

## Sun Must Address Important Issues to Reverse Its Decline

Daryl C. Plummer

In its latest quarter, Sun Microsystems sacrificed profitability to invest in R&D. Sun claims the investment will yield long-term viability, but Sun must execute or that viability may be in doubt.

## NEWS ANALYSIS

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### Event

On 22 July 2003, Sun issued its financial report for fiscal 4Q03 and the full year, ended 30 June 2003. In fiscal 4Q03, Sun recorded revenue of \$2.98 billion, down from \$3.42 billion in fiscal 4Q02. Sun earned a fraction of a cent per share in fiscal 4Q03, compared with \$0.02 per share in 4Q02. For all of fiscal 2003 Sun's revenue fell 8.5 percent from 2002 to \$11.4 billion while its per-share loss of \$0.18 in 2002 increased to a loss of \$0.75 per share in 2003.

### Analysis

Sun's financial performance in part reflects its incomplete transformation from a hardware leader to a network computing and systems company. With increased competition from Linux in the low-end server market and from big rivals such as IBM and Hewlett-Packard on the high end, Sun realizes it can't rely on hardware sales for growth. However, efforts in server virtualization and on-demand computing (N1), software infrastructure (such as Project Orion), and services have not yet matured despite some progress.

Continued decline is likely but not inevitable because Sun has strong assets:

- \$5.7 billion in cash and a slight profit in fiscal 4Q03
- Increasing profit margins from cost cutting
- Strong credibility in the Unix server business
- A large customer base (it's still gaining customers in government markets)
- Diversified infrastructure
- A reputation as an innovator and counterweight to Microsoft

Sun must build on these assets to reverse its slide. For example, Sun still has little credibility in software markets and must make the investments necessary to obtain it:

- Introduce a unique product set (N1 plus Orion plus services) and sell to new and existing customers
- Capitalize more on its lab projects such as JXTA
- Improve its marketing
- Communicate how network computing can generate substantial growth
- Create market momentum for Solaris x86 to capture edge computing opportunities now going to Linux

Sun recently articulated a strategy of selling its Orion software stack and N1 infrastructure to major service providers (such as mobile operators). Sun can grow its software sales if it interests these providers in Java back-end server infrastructure to support Java devices delivering those services. Sun will also continue to target Linux and Windows customers at the low end by promising to legally indemnify enterprises for using open-source software (where Solaris has its origins), a logical step. Nevertheless, some customers will view Sun's renewed emphasis on Solaris/x86 as being lukewarm toward Linux (it offers all of Linux plus much more). As Linux grows in capabilities, Sun will need to convince customers that supporting Solaris does not

indicate a lack of commitment to Linux. Finally, Sun must meld these strategies with high-performance, reliable chips and servers (that is, chip multithreading and throughput computing) to differentiate itself from larger competitors.

Customers shouldn't worry about Sun's independence yet. Its cash and market valuation will continue to shield it from any potential acquirers until at least 2005. However, independence does not guarantee relevance in large markets. Sun's hardware and operating systems will continue to be supported in the long term. However, Sun must move quickly to show significant growth in software and throughput computing to prove this business has a future. Otherwise, the company's future will increasingly be in doubt.

**Analytical Source:** Daryl Plummer, Gartner Research

### Recommended Reading and Related Research

- "Till Sun Delivers Orion Fully, Compare Prices With Individual Products" — Until Sun releases Orion fully, customers should establish a process for evaluating pricing and performance of individual Sun products vs. adopting an integrated Orion system stack. **By Daryl Plummer**
- "Sun Microsystems Trims Itself to Fighting Weight" — Enterprises should view its reorganization as a statement that Sun is serious about fighting to regain profitability. **By Daryl Plummer, Laura McLellan and David Smith**

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