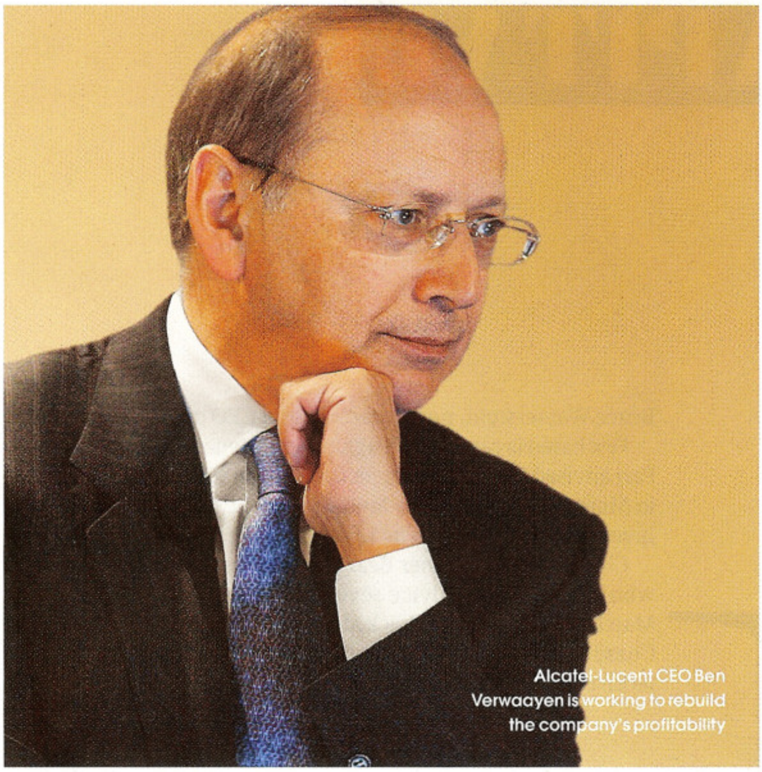

Alcatel-Lucent CEO Ben Verwaayen is working to rebuild the company's profitability

Raising Cash

Alcatel-Lucent moves to strengthen its balance sheet by selling its stake in defense electronics giant Thales.

•• BY DAVID GRAUBARD

TELECOMMUNICATIONS EQUIPMENT giant Alcatel-Lucent, of Paris, had been in talks for months with possible buyers of its 21 percent stake in Thales Group, the French defense electronics company. On December 20 it finally landed a deal. Alcatel-Lucent announced that it had reached a definitive agreement to sell the stake to France's Dassault Aviation.

Thanks to a just-in-time-for-Christmas 25 percent premium to the market value of the Thales holding, the $2.23 billion deal gives Alcatel-Lucent a much-needed opportunity to clean up its balance sheet, which has been weakened by years of corporate losses. Proceeds from the sale, expected to close in 2009, will erase Alcatel-Lucent's net debt position of $858 million as of the third quarter of 2008. In November 2007 aerospace group European Aeronautic Defence and Space Co. EADS, the owner of Airbus, offered $2.3 billion for the Thales stake, but the sale was opposed by then–Alcatel-Lucent CEO Patricia Russo, who saw Thales as a beneficiary of strong defense spending. Russo and Alcatel chairman Serge Tchuruk announced last summer that they were leaving the company.

"We view this [the sale of Thales] as positive news that could boost the stock, and the improved cash position may temper investor fears of the company's insolvency," says Simon Leopold, a technology analyst at Memphis-based Morgan Keegan & Co. who has a buy rating on the stock. For all the financial benefits, however, some shareholders fear that the deal could compromise the growth of Alcatel-Lucent, which had $27.8 billion of revenue in 2007.

The company is hardly alone in the race to raise cash by shedding businesses. Corporations around the globe are scrambling to execute asset sales as prices continue to drop. They face a strategic dilemma in doing so. Short term, the goal is to batten the hatches until a strong economic recovery appears, expected in 2010. But long term, there's a severe cost to selling assets in a down market, because buyers naturally want the most-profitable, most-stable assets. Sell-offs, then, can damage the future profitability of the seller.

"Alcatel-Lucent's liquidation of its Thales stake, while not a core business for the firm, is similar to burning your furniture to heat your home," says Daniello Natoli, a technology analyst who covers Alcatel-Lucent at financial services and research provider Matrix USA in New York. "Eventually, the firm will run out of assets to sell to service its debts."

Natoli, who sees overcapacity as the theme of the closing years of this decade, especially in industries such as telecom equipment, financials and airlines, thinks there's a bigger, macro cost as well. "There is little pricing power. As these highly indebted firms are forced to liquidate their assets, a deflationary spiral will likely ensue within their respective industries," he says.

Alcatel-Lucent American depositary receipts were down 71 percent in 2008, to $2.15, while shares of Thales, which is based in the Paris suburb of Neuilly-sur-Seine and had $16.4 billion of revenue in 2007, were off 27 percent for the year. Thales outperformed such rivals as Boeing Co., based in Chicago, which was down 53 percent, to $41, over the same period. Alcatel-Lucent hasn't shown a profit since Alcatel merged with U.S.-based Lucent Technologies in 2006 to form a company that once had a market cap of $31 billion. That figure has dropped to about $5 billion. The company has lost about $7 billion since the merger.

Russo was replaced in September by veteran telecom executive Ben Verwaayen, former CEO of Britain's BT Group. Neither Verwaayen nor other company officers were available for comment. Alcatel-Lucent advisers BNP Paribas and JPMorgan Chase & Co. declined to comment, as did Thales adviser Société Générale.

Several analysts say the 25 percent premium on Thales's shares was a fair deal for Alcatel-Lucent. Olivier Brochet, who covers Thales for New York–based Natixis Securities, pointed toward a comparable deal in May 2008, when Italy's aerospace giant Finmeccanica bought Cincinnati defense engineering company DRS Technologies at a 35 percent premium. ••

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