SUN MICROSYSTEMS, INC.
Form 10-K
August 29, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 30, 2007

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____.
Commission file number 0-15086

SUN MICROSYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-2805249**
(State of incorporation)	(I.R.S. Employer Identification No.)
4150 Network Circle	**(650) 960-1300**
Santa Clara, CA 95054	(Registrant s telephone number, including area code)
(Address of principal executive offices, including zip code)	**http://www.sun.com/aboutsun/investor**
	(Registrant s url)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. YES **x** NO ¨

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the Exchange Act). YES ¨ NO **x**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES **x** NO ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. YES ¨ NO **x**

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer **x** Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO **x**

The aggregate market value of the voting stock (Common Stock) held by non-affiliates of the registrant, as of December 31, 2006 (the last business day of registrant s second quarter of fiscal 2007), was approximately $15 billion based upon the last sale price reported for such date on The NASDAQ Stock Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the Registrant have been excluded because such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

The number of shares of the registrant s Common Stock (par value $0.00067) outstanding as of August 22, 2007 was 3,537,517,215.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference into Items 10, 11, 12, 13 and 14 hereof.

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PART I

ITEM 1. BUSINESS

GENERAL

Sun Microsystems, Inc. (NASDAQ: JAVA) provides network computing infrastructure product and service solutions. A consistent vision, The Network is the Computer , has been the driving force behind our technology innovation for over 25 years. Our core brands include the Java technology platform, the Solaris operating system, Sun StorageTek storage solutions and the UltraSPARC® processor. By investing in research and development, we create products and services that address the complex information technology issues that customers face today, including increasing demands for network access, bandwidth and storage. This demand is driven by our ability to expand our network s reach by sharing our technologies with the user community, which in turn presents a greater opportunity for us to provide the infrastructure that runs the network.

Our network computing infrastructure solutions are used in a wide range of industries including technical/scientific, business, engineering, telecommunications, financial services, manufacturing, retail, government, life sciences, media and entertainment, transportation, energy/utilities and healthcare. We innovate at all levels of the system and partner with market leaders to provide value and choice for our customers.

For the fiscal year ended June 30, 2007, we had net revenues of $13.9 billion, employed approximately 34,200 employees and conducted business in over 100 countries. We were incorporated in California in February 1982 and reincorporated in Delaware in July 1987.

Our Investor Relations Web site is located at http://www.sun.com/aboutsun/investor. We post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the U.S. Securities and Exchange Commission (SEC): our annual reports on Form 10-K, quarterly reports on Form 10-Q, our current reports on Form 8-K, our proxy statement related to our annual stockholders meeting and any amendments to those reports or statements filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. All such filings are available free of charge on our Investor Relations web site. The contents of these web sites are not intended to be incorporated by reference into this report or in any other report or document we file and our references to these web sites are intended to be inactive textual references only.

BUSINESS STRATEGY

Our business strategy is to provide superior network computing infrastructure solutions that rely on innovation as a core differentiator. We invest in research and development to create products and services that provide competitive differentiation for our customers and for developers adopting our technology. We develop and integrate software, microprocessors, storage, services and systems and share our technology in order to grow communities of developers and users, increase participation on the network and build new markets. By investing in research and development as well as product and services technology acquisitions, we believe it is possible to develop and deliver competitively differentiated systems technology and solutions to address the complex information technology issues customers face today. We intend to continue our investments into new computing technologies and remain focused on the development and delivery of leading-edge network computing products based upon our latest innovations.

Our commitment to open standards and open interfaces, the open source community, sharing and collaboration is key to our long-term success. We believe that creating communities and sharing innovations and technologies will foster global network participation and help to eliminate the digital divide. Our open source initiatives are intended to increase participation in software and hardware design by making our innovative hardware and software intellectual property freely available. A core premise of our software business is that success depends on our ability to attract innovative applications developers to our platforms: the Solaris operating system and Java. We build relationships with these communities to stimulate demand for our commercial products. More Solaris operating system licenses means more open doors for our sales force and for our partners. More Java technology-driven devices means more demand for what we build. Today, there are more than 5.5 billion Java-powered devices in the marketplace. As more people gain access to the network, we see increased opportunities for developers and businesses to deploy applications that create value, from educational institutions deploying high-performance computing (HPC) grids, to banks and social networks serving millions of users. Bringing more people to the network and encouraging development of community-based innovative intellectual property fuels greater demand for the technologies and services that we create. The key investments that we integrate to create value for customers are computer systems and microprocessors, software, services and storage.

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Accordingly, the cornerstones of our business strategy are:

Innovation and Intellectual Property Creation. In order to maintain our position as a leading developer of enterprise and network computing products and technologies, we must continue to invest and innovate. Some examples of our invations since the beginning of fiscal 2007 include:

We introduced the UltraSPARC T2 processor (formerly known as Niagara 2), as part of our processer line that includes chip multi-threading (CMT) at the processor level. Using CoolThreads™ technology, this processor delivers a 64-way system on a single chip with the capability to run an operating system domain on each of its 64 threads (8 threads per core per core, 8 cores per processor). It also integrates the key functions of multiple system-virtualization, processing, networking, security, floating point units and accelerated memory access. Integrating these elements on to a single piece of silicon reduces costs and increases performance, reliability and energy efficiency, which makes it a competitive choice for a diversity of workloads, from networking equipment to high-performance computing or storage devices.

We introduced Sun™ Streaming System, a massively scalable and cost-effective video delivery platform for cable and telecommunications operators. The system delivers advanced video streaming capacity and cost-effective personalized video delivery over existing optical network infrastructure.

We introduced the Sun Blade™ 6000 Modular System. The Sun Blade 6000 Modular System, an enterprise blade platform, provides up to double the memory and double the I/O capacity of competing blades and rackmount servers.

We introduced the Solaris 10 Solaris Dynamic Tracing (DTrace) technology, which has been honored with the top prize in The Wall Street Journal s 2006 Technology Innovation Awards.

We previewed JavaFX™ Script, a radically simple scripting language for creating rich content and applications to run on billions of Java-powered devices, such as mobile phones and Blu-ray Disc players.

We announced two advances that demonstrate our continued leadership in CMT and commitment to advancing the SPARC® architecture. We successfully completed the initial design for fabrication of our new Rock processor and announced our continued enhancement of the Sun Fire T2000 servers.

We announced Project BlackBox, a virtual datacenter in a shipping container. Project BlackBox applies our network computing infrastructure and HPC expertise to provide customers with a secure, modular data center that can be deployed anywhere in a matter of weeks. Several patents are pending on the Project BlackBox, from the general system and installed rack designs, to various aspects of the cooling systems, including its environmental monitoring system that delivers breakthrough economics and energy efficiency.

We introduced the Sun Fire™ X4500 (code-named Thumper), a hybrid data server, which combines a 4-way x64 server (x64 refers to AMD and Intel 64-bit processors) with up to 48 disk drives and 24 terabytes (TB) of storage.

We also delivered key enhancements to our flagship Solaris 10 operating system, including new features and additions to our revolutionary Solaris ZFS File System. This 128-bit file system provides provable data integrity by employing 64-bit checksums that detect and correct silent data corruption and dramatically simplify storage administration and configuration.

We hold a number of U.S. and foreign patents relating to various aspects of our products and technology.

Interoperability and Choice. We take a whole system view of the products that we deliver into the marketplace. We are uniquely qualified to integrate our microelectronics, servers, storage, software and services into eco-responsible solutions that can transform information technology

(IT) into a competitive weapon for customers. Our focus on providing multi-platform implementations provides customers with greater choice for their heterogeneous environments. The Solaris operating system is now available on over 890 different systems and the Java Enterprise System is available on Linux, Windows and HP-UX in addition to Solaris. Our x64 systems are available for use with Solaris, Windows, Red Hat and SuSe Linux operating systems, and our SPARC systems are available with Solaris and Ubuntu Linux. We remain committed to standards-based designs and implementations, including standards-based networking protocols and Web services that allow customers to build heterogeneous network computing environments. Interoperability gives customers choice so they can choose best-of-breed hardware and software solutions for their IT environments.

Environmentally Responsible Products and Business Practices. Eco-responsibility is part of our overall corporate social responsibility strategy, which strives to create positive social change, minimize environmental impact and generate business. Our approach to eco-responsibility is to deliver eco-friendly products that enable sustainable computing, reduce the environmental impact of our own operations, and build and share open source solutions.

We are innovating to develop products and programs that reduce energy needs and carbon dioxide (CO^2) production at all levels including microprocessors, servers, thin clients and computer grids. We are also reducing the environmental impact of our own

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operations by choosing less harmful materials; working to recover, remanufacture or recycle products; and continuing to strive to minimize electronic waste.

In 2006, we partnered with Pacific Gas & Electric to offer California customers an energy incentive rebate when they upgraded to Sun Fire T1000 and T2000 servers with CoolThreads technology. Our cost control objectives are facilitated by our Open Work Practice, which allows our employees to work remotely and eases pollution, reduces energy use and contributes to reduced real estate costs. More than 14,000 of our employees around the world work from home or in a flex office up to two days a week and approximately 2,800 of our employees do so from three to five days a week.

SEGMENT INFORMATION

During fiscal 2007, our operations were organized into two business segments: products and services. Our products revenue is comprised of sales of Computer Systems products and Storage products. Our services revenue is comprised of sales from two classes of services: (1) Support Services, which consists of maintenance and managed services and (2) Professional Services and Educational Services, which consists of technical consulting to help customers plan, implement and manage distributed network computing environments and developing integrated learning solutions for enterprises, IT organizations, and individual IT professionals. In fiscal 2007, 2006, and 2005, Computer Systems represented approximately 47%, 46%, and 53%, respectively, of total net revenues. In fiscal 2007, 2006, and 2005, Storage products represented approximately 17%, 18%, and 12%, respectively, of total net revenues. In fiscal 2007, 2006, and 2005, Support Services represented approximately 29%, 28%, and 27%, respectively, of total net revenues. A table providing external revenue for similar classes of products and services for the last three fiscal years is found in Note 15 to the Consolidated Financial Statements in Item 8. A table presenting revenues, operating income (loss) and total assets for each segment for the three fiscal years ended June 30, 2007 is found in Note 15 to the Consolidated Financial Statements in Item 8.

PRODUCTS

We develop innovative networking computing products and technologies that include energy-efficient servers, storage, open source software, tools, services and training. For information about revenue for similar classes of products and services, refer to Note 15 to the Consolidated Financial Statements Industry Segment, Geographic, and Customer Information and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations.

SYSTEMS

The substantial growth of network data and traffic, increasing compliance and regulatory demands, expanding needs for increased computing capacity and market pressure for energy and space reductions require a broad set of system solutions that are cost effective, reliable, scalable and eco-responsible.

Servers. We offer a full line of scalable servers based on SPARC64®, Sun UltraSPARC, AMD Opteron and Intel® Xeon® microprocessors, that range from cost- and energy-efficient entry-level servers and blade systems through data center/HPC business critical computing servers designed for heterogeneous computing environments.

Entry-level server systems. We offer a wide range of Sun Fire and Sun Blade entry-level server systems differentiated by their size, their cost, their processor architecture (UltraSPARC, SPARC64, AMD Opteron or Intel Xeon), their form factor (rack, blade or stand-alone systems) and the environment for which they are targeted (general purpose or specialized systems). These systems are compatible with the Solaris, Linux and Windows operating system environments.

Enterprise and data center servers. Our enterprise and data center servers, including the Sun Fire and SPARC Enterprise product families, are designed to offer greater performance and lower total cost of ownership than mainframe systems for business critical applications and more computational intensive environments. These systems are based on UltraSPARC, SPARC64, AMD and Intel microprocessor platforms and are also compatible with the Solaris, Linux and Windows operating system environments.

Desktops and Workstations. Our Sun Ultra workstations provide powerful solutions for a wide range of business and technical activities such as software development, mechanical design, financial analysis, graphics, visualization, simulation and education. Sun Ray Ultra-Thin Client platforms provide an alternative to traditional desktop personal computers where client applications are better suited and more economical to running on a network versus an individual desktop platform.

We also offer a line of products aimed at the unique needs of Original Equipment Manufacturers (OEMs) and Network Equipment Providers (NEPs). Rack-optimized systems and our blade product offerings combine high-density hardware architecture and system management software that OEMs find particularly useful in building their own solution architectures. Our NEP-certified Sun Netra systems are designed to meet the specialized needs of NEPs.

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Microelectronics. Our microelectronics business develops and sells silicon-based chips that facilitate networking, cryptography and HPC. These chips are utilized by OEM customers and hardware vendors worldwide in a broad range of devices from servers to routers, switches, network devices, medical imaging, industrial printing and more.

SOFTWARE

Our software offerings consist primarily of enterprise infrastructure software systems, software desktop systems, developer software and infrastructure management software.

Solaris. The Solaris operating system is a high performance, reliable, scalable and secure operating environment for SPARC and x64 platforms. It is optimized for enterprise computing, Internet and intranet business requirements, powerful databases and HPC environments. In addition, we have made certain source code of our software available under an open source license. By making intellectual property freely available, the community is encouraged to download it, examine it, provide feedback and enhancements to it, and develop applications around it. This improves collaboration and cooperation to help accelerate innovation around these technologies. The Solaris operating system runs on hundreds of different server platforms including standard x64/x86 servers. The ability to run on multiple platforms has contributed to the rapid growth of the Solaris operating system on non-SPARC based systems over the last two years and such non-SPARC based systems, account for almost two-thirds of the registered licenses for the Solaris operating system. Additionally, we recently announced that IBM will distribute the Solaris operating system and Solaris Subscriptions for select x86-based IBM System servers and BladeCenter servers to clients through IBM s distribution channels.

Java Technology. Our Write Once, Run Anywhere Java technology, which is used on personal computers, workstation clients and mobile devices is available on the Solaris operating system, Linux, HP-UX, AIX, Tru64 UNIX®, Windows, MacOS X and other platforms. Java technology is used to develop and deploy Web services for consumer and embedded devices such as mobile phones, personal digital assistants (PDAs), digital set top boxes and residential gateways and Java Card smart card technology.

Middleware. We also offer a full range of middleware including mission-critical clustering, messaging, identity management, directory and Web services infrastructure software. Other software offerings include virtualization, provisioning and monitoring software for network computing resource optimization and systems management simplification.

STORAGE

Our entry-to-enterprise-level data storage products and services include heterogeneous tape, disk, software, networking and services for mainframe and open systems environments. With the acquisition of Storage Technology Corporation (StorageTek) in August 2005, we became a top-tier storage vendor, offering a broad range of products and services for securely managing mission critical data assets.

Our tape storage includes libraries, drives, virtualization systems, media and software. Our extensive disk system product line includes data center disks, Network Attached Storage (NAS), Enterprise Archive System, midrange disks, workgroups disks, a boot disk, and a full range of disk device software.

We are leveraging the Solaris operating system across our storage portfolio to increase data management per administrator, scalability, security, utilization rates, observability and self-healing. Our heterogeneous, industry-standard modular storage hardware works with Windows, Linux, z/OS, HP-UX, AIX and Solaris platforms along with other software, so customers can more quickly and cost-effectively adapt to changing business needs. Sun s Storage solutions help to improve data availability, providing fast data access, dynamic data protection for restoration and secure archiving for compliance.

SERVICES

Sun offers a broad range of services from Support and Managed Services for hardware, software and client solutions, to Professional and Educational Services. We assist customers globally, with nearly 850,000 units under Support Services contracts in more than 100 countries.

Our services innovation is focused on integrating technology, knowledge and process to meet customer needs. Our global service and support offerings help our customers increase system service levels, improve data center operational efficiency and effectiveness and deploy next-generation automation technologies to provide predictive, preemptive and proactive service to heterogeneous infrastructures.

SALES, MARKETING AND DISTRIBUTION

Our Global Sales and Services organization manages and has primary responsibility for our field sales, relationships with our selling partners, technical sales support, sales operations and delivery of Support Services and Professional and Educational Services. We

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sell end-to-end networking architecture platform solutions, including products and services, in most major markets globally through a combination of direct and indirect channels. We also offer component products, such as central processor unit (CPU) chips and embedded boards, on an OEM basis to other hardware manufacturers and supply after-market and peripheral products to their end-user installed base, both directly and through independent distributors and value added resellers (VARs).

We have organized our sales coverage within 16 geographically established markets (GEMs) around the world. We employ independent distributors in over 100 countries. In general, our sales coverage model calls for independent distributors to be deployed via strategic alliances with our direct sales force. However, in some smaller markets, independent distributors and Sun Plus partners may be our sole means of sales, marketing and distribution. Our relationships with channel partners are very important to our future revenues and profitability. Channel relationships accounted for more than 65%, 63% and 67% of our total net revenues in fiscal 2007, 2006 and 2005, respectively.

Our partner community is essential to our success. While our product and service offerings are very broad, we recognize that no single supplier of computing solutions can meet all of the needs of all of our customers. We have established relationships with leading Independent Software Vendors (ISVs), VARs, OEMs, channel development providers, independent distributors, computer systems integrators and Service Development Providers (SDPs) to deliver solutions that our customers demand. Through these relationships, our goal is to optimize our ability to be the technology of choice, the platform of choice, the partner of choice and to provide the end-to-end solutions that customers require to compete. Our Worldwide Marketing Organization oversees our marketing planning, determines product and pricing strategy, coordinates advertising, demand creation and public relations activities, maintains strategic alliances with major ISVs and performs competitive analyses. Additionally, ISVs help us maximize our technology footprint by integrating their software products with our platforms and technologies. SDPs, such as Internet Service Providers (ISPs) and Application Service Providers (ASPs), allow us to expand our service coverage without new large-scale investments.

We seek out companies to be our partners who align with our technology direction and our vision of enabling network participation. We partner with Advanced Micro Devices, Inc. (AMD) to expand our entry-level line of Opteron processor-based x64 systems. We have an alliance with Intel Corporation whereby Intel endorses the Solaris operating system and we have agreed to deliver a comprehensive family of servers and workstations based on Xeon processors. We also maintain a strategic alliance with Fujitsu to deliver and support a generation of SPARC-based systems that we developed through collaboration. Our relationship with Fujitsu is discussed in greater detail in Item 1A, Risk Factors . This alliance is intended to enlarge the Solaris operating system footprint, drive increased market share for our enterprise-class systems and allow us to dedicate additional resources to our throughput computing initiative and our next generation of processor products. We also maintain a relationship with Hitachi Data Systems (HDS) to provide high-end storage solutions and extend our storage offerings into other enterprise environments.

Revenues from outside the United States (U.S.) were approximately 59%, 58% and 60% of our total net revenues in fiscal 2007, 2006 and 2005, respectively. Direct sales we make outside of the U.S. are generally priced in local currencies and can be subject to currency exchange fluctuations. The net foreign currency impact on our total net revenues and operating results is difficult to precisely measure. However, because of the general weakening of the U.S. dollar, our best estimate of the foreign exchange benefit approximated 2% of total net revenues for fiscal 2007.

The countries primarily contributing to our international sales are the United Kingdom (U.K.), Germany and Japan. The U.K. represented approximately 8%, 9% and 9% of our total net revenues in fiscal 2007, 2006 and 2005, respectively. Germany represented approximately 7%, 7% and 8% of our total net revenues in fiscal 2007, 2006 and 2005, respectively. Japan represented approximately 5%, 6% and 7% of our total net revenues in fiscal 2007, 2006 and 2005, respectively.

For further financial information on sales outside the U.S., see Net Revenues by Geographic Area in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

For a discussion of risks attendant to our foreign operations, see Risk Factors Our international customers and operations subject us to a number of risks, in Item 1A. See Note 15 to the Consolidated Financial Statements in Item 8 for additional information concerning sales to international customers and business segments.

Although our sales and other operating results can be influenced by a number of factors, and historical results are not necessarily indicative of future results, our sequential quarterly operating results generally fluctuate downward in the first and third quarters of each fiscal year when compared with the immediately preceding quarter.

In January 2007, Access Distribution, the largest distributor of our products, was sold to Avnet, Inc. by General Electric Company. Avnet, which was StorageTek s largest distributor, became a distributor of Sun products after our acquisition of StorageTek in August 2005. Sales to Avnet and

Access Distribution accounted for approximately 11%, 11%, and 13% of net revenues in fiscal 2007, 2006 and 2005, respectively. No other customer accounted for more than 10% of our net revenues. Accounts receivable from Avnet and Access Distribution and its subsidiaries in the aggregate was approximately 13% and 12% of total accounts receivable as of June 30, 2007 and 2006, respectively.

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Our product order backlog at June 30, 2007 was $1.0 billion, as compared with $1.1 billion at June 30, 2006. Our product backlog includes orders for which customer-requested delivery is scheduled within six months and orders that have been specified by the customer for which products have been shipped but revenue has been deferred. Although actual customer delivery can occur over several periods, product backlog can be used to identify potential revenue coverage for future periods. The larger the percentage coverage of targeted pending revenue, the lower the potential risk of non-achievement. Backlog levels vary with demand, product availability, product revenue recognition treatment, and our delivery lead times and are subject to significant decreases as a result of, among other things, customer order delays, changes or cancellations. As such, backlog levels may not be a reliable indicator of future operating results.

WORLDWIDE OPERATIONS

Our Worldwide Operations organization manages company-wide purchasing of materials used in making our products, assists in product design enhancements, oversees our manufacturing operations and those of our manufacturing partners and coordinates logistics operations.

Our manufacturing operations consist primarily of final assembly, test and quality control of enterprise and data center servers and storage systems. For all other systems, we rely on external manufacturing partners. We manufacture primarily in Oregon and Scotland and distribute much of our hardware products from our facilities and our partner facilities located in California, the Netherlands and Japan.

We are expanding our direct ship capabilities, using a customer fulfillment architecture that enables us to ship certain products directly from our suppliers to our customers, with the goal of reducing cost, risk and complexity in the supply chain. We have continued to simplify the manufacturing process by increasing the standardization of components across product types. In addition, we have continued to increase our focus on quality and processes that are intended to proactively identify and solve quality issues. The early identification of products containing defects in engineering, design and manufacturing processes, as well as defects in third-party components included in our products, could prevent or reduce delays of product shipments.

RESEARCH AND DEVELOPMENT

Our research and product development programs are intended to sustain and enhance our competitive position by incorporating the latest advances in hardware, microprocessors, software, graphics, networking, data communications and storage technologies. In addition, we have extended our product offerings and intellectual property through acquisitions of businesses or technologies or other arrangements with our partners. Our product development continues to focus on enhancing the performance, scalability, reliability, availability and serviceability of our existing systems and the development of new technology standards. Additionally, we remain focused on developing system software platforms for Internet and intranet applications, telecommunications and next-generation service provider networks, advanced workstation, server and storage architectures and advanced service offerings. We devote substantial resources to research and development as we believe it provides and will continue to provide significant competitive differentiation.

We conduct research and development principally in the U.S., U.K., France, Ireland, Germany, Japan, China, Russia, Czech Republic and India. Research and development expenses were $2.0 billion, $2.0 billion, and $1.8 billion in fiscal 2007, 2006 and 2005, respectively.

COMPETITION

We compete in the computer systems (hardware and software), storage (hardware and software) and services markets. These markets are intensely competitive. Our competitors are some of the largest, most successful companies in the world. They include International Business Machines Corporation (IBM), Dell, Inc. (Dell), Hewlett-Packard Company (HP), EMC Corporation (EMC), Fujitsu Limited (Fujitsu), HDS and the Fujitsu-Siemens joint venture. We also compete with (i) systems manufacturers and resellers of systems based on microprocessors manufactured by Intel, the Windows family of operating systems software from Microsoft and the Linux family of operating systems from Red Hat and others, as well as (ii) companies that focus on providing support and maintenance services for computer systems and storage products.

We continue to invest significantly in research and development, $2.0 billion in fiscal 2007, to create hardware, software and services based on open standards and innovative business models to offer differentiated solutions to our customer, partner and developer communities. We focus our R&D investments to address complex customer issues such as escalating IT infrastructure costs, data security, under-utilized IT assets and the rising costs of power consumption, cooling and space in data-centers. We believe our innovations will continue to help businesses and developers address these IT concerns, drive high-growth business solutions and differentiate us from our major competitors.

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We believe competition will be at least as intense in the next fiscal year as it was over the last fiscal year. In this environment, the lack of competitive advantage with respect to our hardware, software or services offerings could lead to a loss of competitive position resulting in fewer customer orders, reduced revenues, reduced margins, reduced levels of profitability and loss of market share. For more information about the competitive risks we face, refer to Item 1A. Risk Factors. If we are unable to compete effectively with existing or new competition, the loss of competitive position could result in price reductions, fewer customer orders, reduced revenue, reduced margins, reduced levels of profitability and loss of market share.

PATENTS, TRADEMARKS AND INTELLECTUAL PROPERTY LICENSES

We have used, registered or applied to register certain trademarks and service marks to distinguish our products, technologies and services from those of our competitors in the U.S. and in foreign countries and jurisdictions. We enforce our trademark, service mark and trade name rights in the U.S. and abroad.

We hold a number of U.S. and foreign patents relating to various aspects of our products and technology. While we believe that patent protection is important, we believe that factors such as innovative skills and technological expertise provide even greater competitive differentiation. From time to time we have been notified that we may be infringing certain patents or other intellectual property rights of others. Such notices are in various stages of evaluation, and some have resulted in current litigation. We are evaluating the desirability of entering into licensing agreements in certain of these matters. Based on industry practice, we believe that any necessary licenses or other rights could be obtained on commercially reasonable terms. However, no assurance can be given that licenses can be obtained on acceptable terms or that litigation will not occur. The failure to obtain necessary licenses or other rights, or the adverse resolution of litigation arising out of such claims, could adversely affect our business.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following sets forth certain information regarding our Executive Officers as of August 27, 2007.

Name	Age	Position
Jonathan I. Schwartz	41	Chief Executive Officer and President
Jon H. Benson	45	Senior Vice President, Storage Group
V. Kalyani Chatterjee	44	Vice President, Corporate Controller and Chief Accounting Officer
Michael A. Dillon	48	Executive Vice President, General Counsel and Secretary
John F. Fowler	46	Executive Vice President, Systems Group
Anil P. Gadre	50	Executive Vice President, Chief Marketing Officer
Donald C. Grantham	50	Executive Vice President, Global Sales and Services
Richard L. Green	51	Executive Vice President, Software Group
Michael E. Lehman	56	Chief Financial Officer and Executive Vice President, Corporate Resources
William N. MacGowan	50	Executive Vice President, People and Places, and Chief Human Resources Officer
Eugene G. McCabe	54	Executive Vice President, Worldwide Operations
Gregory M. Papadopoulos	49	Executive Vice President, Research and Development and Chief Technology Officer
David W. Yen	55	Executive Vice President, Microelectronics Group

Mr. Schwartz has served as President and Chief Executive Officer since April 2006, as President and Chief Operating Officer from April 2004 to April 2006, as Executive Vice President, Software from July 2002 to April 2004, as Senior Vice President, Corporate Strategy and Planning from July 2000 to July 2002, as Vice President, Ventures Fund from October 1999 to July 2000. Prior to that, Mr. Schwartz served in several other positions with Sun.

Mr. Benson has served as Senior Vice President, Storage Group, since March 2007 and as Vice President of Engineering for the Storage Group from September of 2005 to March 2007. Prior to joining Sun as part of the StorageTek acquisition, he served in a variety of management and executives positions for StorageTek for the period from 1987 to 2005, most recently as Vice President and General Manager of Automated Tape Solutions from September 2004 to September 2005, and as Vice President of Automated Tape Libraries from 2000 to September 2004.

Ms. Chatterjee has served as Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) since September 2006 and Vice President, Finance and Assistant Controller from February 2006 until September 2006. From March 2004 to February 2006, Ms. Chatterjee served as Sun s Senior Director and Assistant Corporate Controller. From January 2003 to March 2004, Ms. Chatterjee served as the Vice President, Finance with Hotwire, Inc. From January 2000 to November 2002, Ms. Chatterjee served as a Senior Manager at KPMG

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Mr. Dillon has served as Executive Vice President, General Counsel and Secretary since April 2006, as Senior Vice President, General Counsel and Secretary from April 2004 to April 2006, and previously held the position of Vice President, Products Law Group, from July 2002 to March 2004. From October 1999 until June 2002, he served as Vice President, General Counsel and Corporate Secretary of ONI Systems Corp, an optical networking company. Mr. Dillon initially joined Sun in 1993 and thereafter held successive management positions in several legal support groups until October 1999.

Mr. Fowler has served as Executive Vice President, Systems Group since May 2006, as Executive Vice President, Network Systems Group from May 2004 to May 2006, as Chief Technology Officer, Software Group from July 2002 to May 2004 and Director, Corporate Development from July 2000 to July 2002.

Mr. Gadre has served as Executive Vice President, Chief Marketing Officer since November 2004, as Vice President, Software Marketing from May 2002 to November 2004 and Vice President and General Manager of Solaris Software from April 1999 to May 2002. Previously he has held several positions related to Product and Corporate Marketing at Sun.

Mr. Grantham has served as Executive Vice President, Global Sales and Services since April 2006, as Executive Vice President Sun Services from March 2005 to March 2006, as Senior Vice President, Global Services Delivery from January 2004 to March 2005, as Vice President, Global Sales Operations April 2002 to December 2004, as Vice President Sales Operations EMEA January 2001 to March 2002, and as Director of Product Sales and Marketing EMEA from October 1999 to December 2000. Prior to joining Sun, Mr. Grantham served in a variety of management and executive positions at IBM, for the period from 1983 to 1999.

Mr. Green has served as Executive Vice President, Software Group of Sun since May 2006. From May 2004 to May 2006, Mr. Green served as Executive Vice President, Products for Cassatt Corporation. From April 2004 to May 2004, Mr. Green served as Vice President, Java and Developer Programs of Sun and as Vice President, Java from December 1999 to April 2004.

Mr. Lehman has served as Chief Financial Officer and Executive Vice President, Corporate Resources since February 2006 and as Executive Vice President from July 2002 until his resignation from employment in September 2002. From September 2002 to February 2006, he was a member of the board of directors of Sun. He resigned from the Board when he returned to full-time employment at Sun. During that time, he served as a self-employed business consultant. From July 2000 to July 2002, he served as Executive Vice President, Corporate Resources and Chief Financial Officer of Sun, and from January 1998 to July 2000, as Vice President, Corporate Resources and Chief Financial Officer. He is a director of MGIC Investment Corporation.

Mr. MacGowan has served as Chief Human Resources Officer and Executive Vice President of People and Places since April 2006, as Senior Vice President, Human Resources, from April 2004 to April 2006, as Vice President, Human Resources, Global Centers of Expertise, from May 2003 to April 2004, as Vice President, Human Resources, Systems, Storage and Operations, from May 2002 to May 2003, Vice President, Human Resources, Enterprise Services, from May 2000 to May 2002 and as Director, Human Resources, Enterprise Services, from June 1998 to May 2000.

Mr. McCabe has served as Executive Vice President, World Wide Operations of Sun since March 2005, as Senior Vice President, Worldwide Operations from January 2003 to March 2005 and as Vice President, High-End Operations from September 1999 through January 2003. From July 1998 through September 1999, Mr. McCabe served as Vice President, High-End Operations for Compaq Computer Corporation.

Mr. Papadopoulos has served as Executive Vice President, Research and Development and Chief Technology Officer since May 2006, as Executive Vice President and Chief Technology Officer from December 2002 to May 2006, as Senior Vice President and Chief Technology Officer from July 2000 to December 2002 and as Vice President and Chief Technology Officer from April 1998 to July 2000. He served as Vice President and Chief Technology Officer of Sun Microsystems Computer Corporation (SMCC), a wholly-owned subsidiary of Sun from March 1996 to April 1998, as Chief Technology Officer of SMCC from December 1995 to March 1996 and as Chief Scientist, Server Systems Engineering from September 1994 to December 1995. Mr. Papadopoulos had a part-time, non-compensated appointment as a Visiting Professor of Electrical Engineering and Computer Science at the Massachusetts Institute of Technology from September 2002 to August 2003.

Mr. Yen has served as Executive Vice President, Microelectronics Group since March 2007, as Executive Vice President, Storage Group of Sun from May 2006 to May 2007, as Executive Vice President, Scalable Systems Group from April 2004 to May 2006, as Executive Vice President, Processor and Network Products from July 2002 to April 2004, as Vice President and General Manager, Processor Products Group from February 2001 to June 2002, as Vice President and General Manager, Integrated Products Group from July 2000 to January 2001 and as Vice President and General Manager, Enterprise Servers Products from September 1996 to June 2000.

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ITEM 1A. RISK FACTORS

If we are unable to compete effectively with existing or new competitors, the loss of our competitive position could result in price reductions, fewer customer orders, reduced revenues, reduced margins, reduced levels of profitability and loss of market share.

We compete in the computer systems (hardware and software) and storage (hardware and software) products and services markets. These markets are intensely competitive. If we fail to compete successfully in these markets, the demand for our products and services would decrease. Any reduction in demand could lead to fewer customer orders, reduced revenues, pricing pressures, reduced margins, reduced levels of profitability and loss of market share. These competitive pressures could materially and adversely affect our business and operating results.

Our competitors are some of the largest, most successful companies in the world. They include IBM, Dell, HP, EMC, Fujitsu, HDS, the Fujitsu-Siemens joint venture, Microsoft and Intel. We compete with (i) systems manufacturers and resellers of systems based on microprocessors from Intel, the Windows family of operating systems software from Microsoft and the Linux family of operating systems software from Red Hat and others, as well as (ii) companies that focus on providing support and maintenance services for computer systems and storage products. Certain of these competitors compete aggressively on price and seek to maintain very low cost structures. Some of these competitors are seeking to increase their market share, which creates increased pressure, including pricing pressure, on our product lines and service offerings. In particular, we are seeing increased competition and pricing pressures from competitors offering systems running Linux software and other open source software, as well as competitors offering support services. In addition, certain of our competitors, including IBM and HP, have financial and human resources that are substantially greater than ours, which increases the competitive pressures we face. These competitors also have significant installed bases, and it can be very difficult to win a new customer that has made significant investments in a competitor s platform.

Customers make buying decisions based on many factors, including among other things, new product and service offerings and features; product performance and quality; availability and quality of support and other services; price; platform; interoperability with hardware and software of other vendors; quality; reliability, security features and availability of products; breadth of product line; ease of doing business; a vendor s ability to adapt to customers changing requirements; responsiveness to shifts in the marketplace; business model (e.g., utility computing, subscription-based software usage, consolidation versus outsourcing); contractual terms and conditions; vendor reputation and vendor viability. As competition increases, each factor on which we compete becomes more important and the lack of competitive advantage with respect to one or more of these factors could lead to a loss of competitive position, resulting in fewer customer orders, reduced revenues, reduced margins, reduced levels of profitability and loss of market share. We expect competitive pressure to remain intense.

Fujitsu and its subsidiaries have, for many years, been key strategic channel partners for Sun, distributing substantial quantities of our products throughout the world. We entered into a number of agreements with Fujitsu intended to substantially increase the scope of our relationship with them, including through collaborative selling efforts and joint development and marketing of server products known as the Advanced Product Line (APL). The first group of APL server products was released in April 2007 and branded as the SPARC Enterprise line of servers. However, Fujitsu is also a competitor of Sun and, as a licensee of various technologies from Sun and others, it has developed products that currently compete directly with our products.

Over the last several years, we have invested significantly in our Storage products business, including through the acquisition of StorageTek, with a view to increasing the sales of these products both on a stand-alone basis to customers using the systems of our competitors, and as part of the systems that we sell. The Storage products business is intensely competitive. EMC is currently a leader in the storage products market and our primary competitor.

We are continuing the implementation of a solution-based selling approach. While we believe that strategy will enable us to increase our revenues and margins, there can be no assurance that we will be successful in this approach. In fact, our implementation of this selling model may result in reductions in our revenues and/or margins, particularly in the short term, as we compete to attract business. In addition, if our emphasis on solution-based sales increases, we face strong competition from systems integrators such as IBM, Fujitsu-Siemens and HP. Our inability to successfully implement this model would have a material adverse impact on our revenues and margins.

We maintain higher research and development costs, as a percentage of total net revenues, than many of our competitors and our earnings are dependent upon maintaining revenues and gross margins at a sufficient level to offset these costs.

One of our business strategies is to derive a competitive advantage and a resulting enhancement of our gross margins from our investment in innovative new technologies which customers value. As a result, as a percentage of total net revenues, we incur

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higher fixed R&D costs than many of our competitors. To the extent that we are unable to develop and sell products with attractive gross margins in sufficient volumes, our earnings may be materially and adversely affected by our cost structure. We continue to add new products to our entry-level server product line that are offered at a lower price point and that may provide us with a lower gross margin percentage than our products as a whole. Although our strategy is to sell these products as part of overall systems that include other products with higher gross margin percentages, to the extent that the mix of our overall revenues represented by sales of lower gross margin products increases, our gross margins and earnings may be materially and adversely affected.

The products we make are very complex. If we are unable to rapidly and successfully develop and introduce new products and manage our inventory, we will not be able to satisfy customer demand.

We operate in a highly competitive, quickly changing environment, and our future success depends on our ability to develop and introduce new products that our customers choose to buy. If we are unable to develop new products, our business and operating results could be adversely affected. We must quickly develop, introduce, and deliver in quantity new, complex systems, software, and hardware products and components. These include products that incorporate certain UltraSPARC microprocessors and the Solaris operating system, the Java platform, Sun Java System portfolio and Sun N1 Grid architecture, among others. The development process for these complicated products is very uncertain. It requires high levels of innovation from both our product designers and the suppliers of the components used in our products. The development process is also lengthy and costly. If we fail to accurately anticipate our customers needs and technological trends, or are otherwise unable to complete the development of a product on a timely basis, we will be unable to introduce new products into the market on a timely basis, if at all, and our business and operating results would be materially and adversely affected.

The manufacture and introduction of our new products is also a complicated process. Once we have developed a new product, we face several challenges in the manufacturing process. We must be able to manufacture new products in sufficient volumes so that we can have an adequate supply of new products to meet customer demand. We must also be able to manufacture the new products at acceptable costs. This requires us to be able to accurately forecast customer demand so that we can procure the appropriate components at optimal costs. Forecasting demand requires us to predict order volumes, the correct mix of our products, and the correct configurations of these products. We must manage new product introductions and transitions to minimize the impact of customer-delayed purchases of existing products in anticipation of new product releases. We must also try to reduce the levels of older product and component inventories to minimize inventory write-offs. If we have excess inventory, it may be necessary to reduce our prices or write down inventory, which could result in lower gross margins. Additionally, our customers may delay orders for existing products in anticipation of new product introductions. As a result, we may decide to adjust prices of our existing products during this process to try to increase customer demand for these products. Our future operating results would be materially and adversely affected if such pricing adjustments were to occur and we were unable to mitigate the resulting margin pressure by maintaining a favorable mix of systems, software, service and other products, or if we were unsuccessful in achieving component cost reductions, operating efficiencies and increasing sales volumes.

If we are unable to timely develop, manufacture, and introduce new products in sufficient quantity to meet customer demand at acceptable costs, or if we are unable to correctly anticipate customer demand for our new and existing products, our business and operating results could be materially adversely affected.

We face numerous risks associated with our strategic alliance with Fujitsu.

We have entered into a number of agreements with Fujitsu with respect to collaborative sales and marketing efforts and the joint development and manufacturing of server products known as the Advanced Product Line (APL). The first group of APL server products was released in April 2007 and branded as the Sun SPARC Enterprise line of servers. The APL server products are intended to eventually replace a portion of our server product portfolio. In addition, the agreements contemplate that Sun and Fujitsu dedicate substantial financial and human resources to this relationship. As a result, our future performance and financial condition may be impacted by the success or failure of this relationship.

Joint development and marketing of a complex new product line is an inherently difficult undertaking and is subject to numerous risks. If we fail to satisfy certain development or supply obligations under the agreements, or if we otherwise violate the terms of the agreements, we may be subject to significant contractual or legal penalties. Further, if Fujitsu encounters any of a number of potential problems in its business, such as intellectual property infringement claims, supply difficulties, or difficulties in meeting development milestones or financial challenges, these problems could impact our strategic relationship with them and could result in a material adverse effect on our business or results of operations. There can be no assurance that our strategic relationship with Fujitsu will be successful or that the economic terms of the agreements establishing the relationship will ultimately prove to be favorable to us. If any of these risks come to pass, they may have a material adverse effect on our business, results of operations or financial condition.

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We have licensed significant elements of our intellectual property, including our Solaris operating system and Java technology, as open source software and intend to license additional intellectual property in the future under open source licenses, which could reduce the competitive advantage we derive from this intellectual property.

We have released significant elements of our intellectual property, including the Solaris operating system, the Java Enterprise System infrastructure software platform, the Sun N1 Management software and various developer tools, to the open source development community as open source software under an open source license and have made the hardware source code of our UltraSPARC T1 processor available under an open source license. We have also released our Java SE, Java EE and Java ME technologies under an open source license. Although open source licensing models vary, generally open source software licenses permit the liberal copying, modification and distribution of a software program allowing a diverse programming community to contribute to the software. As a result of such release, there could be an impact on revenue related to this intellectual property, and we may no longer be able to exercise control over some aspects of the future development of this intellectual property. In particular, the feature set and functionality of the Solaris operating system may diverge from those that best serve our strategic objectives, move in directions in which we do not have competitive expertise or fork into multiple, potentially incompatible variations. We currently derive a significant competitive advantage from our development, licensing and sale of the Solaris operating system, Java technologies, and system products based on the UltraSPARC family of microprocessors, and any of these events could reduce our competitive advantage or impact market demand for our products, software and services. In addition, disclosing the content of our source code could limit the intellectual property protection we can obtain or maintain for that source code or the products containing that source code and could facilitate intellectual property infringement claims against Sun.

Our reliance on single source suppliers could delay product shipments and increase our costs.

Most of the our products and components are manufactured in whole or in part by third-party manufacturers. Further, there are some components that can only be purchased from a single vendor due to price, quality, technology or other business constraints. For example, we currently depend on Texas Instruments for the manufacture of our UltraSPARC microprocessors, AMD for Opteron processors and several other companies for custom integrated circuits. If we were unable to purchase on acceptable terms or experienced significant delays or quality issues in the delivery of necessary parts and/or components from a particular vendor and we had to find a new supplier for these parts and components, our new and existing product shipments could be delayed which could have a material adverse effect on our business, results of operations and financial conditions.

Our future operating results depend on our ability to purchase a sufficient amount of components to meet the demands of our customers.

We depend heavily on our suppliers to design, develop, manufacture, and deliver on a timely basis the necessary components for our products. While many of the components we purchase are standard, we do purchase some components (standard or otherwise), including color monitors, custom power supplies, application specific integrated circuits (ASICs) and custom memory and graphics devices, that require long lead times to manufacture and deliver. Long lead times make it difficult for us to plan and procure appropriate component inventory levels to meet the customer demand for our products. In addition, in the past, we have experienced shortages in certain of our components (including, ASICs, dynamic random access memories (DRAMs) and static random access memories (SRAMs)). If a component delivery from a supplier is delayed, if we experience a shortage in one or more components, or if we are unable to provide for adequate levels of component inventory, our new and existing product shipments could be delayed and our business and operating results could be materially and adversely affected.

Because we may order components from suppliers in advance of receipt of customer orders for our products that include these components, we could face a material inventory risk.

As part of our component planning, we place orders with or pay certain suppliers for components in advance of receipt of customer orders. We occasionally negotiate supply commitments with vendors early in the manufacturing process of our microprocessors to make sure we have enough of these components for our products to meet anticipated customer demand. Because the design and manufacturing process for these components is very complicated it is possible that we could experience a design or manufacturing flaw that could delay or even prevent the production of the components for which we have previously committed to pay or need to fulfill orders from customers. We also face the risk of ordering too many components, or conversely, not enough components, since supply orders are generally based on forecasts of customer orders rather than actual customer orders. In addition, in some cases, we make non-cancelable order commitments to our suppliers for work-in-progress, supplier s finished goods, custom sub-assemblies and Sun unique raw materials that are necessary to meet our lead times for finished goods. If we cannot change or be released from supply orders, we could incur costs from the purchase of unusable components, either due to a delay in the production of the components or other supplies or as a result of inaccurately predicting

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supply orders in advance of customer orders. Our business and operating results could be materially and adversely affected as a result of these increased costs.

Delays in product development or customer acceptance and implementation of new products and technologies could seriously harm our business.

Generally, the computer systems we sell to customers incorporate various hardware and software products that we sell, such as UltraSPARC microprocessors, various software elements, from the Solaris operating system to the Java platform, Sun Java System portfolio, Sun N1 Grid, the Sun StorageTek SL8500 modular library system and Sun StorEdge array products. Any delay in the development, delivery or acceptance of key elements of the hardware or software included in our systems could delay our shipment of these systems. Delays in the development and introduction of our products may occur for various reasons.

In addition, if customers decided to delay the adoption and implementation of new releases of our Solaris operating system, this could also delay customer acceptance of new hardware products tied to that release. Implementing a new release of an operating environment requires a great deal of time and money for a customer to convert its systems to the new release. The customer must also work with software vendors who port their software applications to the new operating system and make sure these applications will run on the new operating system. As a result, customers may decide to delay their adoption of a new release of an operating system because of the cost of a new system and the effort involved to implement it. Such delays in product development and customer acceptance and implementation of new products could materially and adversely affect our business.

Our products may have quality issues that could adversely affect our sales and reputation.

In the course of conducting our business, we experience and address quality issues. Some of our hardware and software products contain defects, including defects in our engineering, design and manufacturing processes, as well as defects in third-party components included in our products, which may be beyond our control. Often defects are identified during our design, development and manufacturing processes and we are able to correct many of these. Sometimes defects are identified after introduction and shipment of new products or enhancements to existing products.

When a quality issue is identified, we work extensively with our customers (and our suppliers) to remedy such issues. We may test the affected product to determine the root cause of the problem and to determine appropriate solutions. We may find an appropriate solution (often called a patch) or offer a temporary fix while a permanent solution is being determined. If we are unable to determine the root cause, find an appropriate solution or offer a temporary fix, we may delay shipment to customers. We may, however, ship products while we continue to explore a suitable solution if we believe the defect is not significant to the product s functionality. Defects in our products can harm our reputation, delay or prevent sales, result in significant expense and could materially and adversely affect our business.

Our international customers and operations subject us to a number of risks.

Currently, more than half of our revenues come from international sales. In addition, a portion of our operations consists of manufacturing and sales activities outside of the U.S. Our ability to sell our products and conduct our operations internationally is subject to a number of risks. Local economic, political and labor conditions in each country could adversely affect demand for our products and services or disrupt our operations in these markets. We may also experience reduced intellectual property protection or longer and more challenging collection cycles as a result of different customary business practices in certain countries where we do business which could have a material adverse effect on our business operations and financial results. Currency fluctuations could also materially and adversely affect our business in a number of ways. Although we take steps to reduce or eliminate certain foreign currency exposures that can be identified or quantified, we may incur currency translation losses as a result of our international operations. Further, in the event that currency fluctuations cause our products to become more expensive in overseas markets in local currencies, there could be a reduction in demand for our products or we could lower our pricing in some or all of these markets resulting in reduced revenue and margins. Alternatively, a weakening dollar could result in greater costs to us for our overseas operations. Changes to and compliance with a variety of foreign laws and regulations may increase our cost of doing business in these jurisdictions. Trade protection measures and import and export licensing requirements subject us to additional regulation and may prevent us from shipping products to a particular market, and increase our operating costs. In addition, we could be subject to regulations, fines and penalties for violations of import and export regulations. Although we implement policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, including those based in or from countries where practices which violate such United States laws may be customary, will not take actions in violations of our policies. These violations could result in penalties, including prohibiting us from exporting our products to one or more countries, and could materially and adversely affect our business.

Moreover, local laws and customs in many countries differ significantly from those in the U.S. We incur additional legal compliance costs associated with our international operations and could become subject to legal penalties in foreign countries if

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we do not comply with local laws and regulations, which may be substantially different from those in the United States. In many foreign countries, particularly in those with developing economies, it is common for local business people to engage in business practices that violate their local laws and that are prohibited by United States laws applicable to us such as the Foreign Corrupt Practices Act. Although we implement policies, training, and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, as well as our resellers and those companies to which we outsource certain of our business operations, including those based in or from countries where practices which violate such United States laws may be common, will not engage in actions which violate the law or our policies. Any such violation, even if prohibited by our policies, could have a material adverse effect on our business.

We intend to enter into one or more joint ventures with distribution partners with the goal of increasing sales of Sun s products and services in selected geographic markets. Forming a joint venture will subject us to additional compliance and legal risks related to the actions of the joint venture partner.

We are currently implementing a new enterprise resource planning system, and problems with the design or implementation of this system could interfere with our business and operations.

We have commenced a project to consolidate all of our database infrastructure to a single global enterprise resource planning (ERP) system. We have invested, and will continue to invest, significant capital and human resources in the design and implementation of the ERP system, which may be disruptive to our underlying business. Any disruptions or delays in the design and implementation of the new ERP system, particularly any disruptions or delays that impact our operations, could adversely affect our ability to process customer orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations, file SEC reports in a timely manner and otherwise run our business. Further, as we are dependent upon our ability to gather and promptly transmit accurate information to key decision makers, our business, results of operations and financial condition may be materially and adversely affected if our database infrastructure does not allow us to transmit accurate information, even for a short period of time. Even if we do encounter these adverse effects, the design and implementation of the new ERP system may be much more costly than we anticipated. If we are unable to successfully design and implement the new ERP system as planned, our financial position, results of operations and cash flows could be negatively impacted.

Failure to successfully implement our global resourcing activities could adversely affect our results of operations.

We continuously seek to make our cost structure more efficient and focus on our core strengths. We continue to develop and implement our global resourcing strategy and operating model which includes activities that are focused on increasing workforce flexibility and scalability, and improving overall competitiveness by leveraging external talent and skills worldwide. We rely on partners or third party service providers for the provision of certain key business process functions, including IT services and the human resources function, and as a result, we may incur increased business continuity risks. We may no longer be able to exercise control over some aspects of the future development, support or maintenance of outsourced operations and processes, including the internal controls associated with those outsourced business operations and processes, which could adversely affect our business. If we are unable to effectively develop and implement our resourcing strategy due to, among other things, data protection, contract and regulatory compliance issues, we may not realize cost structure efficiencies and our operating and financial results could be materially and adversely affected. Given the uncertainty in forecasting and other variables, actual financial impact from outsourcing may materially differ from our projections. In addition, if we are unable to effectively utilize or integrate and interoperate with external resources or if our partners or third party service providers experience business difficulties or are unable to provide business process services as anticipated, we may need to seek alternative service providers or resume providing these business processes internally, which could be costly and time consuming and have a material adverse effect on our operating and financial results.

We also rely on partners for the provision of key manufacturing activities. Recently, Texas Instruments indicated publicly that it will not be making UltraSPARC microprocessors for Sun on a foundry basis at the 45-nm node. Consequently, we are reviewing alternative foundry solutions, and are considering plans to transition the 45-nm mode foundry operations and supply chain to other potential vendors. If we are unable to effectively execute the transition, we may experience difficulty in delivering our 45-nm next generation microelectronics products and technologies, which could materially and adversely affect our business.

We expect our quarterly revenues, cash flows and operating results to fluctuate for a number of reasons.

Future operating results and cash flows will continue to be subject to quarterly fluctuations based on a wide variety of factors, including: