





# > Q2 2006 Financial Results Conference Call

August 3, 2006



# Welcome



- > Mike Zafirovski, President and CEO
- > Peter Currie, Executive Vice-President and CFO
- > Terry Glofcheskie, VP Investor Relations

# Disclaimer



- > Certain statements in this presentation may contain words such as “could”, “expects”, “may”, “anticipates”, “believes”, “intends”, “estimates”, “targets”, “plans”, “envisions”, “seeks” and other similar language and are considered forward-looking statements or information under applicable securities legislation. These statements are based on Nortel’s current expectations, estimates, forecasts and projections about the operating environment, economies and markets in which Nortel operates. These statements are subject to important assumptions, risks and uncertainties, which are difficult to predict and the actual outcome may be materially different.
- > Nortel has made various assumptions in the preparation of its financial outlook in this presentation, including: (1) the following company specific assumptions: no further negative impact to Nortel’s results of operations, financial condition and liquidity arising from Nortel’s restatements of its financial results; Nortel’s prices increasing at or above the rate of price increases for similar products in geographic regions in which Nortel sells its products; increase in sales to Nortel’s enterprise customers and wireless service provider customers in the Asia Pacific region as a result of Nortel’s joint venture with LG Electronics Inc.; anticipated growth in sales to enterprise customers, including the full year impact to Nortel’s revenues from its acquisition of PEC Solutions, Inc. (now Nortel Government Solutions Incorporated); improvement in Nortel’s product costs due to favorable supplier pricing substantially offset by higher costs associated with initial customer deployments in emerging markets; cost reductions resulting from the completion of Nortel’s significant financial restatements and 2004 restructuring plan; a moderate increase in costs over 2005 related to investments in the finance organization and remedial measures related to Nortel’s material weaknesses in internal controls; increased employee costs relative to expected cost of living adjustments and employee bonuses offset by a significant reduction in executive recruitment and severance costs incurred in 2005; and the effective execution of Nortel’s strategy; (2) the following macroeconomic and general industry assumptions: a modest growth rate in the gross domestic product of global economies in the range of 3.2% which is unchanged from the growth rate in 2005; global service provider capital expenditures in 2006 reflecting flat to low single digit growth as compared to low double digit growth in 2005; a general increase in demand for broadband access, data traffic and wireless infrastructure and services in emerging markets with the rate of growth in developed markets beginning to slow; and a moderate impact as a result of expected industry consolidation among service providers in various geographic regions, particularly in North America and EMEA; (3) the following assumptions related to its potential additional services revenues generated from its strategic alliance with Microsoft: a lack of new competitive technologies to displace or diminish the revenue potential of the joint unified communications solution; stable regional market dynamics for this solution, with the greatest revenue opportunities existing in North America and Europe; primary focus of future services revenues on integration and network monitoring, and a fixed market stable hourly service rate in 2007; Nortel capturing a significant amount of the revenue associated with the service and product revenue generated from any Converged Office deployment where Nortel is involved; successful evolution of Exchange Server and associated software from Microsoft to a unified messaging platform; ability to leverage Nortel’s existing installed base market and capture a significant amount of the IP conversion market for this installed base by 2009; significant growth in Nortel’s global sales in VoIP solutions year over year for the next four years, partially offset by a reduction in revenue per sale resulting from Nortel’s multipartner strategy; the continued success of Nortel evolving its technologies in a complementary fashion with its existing and future suppliers; and sustained dedication of the parties to grow aggressively this market opportunity; and (4) assumptions related to the following matters: (i) Global Operations; (ii) Organizational Simplification and Investment: the total cost incurred related to the 2006 restructuring plan is based on current employee headcount reductions including within restructuring activities set forth in this presentation, annualized cost savings are based on an average headcount cost savings (headcount costs being calculated based on employee salary, fringe and other related costs), all charges and timing impact of charges are based on FASB 112 and FASB 146 accounting pronouncements, and annual cost savings are based on completion of the 2006 restructuring plan by the end of 2007; and (iii) post-retirement benefits: that the methodology for calculating pension and post-retirement expenses and liabilities is consistent with that used in Nortel’s recently filed 2005 Annual Report on Form 10-K/A (“2005 10-K/A”); that the management assumptions set forth in the 2005 10-K/A remain valid, including, without limitation, that the expected long-term rate of return on pension plan assets used to estimate pension expenses is 7.4% on a weighted average basis, that the discount rates used to estimate the net pension obligations and expenses is 5.1%, that the assumption used to estimate the post-retirement benefit obligations and cost was an expected discount rate of 5.4%, both on a weighted average basis; that there is no demographic shift in Nortel’s work force; that the pension and post-retirement benefits projections are consistent with those set out in the 2005 10-K/A; and that there are no changes in accounting standards with respect to the accounting for pension and post-retirement benefits applicable GAAP. The above assumptions, although considered reasonable by Nortel at the date of this presentation, may prove to be inaccurate and consequently Nortel’s actual results could differ materially from its expectations set out in this presentation. Further, actual results or events could differ materially from those contemplated in forward-looking statements as a result of the following: (1) risks and uncertainties relating to Nortel’s restatements and related matters including: Nortel’s most recent restatement and two previous restatements of its financial statements and related events; the negative impact on Nortel and NNL of their most recent restatement and delay in filing their financial statements and related periodic reports; legal judgments, fines, penalties or settlements, or any substantial regulatory fines or other penalties or sanctions, related to the ongoing regulatory and criminal investigations of Nortel in the U.S. and Canada; any significant pending civil litigation actions not encompassed by Nortel’s global class action settlement; any substantial cash payment and/or significant dilution of Nortel’s existing equity positions resulting from the approval of its global class action settlement, or if such global class action settlement is not approved, any larger settlements or awards of damages in respect of such class actions; any unsuccessful remediation of Nortel’s material weaknesses in internal control over financial reporting resulting in an inability to report Nortel’s results of operations and financial condition accurately and in a timely manner; the time required to implement Nortel’s remedial measures; Nortel’s inability to access, in its current form, its shelf registration filed with the United States Securities and Exchange Commission (SEC), and Nortel’s below investment grade credit rating and any further adverse effect on its credit rating due to Nortel’s restatements of its financial statements; any adverse affect on Nortel’s business and market price of its publicly traded securities arising from continuing negative publicity related to Nortel’s restatements; Nortel’s potential inability to attract or retain the personnel necessary to achieve its business objectives; any breach by Nortel of the continued listing requirements of the NYSE or TSX causing the NYSE and/or the TSX to commence suspension or delisting procedures; (2) risks and uncertainties relating to Nortel’s business including: yearly and quarterly fluctuations of Nortel’s operating results; reduced demand and pricing pressures for its products due to global economic conditions, significant competition, competitive pricing practice, cautious capital spending by customers, increased industry consolidation, rapidly changing technologies, evolving industry standards, frequent new product introductions and short product life cycles, and other trends and industry characteristics affecting the telecommunications industry; any material and adverse affects on Nortel’s performance if its expectations regarding market demand for particular products prove to be wrong or because of certain barriers in its efforts to expand internationally; any reduction in Nortel’s operating results and any related volatility in the market price of its publicly traded securities arising from any decline in its gross margin, or fluctuations in foreign currency exchange rates; any negative developments associated with Nortel’s supply contract and contract manufacturing agreements including as a result of using a sole supplier for key optical networking solutions components, and any defects or errors in Nortel’s current or planned products; any negative impact to Nortel of its failure to achieve its business transformation objectives; additional valuation allowances for all or a portion of its deferred tax assets; Nortel’s failure to protect its intellectual property rights, or any adverse judgments or settlements arising out of disputes regarding intellectual property; changes in regulation of the Internet and/or other aspects of the industry; Nortel’s failure to successfully operate or integrate its strategic acquisitions, or failure to consummate or succeed with its strategic alliances; any negative effect of Nortel’s failure to evolve adequately its financial and managerial control and reporting systems and processes, manage and grow its business, or create an effective risk management strategy; and (3) risks and uncertainties relating to Nortel’s liquidity, financing arrangements and capital including: the impact of Nortel’s most recent restatement and two previous restatements of its financial statements; any inability of Nortel to manage cash flow fluctuations to fund working capital requirements or achieve its business objectives in a timely manner or obtain additional sources of funding; high levels of debt, limitations on Nortel capitalizing on business opportunities because of credit facility covenants, or on obtaining additional secured debt pursuant to the provisions of indentures governing certain of Nortel’s public debt issues and the provisions of its credit facilities; any increase of restricted cash requirements for Nortel if it is unable to secure alternative support for obligations arising from certain normal course business activities, or any inability of Nortel’s subsidiaries to provide it with sufficient funding; any negative effect to Nortel of the need to make larger defined benefit plans contributions in the future or exposure to customer credit risks or inability of customers to fulfill payment obligations under customer financing arrangements; any negative impact on Nortel’s ability to make future acquisitions, raise capital, issue debt and retain employees arising from stock price volatility and further declines in the market price of Nortel’s publicly traded securities, or any future share consolidation resulting in a lower total market capitalization or adverse effect on the liquidity of Nortel’s common shares. For additional information with respect to certain of these and other factors, see Nortel’s 2005 10-K/A, Quarterly Reports on Form 10-Q and other securities filings with the SEC. Unless otherwise required by applicable securities laws, Nortel disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.



# Agenda

1 General Update

2 Q2 2006 Financials

3 Guidance

4 Plans / Priorities

5 Q&A



## Q2 2006 General Update

- > Strong Orders (+22%), Sales (+5%) & Backlog (+\$194M to \$5.9B)
  - Timing of contract completion impacted year over year comparisons for several product lines & regions
- > Many Customer Visits (tactics/ strategies); several encouraging wins
- > Gross Margin at 38.8%, up 70 BPs from Q1, but below our 40% target
- > Microsoft Strategic Alliance – completed
- > Management Team – completed
- > Debt Refinancing – completed
- > Transfer of Manufacturing to Flextronics – completed
- > Programs to Improve Competitiveness – announced / being implemented
- > Business Transformation “Lean Six Sigma” & “Own It” programs – gaining traction
  - Keys to OM expansion (short & long term)
- > Expect Total Year Revenue & Gross Margin In-Line with Prior Communications

# Orders

US\$M



	Q2'06	Q2'05	△
North America	1,601	1,345	19%
EMEA	724	599	21%
Asia	497	319	56%
CALA	116	138	(16%)
<b>TOTAL</b>	<b>2,938</b>	<b>2,400</b>	<b>22%</b>

- > Book to Bill 1.1 same as Q1 '06
- > Total Backlog of \$5.9B up \$515M YTD
- > Key Drivers:
  - N. America: CDMA
  - EMEA: Optical, Data Networking
  - Asia: Nortel-LG Joint Venture

# Q2 2006 Financial Highlights

US\$M



	Q2'06	Q2'05	△
Revenue	\$2.7B	\$2.6B	5%
Gross Margin	38.8%	43.3%	(5pts)
SG&A	21.7%	22.5%	1pts
R&D	17.8%	18.6%	1pts
Operating Expenses	\$1.1B	\$1.1B	\$0.0
<b>Operating Margin*</b>	<b>(0.7%)</b>	<b>2.2%</b>	<b>(3pts)</b>
Other **	(\$414M)	\$83M	\$497M
EBT ***	\$395M	(\$25M)	\$420M
<b>Net Earnings (Loss)</b>	<b>\$366M</b>	<b>(\$33M)</b>	<b>\$399M</b>
<b>Cash Flow from (used in) Ops</b>	<b>(\$108M)</b>	<b>\$110</b>	<b>(\$218)</b>
<b>Period-End Stock Price</b>	<b>\$2.24</b>	<b>\$2.61</b>	<b>(\$0.37)</b>

\*Operating Margin is a non-GAAP measure defined as Gross Margin less SG&A and R&D expenses

\*\*Amortization of Intangibles, Shareholder Settlement expenses, Special Charges, Gain of Sale of Business, Other Income/Expense, Interest Expense, IPR&D

\*\*\*Earnings from continuing operations before income taxes, minority interests and equity in net earnings (loss) of associated companies



# Mobility and Converged Core Revenue

US\$M

	Q2'06	Q2'05	△
<b>Mobility and Converged Core</b>	<b>1,591</b>	<b>1,484</b>	<b>7%</b>
CDMA	588	620	(5%)
GSM/UMTS	723	565	28%
Circuit and Packet Voice	280	299	(6%)

- > CDMA: Down 5% from strong Q2'05
  - strong momentum expected for rest of year
  - market remaining steady over next several years
- > GSM/UMTS: Growth driven in part by recognition of previously deferred contracts
- > Circuit and Packet Voice: declined due to revenue timing, expect strong 2H06 growth
- > Solid Momentum:
  - CDMA 1xEV-DO Revision A with Verizon beginning 3Q06
  - Lead System Integrator for IMS ready next-generation solution for Israel's HOT Telecom
  - 3-year general purchase agreement with Liberty Global
  - HSDPA network deployment with KTF in Korea

# Enterprise Solutions and Packet Revenue

US\$M



	Q2'06	Q2'05	△
<b>Enterprise and Packet Networks</b>	<b>1,068</b>	<b>1,074</b>	<b>(1%)</b>
Circuit and Packet Voice	361	459	(21%)
Optical Networking	326	304	7%
Data Networking and Security	381	311	23%

- > Circuit and Packet Voice: Highest revenue in last 4 quarters
  - tough Q2'05 comparison (S/W upgrade program)
  - IP Telephony growth drives 2H06 growth
  - Rolls Royce multi-year Managed VoIP Services
- > Optical: Continued growth, #1 in Metro DWDM
  - Spain's TeleCable Secure Private Network Solution and Services
- > Data Networking and Security: Good demand coupled with recognition of previously deferred revenue



# Geographic Revenue

US\$M

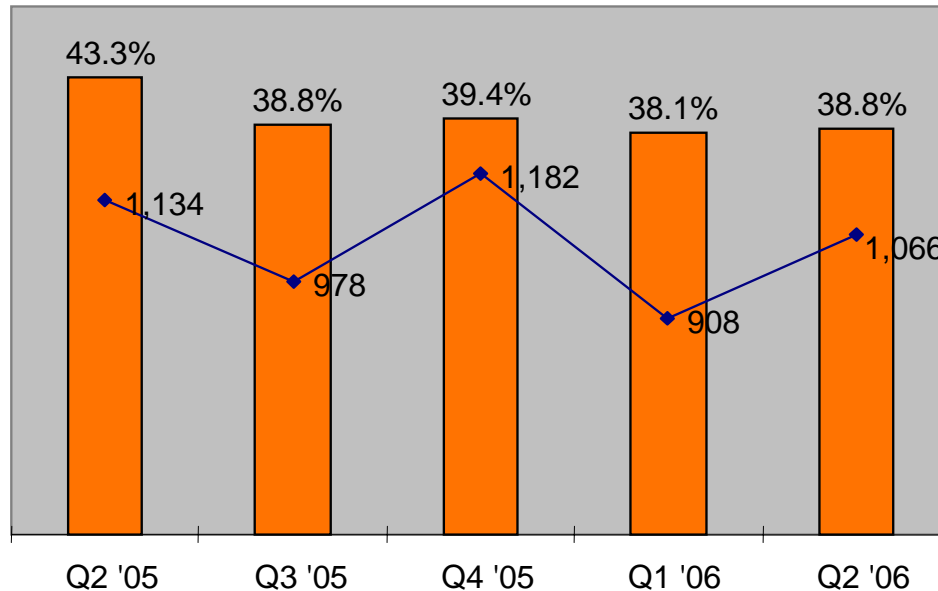
	Q2'06	Q2'05	△
North America	1,253	1,539	(19%)
EMEA	894	666	34%
Asia	449	284	58%
CALA	148	130	14%
<b>Total</b>	<b>2,744</b>	<b>2,619</b>	<b>5%</b>

- > N. America, EMEA and Asia Pacific comparisons vs. prior year impacted in part by timing of revenue recognition ( negative for N.A., positive for others)
- > Broad based revenue growth expected for rest of 2006



# Gross Margin

US\$M

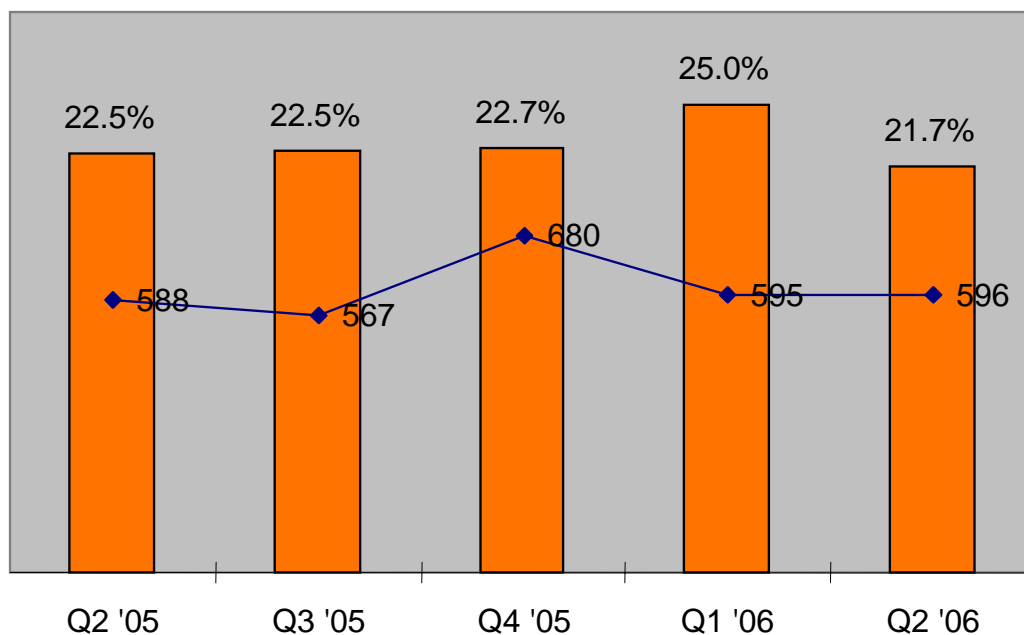


	Q2'06	Q2'05	Δ
\$	1,066	1,134	(68)
% Rev	38.8%	43.3%	(5pts)

- > Sequential GM% improvement: volume driven
- > Decline vs. previous year: impacted by higher proportion of international revenues and higher next generation wireless product sales, as well Q2'05 software upgrade revenue releases
- > Increased pricing pressures on certain products
- > Additional cost associated with EU RoHS compliance

# SG&A

US\$M



	Q2'06	Q2'05	Δ
\$	596	588	(8)
% Rev	21.7%	22.5%	1pts

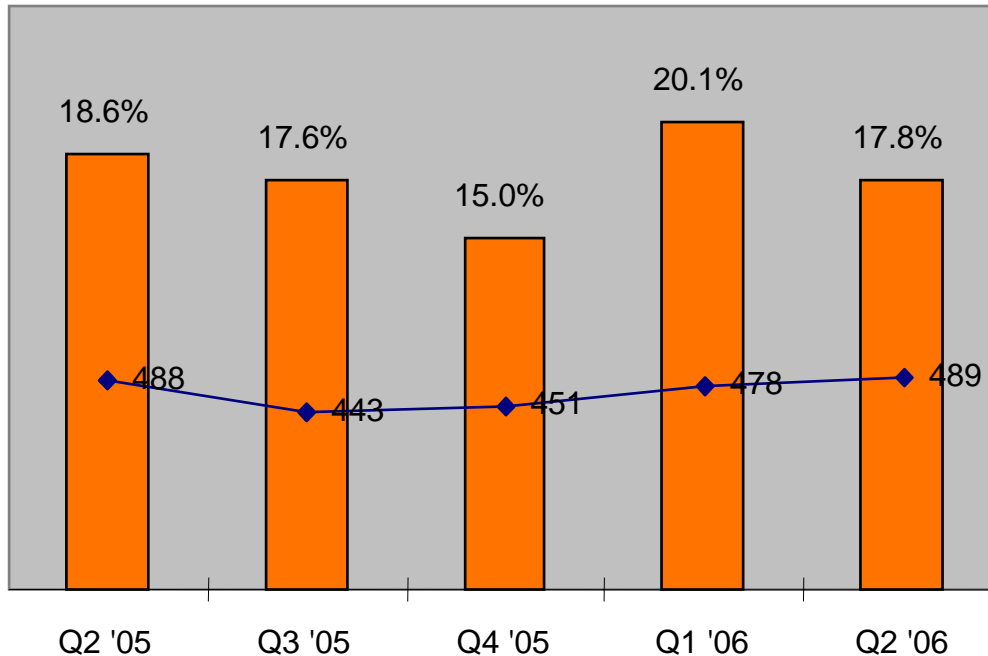
> Q2'06 included:

- Nortel-LG JV and PEC SG&A costs
- Unfavorable impact of foreign exchange due to Canadian \$ strength vs. US \$
- Continued impact of cost containment initiatives offset by headcount increase in Enterprise



# R&D

## US\$M



	Q2'06	Q2'05	Δ
\$	489	488	(1)
% Rev	17.8%	18.6%	1pts

> Q2'06 included

- LG JV R&D costs
- Unfavorable impact of foreign exchange due to Canadian \$ strength vs. US \$
- Increased investment in targeted product areas: video, IMS, and WiMAX
- Savings from cost containment activities and '04 restructuring

# Q2 2006 Highlights

US\$M



	Q2'06	Q2'05	△	Q2'06 YTD	Q2'05 YTD	△
Revenue	\$2.7B	\$2.6B	5%	\$5.1B	\$5.0B	2%
Gross Margin	38.8%	43.3%	(5pts)	38.5%	42.9%	(4pts)
SG&A	21.7%	22.5%	1pts	23.2%	23.3%	(0pts)
R&D	17.8%	18.6%	1pts	18.9%	19.2%	(0pts)
Operating Expenses	\$1.1B	\$1.1B	(\$0.0)	\$2.2B	\$2.1B	(\$0.1)
<b>Operating Margin*</b>	<b>(0.7%)</b>	<b>2.2%</b>	<b>(3pts)</b>	<b>(3.6%)</b>	<b>0%</b>	<b>(4pts)</b>
Other **	(\$414M)	\$83M	\$497M	(\$419M)	\$120M	\$539M
EBT***	\$395M	(\$25M)	\$420M	\$235M	(\$102M)	\$337M
<b>Net Earnings (Loss)</b>	<b>\$366M</b>	<b>(\$33M)</b>	<b>\$399M</b>	<b>\$199M</b>	<b>(\$137M)</b>	<b>\$336M</b>
<b>Cash Flow from (used in) Ops</b>	<b>(\$108M)</b>	<b>\$110M</b>	<b>(\$218M)</b>	<b>(\$282M)</b>	<b>(\$153M)</b>	<b>(\$129M)</b>
<b>Period-End Stock Price</b>	<b>\$2.24</b>	<b>\$2.61</b>	<b>(\$0.37)</b>	<b>\$2.24</b>	<b>\$2.61</b>	<b>(\$0.37)</b>

\*Operating Margin is a non-GAAP measure defined as Gross Margin less SG&A and R&D expenses

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# Significant Impact Items

(US\$M, except for per share figures)

	Q2'06	IMPACT PER DILUTED SHARE
Shareholder Settlement Mark to Market	510	\$0.12
Restructuring Charges	(45)	(\$0.01)
Gain / (Loss) on Sale of Assets	(10)	(\$0.00)

# Cash Flow

US\$M

<b>Net Cash – Beginning of Period</b>
From (used in) operating activities
Investing Activities
Financing Activities
F/X Effect
Change in cash
<b>Net Cash – End of Period</b>

<u>Q2'06</u>	<u>Q1'06</u>
2,695	2,951
(108)	(174)
(569)	(100)
(153)	4
<u>39</u>	<u>14</u>
(791)	(256)
<b>1,904</b>	<b>2,695</b>

> \$2.0B US Debt Refinancing closed July 5 2006

# Operating Metrics

US\$M



	Q2'06	Q1'06
DSO (Days)	91	99
NID (Days)	148	165
DPO (Days)	56	64
Deferred Revenue	\$3.7B	\$3.7B
Book to Bill	1.1	1.1
Order Backlog	\$5.9B	\$5.7B



# Guidance

## > Full year 2006

- We expect strong revenue momentum for the rest of 2006, resulting in high single digit growth for the full year 2006 compared to 2005.
- For the full year, we expect gross margins to be around 40% as a percentage of revenues and
- Operating expenses flat to up slightly from 2005, with foreign exchange and growth related expenses off-setting productivity and efficiencies.

## > Q3 2006

- For the third quarter of 2006, we expect revenue growth in excess of 10 percent compared to the third quarter of 2005 and gross margin and operating expenses to be in-line with our full year guidance.



# Our Plan and Framework

Near term, long term and foundational

## BIG—NEAR TERM PRIORITIES

- > **Business Transformation**
- > Integrity Renewal
- > **Growth Imperatives**

## 6-POINT PLAN—LONG TERM

- > World-class management team, culture and processes
- > Aggressive focus on the balance sheet, corporate governance and business/financial controls
- > Drive to world-class cost structure and quality levels
- > Target 20% share for all key activities
- > Invest for profitable growth
- > Increased emphasis on service and software solutions

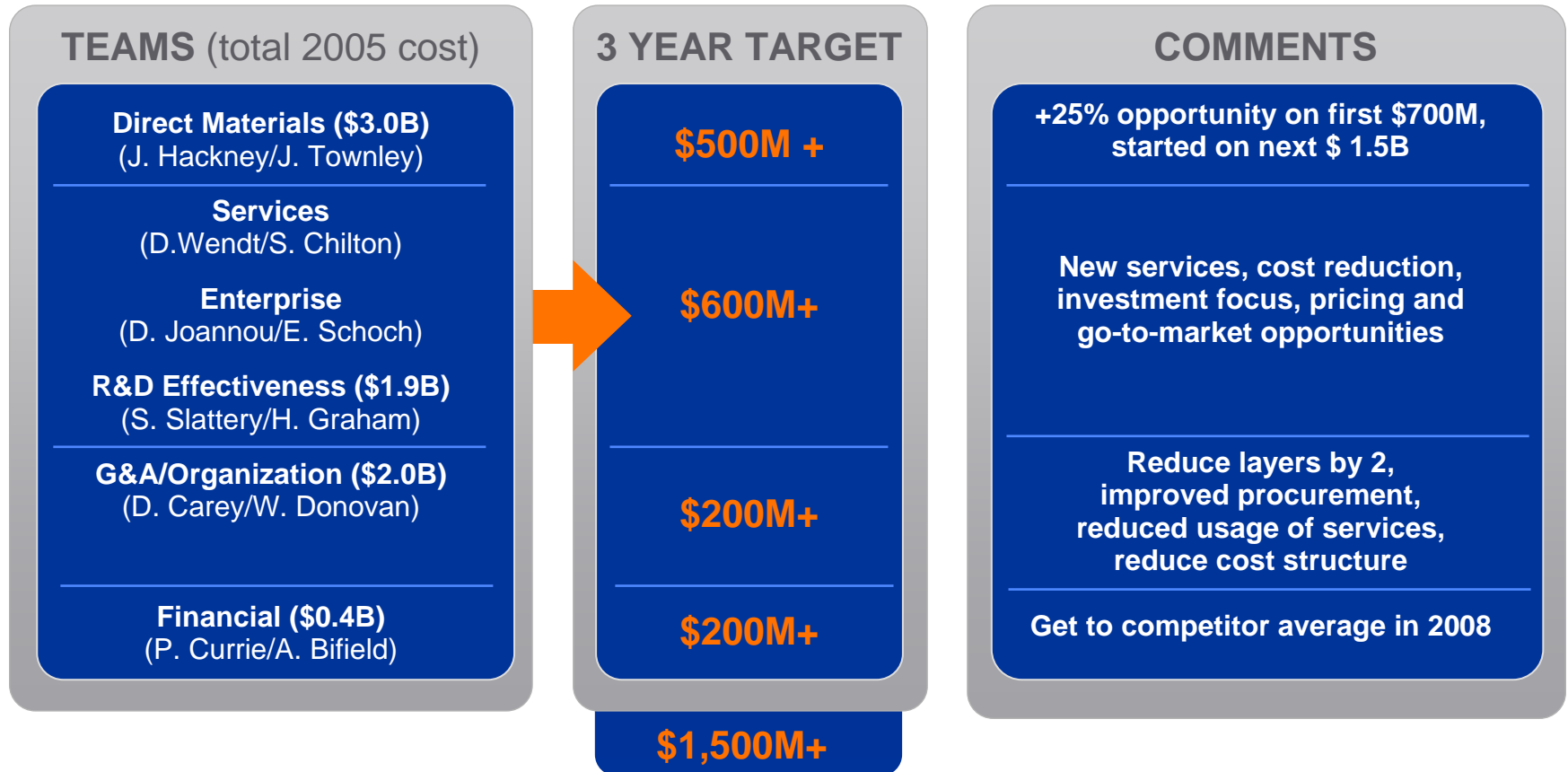
Foundational

Growth

## OPERATING RHYTHM—FOUNDATIONAL

- > I. People
- > II. Strategy
- > III. Product (MGPD)
- > IV. Budget

# Targeting \$1.5B of Operating Margin Expansion



Leadership commitment to deliver identified savings



# Q2 Update: Targeting \$1.5B of Operating Margin Expansion

## TEAMS (total 2005 cost)

**Direct Materials (\$3.0B)**  
(J. Hackney/J. Townley)

**Services**  
(D. Wendt/S. Chilton)

**Enterprise**  
(D. Joannou/E. Schoch)

**R&D Effectiveness (\$1.9B)**  
(S. Slattery/H. Graham)

**G&A/Organization (\$2.0B)**  
(D. Carey/W. Donovan)

**Financial (\$0.4B)**  
(P. Currie/A. Bifield)

## 3 YEAR TARGET

**\$500M +**

**\$600M+**

**\$200M+**

**\$200M+**

**\$1,500M+**

## Q2 Update

Program in place for first \$200M savings  
'06 transition costs and inventory bleed-off  
nominal in '06 with large incremental in '07 and '08

Warranty Policy revisions in-line with market  
Centres of Excellence established Mexico and Turkey  
New Go-To-Market Model

Organizational Simplification and Pension Plan  
Changes

SAP implementation on-track

Progress continues

# Growth Imperatives



## Actions We Are Executing

### Enterprise Go-to-Market

Invested in and strengthened channels  
Boosted SMB initiatives  
Launched IPT 1-2-3  
Expanded inside sales force

### Services

Established new operational model  
Invested in tools and processes  
Strengthened delivery  
Expanded services portfolio

### Metro Ethernet Networks

Launched MEN business unit  
Invested in MEN market development  
Introduced new ME and wireless products

### Microsoft Strategic Alliance

\$1B in new revenue over 3-year period  
Joint marketing, sales, channel dev.  
Will drive growth in enterprise & services

## Foundation We Are Building

**Mobility and  
Convergence**

**Enterprise  
Transformation**

**Services and  
Solutions**

**Business Made Simple**



# Summary

- > Comprehensive game plan
  - Restore Foundation
  - Recreate a Great Company
- > Committed to Integrity—forthright and transparent
- > Commitment to growth and strong financials

Passionate, Relentless Pursuit of Superior Results  
and Doing the Right Thing



> Q&A