

**NORTEL IN BRIEF**

Nortel is a recognized leader in delivering communications capabilities that make the promise of Business Made Simple a reality for our customers. Our next-generation technologies, for both service provider and enterprise networks, support multimedia and business-critical applications. Nortel's technologies are designed to help eliminate today's barriers to efficiency, speed and performance by simplifying networks and connecting people to the information they need, when they need it. Nortel does business in more than 150 countries around the world. For more information, visit Nortel on the Web at [www.nortel.com](http://www.nortel.com).

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**SELECTED FINANCIAL DATA**

Prepared in accordance with accounting principles generally accepted in the United States of America (millions of U.S. Dollars, except gross margin and per share amounts)

	<b>2007</b>	<b>2006</b>
Revenues	\$ 10,948	\$ 11,418
Gross margin percent	42.1%	38.9%
Net earnings (loss)	(957)	28
Earnings (loss) per common share – basic and diluted	(1.98)	0.06
Cash and cash equivalents	3,532	3,492
Total assets	17,068	18,979
Long-term debt	3,816	4,446
Shareholders' equity	2,758	1,121

All amounts in annual report are in U.S. Dollars unless otherwise specified.

The need to connect in a way that transcends time and space is driving it. The hunger for a heightened experience of everything is feeding it. Everyone on the planet craves it: bandwidth.

100 million videos watched on YouTube every day. Eight hours of video uploaded every minute. And high definition needs five times the bandwidth of regular video. The Internet is running out of Internet.

This is a drumbeat Nortel hears and understands. See how we are innovating to deliver the future at: [www.nortel.com/annualreport2007](http://www.nortel.com/annualreport2007)



## CHAIRMAN'S MESSAGE TO SHAREHOLDERS



The journey to renewal at Nortel continued throughout 2007. Progress on our multi-year transformation plan was made across the board and we are regaining a day-to-day operating rhythm for the company. We have also seen the further strengthening of the leadership team under CEO Mike Zafirovski with the appointment of several key executives including Paviter Binning as Executive Vice President and Chief Financial Officer and William Nelson as Executive Vice President, Global Sales.

These are two critical roles at Nortel. Having a leading, experienced CFO will be central to achieving the ever-higher quality financial controls and business processes Nortel needs to improve its operational effectiveness. Having a sales leader with deep experience and broad exposure to best-in-class sales and channels strategies will be key to delivering on the market opportunity we see before us. The Board welcomes them both.

We remain committed to integrity through effective corporate governance practices and enhanced compliance. We have gone from six material weaknesses to none. I am pleased to see this is being recognized by external experts in this regard. Nortel's Corporate Governance Quotient, as prepared by Risk Metrics, outperformed 97.8% of the companies in the S&P/TSX Composite and 91.7% of the companies in the Technology Hardware and Equipment group. And, according to Toronto's Globe & Mail governance report, Board Games, Nortel ranked 13 out of 190 companies. Throughout 2007 we continued to focus on increasing employee awareness of ethical issues through our code of business conduct. As is our CEO, the Nortel board is steadfast in its belief in rebuilding a great company the right way.

Nortel's strategy is continuing to gain traction in the marketplace and the level of customer engagements is encouraging. The company is also working to manage the company's technology investments to ensure higher yields and more profitable growth. Listening to customers' needs and understanding their business issues will be key to driving demand for Nortel's differentiated offerings. It is very clear, the leadership team in place is committed to engaging wherever work needs to be done to drive Nortel's transformation and overall business forward.

We have come a long way, but are very aware that there is more work to be done. It continues to be a privilege to work with Mike and the Board as we move towards a brighter future for Nortel. I am very much looking forward to what is in store and the opportunity to return this great global company to the leadership position it is capable of achieving.

A handwritten signature in black ink that reads "Harry J. Pearce". The signature is written in a cursive, flowing style.

Harry J. Pearce  
*Chairman of the Board*

## PRESIDENT AND CEO'S MESSAGE TO SHAREHOLDERS



Dear Nortel Investor:

Last year I told you that we were hard at work to transform Nortel and return your company to industry leadership; to become a great company again. Let me say up front that, like you, I am very disappointed with the stock performance and will address it later in this letter. But, I'm pleased to report to you, we have made very good progress throughout 2007, while competing effectively in a difficult environment. We did this while also fundamentally reshaping our company to compete and grow. We expect our progress to continue in 2008 and beyond.

We are on a multi-year journey to rebuild our company the right way. Today, we are more engaged with our customers, our industry and our business than we have been in a long time. Our employees – many of whom are shareholders themselves – are enthusiastic and deeply committed to our success. I am also gratified by the way the Board and the Nortel leadership team have forged a highly productive and transparent relationship that works in the best interests of the company. We are seeing our strategic vision of a hyperconnected world becoming real, not just in our research labs, but with our customers around the globe. We continue to simplify our own business, to make it easier for customers to do business with us and make our products, services and solutions simpler and more intuitive. This is the promise of **BUSINESS MADE SIMPLE**. As our new global advertisements say: *Why make it hard, when you can make it simple?*

In the prior letters, I highlighted our longer-term financial objectives as the litmus test of a normal, healthy company:

- .....  
Double-digit operating margin  
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- .....  
Strong cash generation  
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- .....  
Consistent revenue growth above market  
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- .....  
Improving share price  
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In 2007, we made strong headway in margin and good progress in revenue growth and cash generation. However, as already noted, the stock performance has been very disappointing. Let me provide you a little perspective on each of these areas:

**Operating margin (OM) for the year was 3.7%, the highest since 2000.**<sup>1</sup> We have now reported six consecutive quarters of strong year-over-year OM improvement, reflected

in a 353 basis points (bps) improvement in the second half of 2006 and a 369 bps improvement in 2007.

This OM improvement goes against the trends in the industry and is evidence that our business transformation plans are gaining traction and delivering tangible value to the business. I am particularly pleased with the attainment of double digit productivity in our global operations which has allowed our gross margin to expand. We have also invested more R&D dollars into growth and emerging areas while reducing the overall R&D spend. In 2008, we expect to see operating margin expansion of another 300 bps.<sup>2</sup>

**Cash flow from operations was positive for the second year in a row.**<sup>3</sup> Our cash conversion cycle was 40 days in the fourth quarter of 2007, an improvement of 8 days on top of the 10-day improvement that was made in 2006 as our Lean Six Sigma process improvements continue to gain traction. In addition, we have been successful in going to the capital markets and raising additional financing. The proceeds of the resulting convertible debt offering were used to proactively pay down a significant portion of the \$1.8 billion debt which is due in 2008.

**Revenues for the year, adjusted for UMTS, were up 2%.**<sup>4</sup> Enterprise revenues were up 14% year over year driven by our continued investments in our Go To Market strategy and product portfolio renewal. Our CDMA Wireless revenues were up 5% in a flat market. We maintained our #1 market share position in Carrier VoIP and achieved 12% growth in our optical DWDM business. Global Services revenues were up 7%<sup>4</sup> with consecutive sequential growth in all four of our Services focus areas. While our revenues remain solid for our core products, our investments are increasingly targeted on high-growth opportunities; some of these are nearer term, such as our innovative 40Gig Optical solution and PBT/PBB Carrier Ethernet technology. Others are longer term including the fourth generation LTE wireless market opportunity.

**Our share price has been disappointing.** We understand the market challenges and perceptions facing the industry. Intense competition, pricing pressures, consolidating customers, lower margins in developing countries and the slowing economy have battered the Nortel stock as well as our competitors, particularly on the carrier side. There is also the added skepticism regarding Nortel's potential to again be a great, relevant (and much higher market cap) company. Concerns expressed on Nortel are around our scale and portfolio age and mix. I even remember a magazine cover story that labeled our efforts: "mission impossible." And, to this day, I remember how fired up my team got in response; to prove that it was possible and that we were going to return this company to greatness.

We understand the environment and the related challenges and opportunities. We simply see the potential for Nortel differently. Today, more than ever, I believe we are on the right path. In the following pages, I will try to summarize why we are confident about the industry; our strategy, including how it is resonating with customers, partners and employees; progress in executing on our six-point plan; and, the journey ahead. In brief, how and why we will be successful.

## AN INDUSTRY IN TRANSITION

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Yes, the current environment is challenging, and the slowdown in the economy will impact the short-term growth in the industry, but the trends, overall size and specific growth pillars within the industry are appealing.

A year ago we predicted a future where every device and application that *could* benefit from being connected to the Internet and telecom systems *would* become connected. We called that future Hyperconnectivity. Now, one year later, we have seen that this prediction is happening even faster than we had expected. Did you see the Internet-based YouTube videos driving presidential debates in the USA, or e-book readers, such as Amazon Kindle, which is always-on and connected? We have seen underprivileged children in the developing world get Internet access via the One Laptop Per Child effort. We have seen the iPhone bring the cell phone experience to new levels of usage. And, we have seen the number of connected people expand with over 500 million new users of the global cellular networks in 2007 alone. Nortel is at the center of an industry that is now bigger, more critical to our work, life and economies than it was last year and, as Hyperconnectivity accelerates, it will become even more so as we move forward.

Our industry, while in transition, is clearly increasing in value and relevance. And, the markets where we operate are very significant. They generated approximately \$290 billion in 2007 – and are expected to grow by 5% to 6% a year, albeit less in 2008 with the slowdown in the economy. Even more importantly, some of the pillars that will drive Hyperconnectivity (unified communications, 4G, wireless broadband, 40Gig, 10Gig Ethernet and related applications) are expected to be in excess of 35% annually. Focusing on these high-growth areas will help us establish entry points for increasing growth and relevance in key customer segments.

## NORTEL STRATEGY

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This hyperconnected world, and the increasing demands it is placing on our industry, is a challenge that Nortel was built to address. We are about scale, robustness, efficiency and making communications possible. Our 112-year history has proven this and now as the industry accelerates into a new era – one we are helping to shape – those capabilities are at the core of our ability to compete and win. The Nortel strategy that we articulated over the past year, and have been executing on, is one of transforming the telecom world to live in the hyperconnected world. Our strategy capitalizes on this profound change and makes the connected future a reality. The two cornerstones of this change are the creation of a **true broadband** experience and the **communications enablement of the IT world**.

The **true broadband** experience is simply defined as the ability for you to be connected wherever you want, using whatever device or system you need, at a cost level that is acceptable and a quality level to which you are accustomed. Most importantly, this pervasive personal broadband experience must be so transparent and simple that you are able to incorporate that connectedness into your life and forget about the technology that is enabling the experience.

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### GROWING NORTEL FOR THE FUTURE: OUR THREE-PRONGED STRATEGY



Transformed Enterprise

Next Generation Mobility and Convergence

Services and Solutions

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The **communications enablement of IT** is a change of equal magnitude, as we believe that today the tools we use to create, store and view information are not integrated with the tools and systems we use to communicate that knowledge. By working with our partners such as Microsoft and IBM, both IT leaders, we are creating an experience where you can seamlessly move from the creation of knowledge to the collaboration and communications of that knowledge without continually stepping in and out of the most natural interfaces and applications available. This is essentially the convergence of IT and telecom, and Nortel, as the expert on communications, becomes an inseparable part of that future.

**WHY WE WIN**

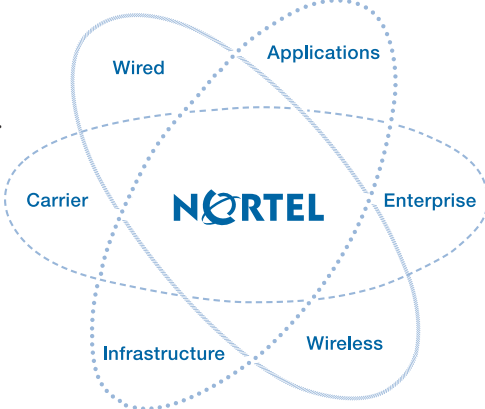
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With the changes that Hyperconnectivity drives and the acceleration of our use of technology, the companies that not only speak about the future but have the technical expertise and scale to make that future a reality will be positioned to win. With approximately 12,000 researchers and engineers and a history and culture of innovation, Nortel is in a position to lead the industry by creating the technologies that this future will be based on.

Our ability to win in this market is based not on our ability to simply show up but rather on our ability to move faster than our competitors to make the promise of Hyperconnectivity real. More than any other communications industry leader today, Nortel possesses a powerful combination of capability and experience that uniquely positions us to leverage emerging market dynamics and customer demand.

We have expertise in wired and wireless networks and a long history with both carriers and enterprises. Most important, we understand how to connect the dots between them. And, we are one of the few networking companies with a deep understanding of how to build and deliver applications.

Given the progress we have made in the last year and the response to our aggressive bets to accelerate to the future, we feel very well positioned to gain share and thrive in the hyperconnected era. An era that we were first to see and are now moving fast to be first to make real.



**THE NORTEL ADVANTAGE**

This drives our three-pronged strategy, to be a communications leader for:

## TRANSFORMED ENTERPRISE

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Nortel has a robust enterprise customer base that is deploying our products and applications over converged networks to provide new capabilities like unified communications and improved capacity, speed, security and reliability, all while lowering costs. Enterprises are shifting their focus from independent telephony networks to building collaborative communications into their business processes. As this takes place, business applications will be designed, built and deployed in new ways to deliver integrated communications that enhance productivity and provide a competitive advantage to our customers. Nortel works with a world-class ecosystem of partners to ensure enterprises have the best possible communications and networking solutions.

Modern enterprises need rock-solid reliability and strength to meet the accelerating needs of global business. Nortel is building some of the most sophisticated enterprise solutions in the world. We are creating the communication-enabled applications experience for the enterprise and leapfrogging the competition. Many speculated that aligning with major IT companies was too risky or would benefit our partners at Nortel's expense. Yet, our technological capability allowed us to forge deep and meaningful partnerships where the value of our integrated solutions was immediately seen by our customers. The impact on our Enterprise business has been nothing short of exceptional. The innovation investments creating this value include Service Oriented Architecture (SOA), enabling the IT ecosystem to access our vast communications capabilities.

Additionally, our shift to this software architecture has transformed the speed and flexibility we have in delivering new experiences to both enterprises and carriers. A year ago it was realistic to expect new capabilities to take years to develop but today we have many new solutions being delivered in weeks. This is key to serving our customers and their consumers who have come to expect the instant delivery of new capabilities. Now, that expectation for instant adaptation can be satisfied in their communications experience as well, thanks to Nortel.

Customer engagements are demonstrating the business value Nortel brings to the table:

**Mumbai and Bangalore Airports:** In emerging markets, like India, airports need to cope with immediate growth in demand as well as deliver a vision for the future that considers the evolving needs of airport users. These networks are challenging because they integrate multiple technologies, but above all, they *must* be reliable and secure and flexible enough to cope with huge growth in demand. By leveraging Nortel's ex-

pertise across optical, Ethernet, and enterprise technologies and focusing on specific customer needs, we are helping shape the modern airport. The new wired and wireless infrastructures will benefit passengers, airline staff, retailers, security and airport operations employees.

**Vancouver Olympic Committee:** Managing communications for the Olympics – connecting the news media, athletes, Olympic families, officials, workforce and volunteers – that’s about as complex as it gets. As the official converged network supplier for the Vancouver 2010 Olympic Games, Nortel will be working with Bell Canada and Olympic organizers to deliver the most sophisticated, all-IP network ever built for a global sporting event. This is a marquee opportunity that will give Nortel global visibility. The network will cover 15 disperse Vancouver and Whistler Games venues, as well as numerous support sites to meet the voice, video and data communications needs of as many as 90,000 individuals, not to mention a million plus spectators. This deployment includes 75% of Nortel’s total product offerings, and we’re building the whole system from the ground up.

## NEXT GENERATION MOBILITY AND CONVERGENCE

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Nortel is boosting the adoption of mobile multimedia and the delivery of a true mobile broadband experience through our leadership in 4G-enabled technologies such as LTE, WiMAX, and IMS. Coupled with our innovation leadership in Carrier Ethernet and 40 Gigabit optical technologies, we are working to deliver affordable true broadband. These unique capabilities along with our #1 position in Carrier VoIP, deep knowledge of CDMA and GSM, and other applications/solutions such as fixed mobile convergence, IPTV and application servers puts Nortel in a strong position to deliver advanced, high value solutions to our customer over a number of access technologies.

To make the true broadband experience real, Nortel has leveraged its history of scaling communications systems capacity to create new mobile wireless, optical and packet transport technologies. Our significant investments have, again, leapfrogged the industry and created true first-mover advantage in next generation communications. We are helping make 4G wireless networks a reality and, as a result, some of our most significant carrier customers are now in the vanguard of 4G adoption. Our strategic investments aimed at accelerating the wireless future means we are now viewed as one of the most aggressive proponents of moving the industry forward.

In the high-capacity Optical Internet core business Nortel is again leading with innovation. When many competitors stopped investing in new optical technologies because of momentary excess capacity, we took the long-term view and continued to invest to satisfy what we saw as an insatiable demand for capacity. This year, we will begin to ship our 40 Gigabit optical systems with technology that leverages the existing fiber optic infrastructure. We are unique in this capability and, given the cost of replacing the tens or hundreds of billions of dollars of existing fiber, our offering creates a true competitive advantage for Nortel. Beyond 4G and Optical, innovation is alive and well in the rest of Nortel. Our Metro Ethernet customer base has gone from a vision to having over 30 operator wins in less than a year.

We are deploying end-to-end WiMAX solutions with operators around the world. And we are trialing LTE, the next evolution of 4G, with operators including **Verizon Wireless**. We have dedicated more than eight years to developing 4G and hold significant intellectual property rights around technologies for WiMAX and LTE.

These technologies aren't just about faster connections; they are about newer, more cost-efficient solutions for our customers.

We are working with **Wind Telecom** in the Dominican Republic to launch one of the world's first commercial WiMAX networks and deliver broadband services to urban and rural customers who have limited access, as well as to enterprises that can use advanced broadband for eCommerce and to improve their bottom lines. Our WiMAX technology delivers the highest performance at the most competitive cost-per-mega-bit in the industry. Nortel has all the elements needed to bring carriers successfully into the 4G world: innovation in WiMAX and LTE, a strong ecosystem, all IP-core, and a deep understanding of what consumer and business users are looking for from their wireless experience.

We're seeing strong traction with our Metro Ethernet and Optical products. In last year's annual report we told you about **BT's** selection of our Metro Ethernet technology as a key component to their 21st Century Network. In 2007 we landed another milestone contract with **Verizon** for a Pan-European optical network to accommodate surging network traffic across the UK, France, Belgium, Germany and the Netherlands. Key to this win is our ability to scale the network from handling 10Gig of traffic to 40Gig as needed to meet the growing needs of Verizon's large enterprise customers. We are also working with **Telefonica** on 40Gig. And our Global Services business was also critical for providing the turn-key installation and integrating existing management and operation center systems.

## SERVICES AND SOLUTIONS

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As networks converge and customers move forward to realize the promise of unified communications, they face increasing levels of operational risk and complexity. Customers are searching for services and solutions – not just point products – and Nortel has the capabilities and ecosystem of partners to respond to that demand. Customers want a business partner who can provide end-to-end services and solutions that reduce complexity and translate into true competitive advantage. They want, in essence, **BUSINESS MADE SIMPLE**.

Nortel Global Services offers end-to-end solutions combining comprehensive network expertise, world class partners and global reach. Together with our partners, we provide a complete lifecycle of multi-vendor, multi-technology services for the Carrier and Enterprise markets including: implementation, support, managed and applications services. We offer our services and solutions to our clients in the context of their specific industry needs and challenges with solutions for verticals

such as healthcare, hospitality, financial services, government and education tailored to their unique requirements.

Nortel Global Services employs a consultant-led approach, combining our expertise in key technology areas such as Contact Centers, Unified Communications, Multimedia/Telepresence and Managed Services with the power of our ecosystem, enabling our customers to realize the rewards of a **Services Powered Business**.

Operators, like Mexico's leading telecommunications company **TELMEX**, are awarding Nortel managed services contracts because we take the complex and make it simple. For TELMEX, we bring cutting-edge IP telephony and multimedia services to their enterprise customers by hosting them on our own network. This helps TELMEX focus their capital investments elsewhere, as they save the expense of installing, operating and maintaining their own network. For TELMEX, it is important we provide a flexible solution that easily adapts and scales to the needs of their customers.

Our managed services agreement with India's **Bharti Airtel** was recognized with one of the 2007 Outsourcing Excellence Awards, otherwise known as the 'Oscars of Outsourcing.' And, we are sharpening our focus on comprehensive solutions for such vertical markets as hospitality, healthcare, education, finance, and state and municipal government. For example, our healthcare solutions are helping to streamline orders and technician dispatch in the radiology department of **Baylor University Medical Center** in Dallas, and to dramatically reduce patient discharge time and cost for Orlando's M.D. Anderson Cancer Center, a subsidiary of **Orlando Regional Healthcare**. And, the **State of Kentucky** is implementing a complete Nortel Education Solution, including infrastructure, applications, managed services and security services. The solution enhances the learning experience, supporting intelligent classrooms and online tools for collaboration and assessment.

## EXECUTING ON OUR SIX-POINT PLAN

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Success in this marketplace will require both a sound strategy that resonates with customers and operational effectiveness. As you have seen, we are stabilizing the company financially and we won't stop. We have made substantial progress against our transformation plan which I established two years ago and called our **six-point plan to re-create a great company**. Management and employees have been unrelenting in driving the broad objectives and commitments in each area, and much was accomplished in 2007. And, let me assure you, we will be accelerating our progress and efforts in these areas in 2008.

- 1. World-class management team, culture and processes.** We continue to build a high-performance culture day-in, day-out, through excellence in everything. The quality of the leadership team continues to set the bar for any industry with important additions in 2007 of a new CFO, EVP of Global Sales, CIO and other key roles. Equally important, we have been focused on developing the company's emerging leaders at all levels, improving people management skills across the company, and engaging with and motivating all employees. We enhanced our focus on driving growth, efficiency and customer satisfaction, and undertook over 250 Lean Six Sigma projects in one of the fastest and best implementations

I have ever seen. We opened Centers of Excellence in Mexico and Turkey to provide customers with technical and operational support; and, we implemented employee improvement ideas through our Own It! program with a \$60M financial benefit. Employees are very engaged in the turnaround – participating in brainstorming sessions, creatively driving change and taking personal ownership and responsibility, alongside leadership, for Nortel's transformation.

2. **Aggressive focus on the balance sheet, corporate governance and business/financial controls.** From new debt refinancing to an improved cash position, the financial aspects of the company's transformation are improving. The regulatory and accounting matters of the past have been concluded. We have gone from six material weaknesses in internal controls for financial reporting two years ago to none today. We continued the transformation of the finance organization and focused on deploying SAP processes in order management, materials handling, repair and return, inventory and shipping. Recognition for our governance processes is increasing. Nortel's Corporate Governance Quotient, as prepared by Risk Metrics, outperformed 97.8% of the companies in the S&P/TSX Composite. We reached settlements with both the Ontario Securities Commission and the Securities and Exchange Commission. Today, our future rests on our ability to innovate, compete and deliver value to our customers.
3. **Drive to world-class cost structure and quality levels (and mid-teens operating margin).** This is perhaps the toughest, but arguably one of the most important pillars of our transformation. Achieving the right cost structure and quality levels is critical to fund our future and to ensure our ability to compete and win in the market. We have made progress, but we are still not achieving our stated business model. We have achieved a cumulative \$840 million at the end of 2007 of the overall \$1.5 billion margin expansion planned for our Business Transformation efforts.

#### NORTEL'S BUSINESS MODEL

	2006	2007	LONGER-TERM GOAL
GROSS MARGIN	38.9 %	42.1 %	43 %
R&D	17.0 %	15.7 %	14-15 %
SG&A	21.9 %	22.7 %	15-17 %
OPERATING MARGIN	0.0 %	3.7 %	13.0 %

We continue to be committed to this business model and have plans to achieve it, while making the right investments to ensure our future.

4. **Target 20% share for all key activities.** In 2007, we continued to focus efforts in markets where we could demonstrate relevance and achieve the scale we need to lead and drive profitable growth. We define relevance as achieving a 20% market share in R&D intensive areas; reaching a top-three position in specific markets; or, demonstrating an ability to deliver unique solutions/services to customers. We recognize that this is a multi-year journey and have made progress toward our goals through our own development, partnering, divestitures or acquisitions. This work continues.
5. **Invest for profitable growth.** R&D is almost at our target of 15% of revenue. We have been able to redirect hundreds of millions to new technologies discussed throughout this letter and are involved in more emerging technologies than a year ago. That is progress. We are

also reshaping the R&D function and driving toward capabilities like CMMI, a new strategy on R&D sites, design-to-value processes, and common engineering. As we further renew our commitment to being a market leader, we are seeing results of that both in the marketplace and in employee satisfaction, critical to attracting and retaining the right technical leaders.

- 6. Increased emphasis on service and software solutions.** In 2007 we built a unique services and solutions offering that combines world-class partnering capability, comprehensive networking expertise and global reach. We partnered with market leaders HP, IBM, Microsoft and Dell to create a global ecosystem for delivering and managing comprehensive solutions for our customers. We identified and targeted services investment in key growth areas: Multimedia Services, Managed Services, Contact Center Solutions, and Unified Communications Solutions. We also continued to focus on delivering end-to-end solutions – spanning the requirements across wired/wireless, enterprise and carrier markets, applications and infrastructure – in every region of the world. And, we leveraged our applied technology knowledge and services expertise to create innovative customer business solutions for our key vertical market segments, including healthcare, finance, hospitality, education and local government. We have made great progress and are in a position to accelerate.

## THE JOURNEY AHEAD

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I see a year of promise, but also a year of market uncertainty ahead of us. Our transformation and renewal will continue to unfold against a backdrop of not just industry, but global business and economic change. I realize the world will not stand still and neither will Nortel. We will continue to take bold and difficult steps to ensure we are in control of our destiny.

I wish all our shareholders could have seen the enthusiasm of our leadership team and of our global sales teams when I assembled them recently to review our 2007 performance and 2008 execution priorities. Our theme for 2008 is simple: To accelerate. There is a true sense of momentum we have in driving results; a tenacity that is building a high-performance culture across Nortel. Our energy and mindset in pursuing our objectives is truly contagious.

For us, this is not completely new. Even though I have only been here for a short while in comparison to Nortel's history, I am deeply aware of the thread of renewal that has run through this company since its inception. For over a century, we have drawn people together around a simple human need: communication. Over that time, some of the world's greatest innovators and thinkers have joined our ranks to be part of a great enterprise dedicated to simplifying and enriching that endeavor.

As we enter a new era for Nortel and for communication, I am proud of our employees for bringing us this far and I would like to thank you, our shareholders, for your trust and support in this journey. I am encouraged by the opportunities that are ahead with customers, partners and you. Together, we can see Nortel into the next decade and its next phase of innovation and industry leadership.



Mike Zafirovski,  
*President and CEO*

<sup>1</sup> Operating Margin is a non-GAAP measure defined as Gross Profit less SG&A and R&D expenses. Operating Margin percentage is a non-GAAP measure defined as Operating Margin divided by Revenue. Nortel's management believes that these measures are meaningful measurements of operating performance and provides greater transparency to investors with respect to Nortel's performance and supplemental information used by management in its financial and operational decision making. These non-GAAP measures may also facilitate comparisons to Nortel's historical performance and competitors' operating results. These non-GAAP measures should be considered in addition to, but not as a substitute for, the information contained in Nortel's financial statements prepared in accordance with GAAP. These measures may not be synonymous to similar measurement terms used by other companies. Note that commencing in the first quarter of 2008, the primary financial measure used by the CEO in assessing performance is Operating Margin.

<sup>2</sup> The Company's financial outlook contains forward-looking information and as such, is based on certain assumptions, and is subject to important risk factors and uncertainties that could cause actual results or events to differ materially from this outlook. 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 letter, including 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; 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.; improvement in Nortel's product costs due to favorable supplier pricing, offset by higher costs associated with customer deployments in emerging markets; cost reductions resulting from the 2008 and 2007 restructuring plans; increased employee costs relative to expected cost of living adjustments and employee bonuses; and the effective execution of Nortel's strategy, including the execution of Nortel's supply chain strategy and the implementation of its Business Transformation initiatives in 2008. Nortel has also made certain macroeconomic and general industry assumptions in the preparation of its financial guidance including: global service provider capital expenditures in 2008 reflecting low to mid single digit growth as compared to mid to high single digit growth in 2007; global growth rate to remain stable with investments in next generation products and services to exceed declines in purchases of legacy equipment; and a moderate impact as a result of expected industry consolidation among service providers in various geographic regions, particularly in North America and EMEA. The above assumptions, although considered reasonable by Nortel at the date of this letter, may prove to be inaccurate and consequently Nortel's actual results could differ materially from its expectations set out in this letter. Further, actual results

or events could differ materially from those contemplated in forward-looking statements. For additional information with respect to certain of these and other factors, see Nortel's Annual Report on Form 10-K and other securities filings with the United States Securities and Exchange Commission. 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.

<sup>3</sup> Cash flow from operations of \$182 million, which excludes the \$585 million outflow related to the litigation settlement, is a non-GAAP measure. Nortel's management believes that this supplemental information is meaningful, given the impact on cash flow from operations of the global class action litigation settlement, by providing greater transparency to investors with respect to Nortel's performance and by facilitating comparisons to Nortel's historical performance. This non-GAAP measure should be considered in addition to, but not as a substitute for, the information contained in our financial statements prepared in accordance with GAAP.

<sup>4</sup> Consolidated revenue excluding UMTS revenue is a non-GAAP measure. Nortel's management believes that this supplemental information is meaningful, given the sale of the UMTS Access business, by providing greater transparency to investors with respect to Nortel's performance and by facilitating comparisons to Nortel's historical performance. These non-GAAP measures should be considered in addition to, but not as a substitute for, the information contained in Nortel's financial statements prepared in accordance with GAAP.

## CERTIFICATION

Mr. Zafirovski, President and Chief Executive Officer, certified to the New York Stock Exchange on May 25, 2007, pursuant to Section 303A.12 of the NYSE's listing standards, that he was not aware of any violation by the Company of the NYSE's corporate governance listing standards as of that date.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 were filed as exhibits to our 2007 Annual Report on Form 10-K.

## CORPORATE HEADQUARTERS

Nortel Networks Corporation  
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Tel: 905 863-7000

## STOCK EXCHANGE LISTINGS

The common shares of Nortel Networks Corporation are listed on the New York Stock Exchange (NYSE) and the Toronto Stock Exchange. The 4.25% Convertible Senior Notes due 2008 issued by Nortel Networks Corporation are listed on the NYSE.

## FORM 10-K AND ANNUAL REPORTS

Nortel Networks Corporation's Annual Report on Form 10-K, and other documents filed with the United States Securities and Exchange Commission and applicable Canadian securities regulatory authorities, and this annual report – in English and French – are available free of charge on our website: [www.nortel.com](http://www.nortel.com) under "Investor Relations," or paper copies can be requested through:

[http://www.nortel.com/corporate/investor/info\\_request.html](http://www.nortel.com/corporate/investor/info_request.html)

or by contacting Nortel Investor Relations:

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These documents are also available without charge upon request to:

## TRANSFER AGENT AND REGISTRAR

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