with the Alcatel-Lucent transaction spanned several months and affected more than 1.2 million registered shareholders.
Institutional Ownership Analysis

Now, let's analyze the fluctuations in ownership in the Alcatel-Lucent DR program during a 6 and 12-month period.

We will compare the Alcatel-Lucent DR program as of September 30, 2007, with the “equivalent” Alcatel-Lucent DR program as of September 30, 2006 (Alcatel DR program plus Lucent ownership in equivalent Alcatel DRs, taking into account the fixed exchange ratio of 0.1952 Alcatel-Lucent DRs for each Lucent share).

The analysis below is based on public filings, and data may not be similar with previous filings but, nonetheless, provides a good representation of the Alcatel-Lucent DR program. Collected data accounted for 59% of the “equivalent” Alcatel-Lucent DR program as of September 30, 2006 (as described aside), and 66% of the Alcatel-Lucent DR outstanding as of September 30, 2007.

Below is a table summarizing the shift in Institutional Ownership on a 6 and 12 month basis, since September 30, 2006:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td># of Int. Investors</td>
<td>Position Change</td>
</tr>
<tr>
<td>New</td>
<td>80 (1)</td>
<td>48142211</td>
</tr>
<tr>
<td>Increased</td>
<td>129</td>
<td>90458039</td>
</tr>
<tr>
<td>No Change</td>
<td>117</td>
<td>-</td>
</tr>
<tr>
<td>Decreased</td>
<td>189</td>
<td>-146124868</td>
</tr>
<tr>
<td>Sold Out</td>
<td>303 (2)</td>
<td>-72289773</td>
</tr>
<tr>
<td>Bought &amp; Sold in the period</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Net flow-back</td>
<td>-223 (1-2)</td>
<td>-79814391</td>
</tr>
</tbody>
</table>

*Source: The Bank of New York Mellon, ADR Insight*

**Over the 6 month-period** (from Sept 30, 2006 to Mar 31, 2007) the number of institutional investors fell by 30% (net 223 sold-out investors out of 738 investors) according to public filings.

The number of DRs held fell by 80 million, or 13.3% of the total of DRs identified through public filings.

As a result, the net flow-back over the 6-month period described above accounted for 80 million DRs and 223 institutional investors. These figures, based on public filings, explain 79% of the “Real” flow-back (80 million ADRs out of 102 million actually cancelled over the period) taking into account the lowest point of DRs outstanding on February 2007.

According to public filings, the flow-back was significant in terms of the number of institutional investors (-30%) but minimal in terms of sold-out positions (-13.3%):

- Out of the 303 total sold-out institutional investors (72 million ADRs) only 19 held positions greater than 1 million shares, and these 19 accounted for 46.8 million DRs or 65% of the total divested positions.
- Out of the 189 investors who decreased their positions by 146 million shares, only 19 held position greater than 1 million shares.
Over the 12 month-period (from Sept 30, 2006 to Sept 30, 2007) the number of DR institutional investors fell by 42% (net 313 sold-out investors out of 738 investors) according to public filings. In terms of the number of DRs held, there was an increase of 17.7 million DRs over one year, or 3% of the total of DRs identified through public filings.

During the 12 month-period, a net flow-back of 313 institutional investors occurred, however, an in-flow of 17.7 million DRs was observed.

FLOW-BACK ANALYSIS
Reasons for flow-back and in-flow

Flow-back, or DR cancellation, refers to an investor’s right to convert DRs for delivery of local shares. Flow-back typically occurs when investors sell a company’s cross-listed shares back into the local market.

As a result of an impending cross-border merger or acquisition, a significant increase in flow-back is usually anticipated. In many cases there is a direct correlation between M&A transactions and flow-back due to:

- **Index Funds.** Due to a cross border transaction, the U.S. Company, Lucent, is removed from the U.S. Index, S&P500, and the new company, Alcatel-Lucent, becomes over weighted in the local index, i.e. CAC40. To reflect this shift, index funds have to sell DRs and purchase shares in the local market which creates a unique spike in cancellation of DRs.

- **Arbitrageurs.** Flow-back of DRs also occurs when arbitrageurs take advantage of domestic and foreign market mispricings, especially in M&A circumstances. In December 2006 arbitrageurs bought Alcatel-Lucent DRs on average at $0.15 less than ordinary share prices. Then they cancelled these ADRs and sold the ordinary shares on the local market, profiting from the spread between the two share prices.

- **“Classic” Long/Short Strategy.** This arbitrage strategy consists of taking a long position on the target and a short position on the acquirer, borrowing the last one on the local market. When those investors receive DRs resulting from the transaction, they will be forced to cancel their DRs to repay their borrowing.

- **Country of Origin of the Target.** It is common for an investment fund to sell out its stake in the new company due to its investment guidelines. For example, a United States technology fund only includes technology stocks incorporated in the U.S. France’s leading technology company, Alcatel, decides to merge with the U.S.’s leading technology company, Lucent, and incorporates the new company, Alcatel-Lucent, in France. The net effect of this action would force the fund to sell all of its DRs in the new company, because the new company will no longer fall within the fund’s investment guidelines.

<table>
<thead>
<tr>
<th>Acquiror</th>
<th>Target</th>
<th>Date</th>
<th>DRs Issued</th>
<th>Flow-Back / In-Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>RBS</td>
<td>ABN Amro</td>
<td>Oct 31, 2007</td>
<td>10,600,000</td>
<td>+58 million</td>
</tr>
<tr>
<td>BBVA</td>
<td>Compass</td>
<td>Sep 7, 2007</td>
<td>196,000,000</td>
<td>-92 million</td>
</tr>
<tr>
<td>CGG</td>
<td>Veritas DGC</td>
<td>Jan 11, 2007</td>
<td>46,000,000</td>
<td>-39 million</td>
</tr>
<tr>
<td>Alcatel</td>
<td>Lucent Technologies</td>
<td>Nov 30, 2006</td>
<td>878,000,000</td>
<td>-140 million</td>
</tr>
<tr>
<td>Vivo</td>
<td>TCO/TLE/TSD</td>
<td>Apr 5, 2006</td>
<td>102,000,000</td>
<td>+84 million</td>
</tr>
<tr>
<td>Teva</td>
<td>Ivax</td>
<td>Jan 1, 2006</td>
<td>123,000,000</td>
<td>-13 million</td>
</tr>
</tbody>
</table>

Source: The Bank of New York Mellon
In reviewing the largest transaction recently handled by The Bank of New York Mellon (see table on page 7), we can assert that a merger or acquisition initiated by a foreign company involving a U.S. company is more likely to see greater flow-back than a transaction involving two non-U.S. companies.

However, in the context of a merger or acquisition there are other factors that would explain in-flow (or DR issuance):

- **Company’s specific characteristics.** Companies whose activities are very international, or who are firmly established in the country of acquisition, generally offer their shareholders an important level of protection and access to company information.

- **Confidence in the new company and perceived potential for success of the merged company.** In a securities transaction, the initiator can highlight the good performance of his security on the market, the positive prospects for the market and the new company’s business model.

Although every transaction will create a different result, the country of origin of the target is the most important element to take into account.

Some level of flow-back may be unavoidable. However, to minimize the impact, a strong communication program and investor relations outreaches are key.

**CGG-Veritas Acquisition**

An example of significant flow-back:

On January 12, 2007, Compagnie Générale de Géophysique (France) acquired Veritas DGC (U.S.), both providers of geophysical services and equipment. This transaction is an example of where there was significant flow-back.

Prior to the acquisition, CGG’s DR program had 2.7 million DRs outstanding or 2.8% of the company’s market cap. The transaction was structured half in DRs and half in cash, amounting to a total value of $3.1 billion. To complete the transaction, The Bank of New York Mellon issued approximately 46 million DRs to the former holders of Veritas DGC common stock.

October 2, 2007 marked the lowest point for DRs outstanding with 9,647,155 DRs remaining, representing 7% of the company’s market cap. We thus estimate the 9 month flow-back at 79% of the DRs issued as of the acquisition date.

Many investors anticipated that Veritas DGC would be acquired by CGG and took positions in the companies (respectively long and short) prior to any announcements. Once the transaction was finalized, DR holders of the new company were forced to cancel their DRs to repay borrows.

With more than 16 million DRs as of January 31, 2008 (or 11.7% of the company’s market cap,) the DR program for CCGVeritas has increased by 34% since October 2, 2007.

**Sanofi-Aventis Merger**

An example of significant in-flow:

In August 2004, Sanofi-Synthelabo (France) merged with Aventis (German), both pharmaceutical companies. This Merger is an example of where there was a significant in-flow reaction.

Prior to the Merger, Sanofi-Synthelabo’s DR program had 40 million DRs outstanding or 4% of the company’s market cap. The transaction was structured 81% in DRs and 19% in cash, amounting to a total value of $2.2 billion. To complete the transaction, The Bank of New York Mellon issued 44 million DRs to the former holders of Aventis’ DRs.

As of September 30, 2004, or 1 month after the Merger date, the DR program of Sanofi-Aventis experienced a modest flow-back of 12 million DRs.

As of 4Q05, or 15 months after the Merger, the DR program for Sanofi-Aventis more than tripled its size. With 227 million DRs outstanding as of the December 31, 2005, the company’s ADR program accounted for 8.3% of its global market cap.

The fact that an in-flow occurred following this Merger is essentially due to the fact that the two companies were both European and fit within the same investment guidelines. The company’s increase in market cap has been replicated into Index fund portfolios, explaining the increase of the DR program for Sanofi-Aventis.
WHY USE DRs?
Below are the main reasons explaining why a merger or acquisition using DRs is favored by both the issuer who initiates the transaction and the U.S. investor who holds shares of the target.

A limited premium:
According to a study performed by H.E.C and endorsed by an empirical theory analysis, the difference between the acquisition premiums paid by foreign companies according to whether the transaction makes use of DRs or not is at least 4 to 5 percentage points (extract of “The Importance of Depositary Receipts in Public Offers for U.S. Companies”)

Tax Deferment:
An important reason for a successful bid is the tax status of the acquisition. A transaction in DRs involves a tax deferment as long as the securities obtained by the shareholders of the target are not resold on the market. Conversely, acquisitions in cash lead to immediate tax on the capital gains resulting from the transaction. This tax implication impacts on the decrease of the premium paid at the time of an acquisition in securities. Hence, it affects the success of the transaction.

CONCLUSION
Extraordinary corporate events require clear communications with security holders. Mergers and acquisitions are highly sensitive and involve complex work to achieve desired results.

To accomplish a merger or acquisition in the best circumstances, The Bank of New York Mellon recommends using an information agent and an experienced tender/exchange agent familiar with cross border transactions, in addition to ongoing investor communications program. This increases the chance of a well-executed and successful transaction.

The Bank of New York Mellon also recommends that any stock consideration in such cross-border transactions be in the form of DRs, not foreign shares. This provides U.S. investors with a U.S. dollar denominated security for easy trading and settlement, dividend payments in U.S. dollars, and ease of communication with a U.S. based transfer agent.

For any questions concerning this study, please do not hesitate to contact your Relationship Manager or

Benjamin Brisedou
Business Development
Phone: +1 212 815 5133
benjamin.brisedou@bnymellon.com

---

The French Depositary Receipt Contacts

Head Office
New York: 101 Barclay Street, 22nd Floor, New York, NY 10286 – General Fax: +1 212 571 3050

Marianne Erlandsen, MD
Western Europe Relationship Management Head
Phone: +1 212 815 4747
marianne.erlandsen@bnymellon.com

Michael Finck, MD
Head of Global Corporate Actions
Phone: +1 212 815 2190
michael.finck@bnymellon.com

Joanne F. DiGiovanni, VP
Co-Head of Global Corporate Actions
Phone: +1 212 815 2204
joanne.digiovanni@bnymellon.com

Robert Goad, VP
Team Leader
Phone: +1 212 815 8257
robert.goad@bnymellon.com

Joanne F. DiGiovanni, VP
Co-Head of Global Corporate Actions
Phone: +1 212 815 2204
joanne.digiovanni@bnymellon.com

Robert Goad, VP
Team Leader
Phone: +1 212 815 8257
robert.goad@bnymellon.com

Joanne F. DiGiovanni, VP
Co-Head of Global Corporate Actions
Phone: +1 212 815 2204
joanne.digiovanni@bnymellon.com

Robert Goad, VP
Team Leader
Phone: +1 212 815 8257
robert.goad@bnymellon.com

Regional Offices

One Canada Square, London E14 5AL, United Kingdom – Fax: +44 207 964 6028
13-15 Boulevard de la Madeleine, 75001 Paris, France - Fax: +33 1 42 97 43 73

Laurent Drouin, VP
Regional Manager
Phone: +33 1 42 97 90 25
laurent.drouin@bnymellon.com

Robert Secoy, AVP
Business Development
Phone: +44 207 964 6325
robert.secoy@bnymellon.com

Laurent Drouin, VP
Regional Manager
Phone: +33 1 42 97 90 25
laurent.drouin@bnymellon.com

Robert Secoy, AVP
Business Development
Phone: +44 207 964 6325
robert.secoy@bnymellon.com