SUN MICROSYSTEMS INC
Form 10-K
September 29, 2003
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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, 2003

¨   **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,	**http://www.sun.com/aboutsun/investor**
including zip code)	(Registrant s url)

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

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

* Common Stock

* Share Purchase Rights

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 the 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.   x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).   YES   x   No   ¨

The aggregate market value of the voting stock (Common Stock) held by non-affiliates of the registrant, as of December 27, 2002 (the last business day of registrant s second quarter of fiscal 2003), was approximately $10.2 billion based upon the last sale price reported for such date on The Nasdaq National 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 September 15, 2003 was 3,240,726,143.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Proxy Statement for the 2003 Annual Meeting of Stockholders are incorporated by reference into Items 10, 11, 12 and 13 hereof.

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PART I

ITEM 1.   BUSINESS

GENERAL

Sun s business is singularly focused on providing products and services for network computing. Network computing has been at the core of the company s offerings for the 21 years of our existence and is based on the premise that the power of a single computer can be increased dramatically when interconnected with other computer systems for the purposes of communication and sharing of computing power. Together with our partners, we provide network computing infrastructure solutions that comprise computer systems (hardware and software), network storage systems (hardware and software), support services and professional and educational services. Our customers use our products and services to build mission-critical network computing environments on which they operate essential elements of their businesses. Our network computing infrastructure solutions are used in a wide range of technical/scientific, business and engineering applications in industries such as telecommunications, government, financial services, manufacturing, education, retail, life sciences, media and entertainment and healthcare.

For the fiscal year ended June 30, 2003, we had revenues of $11.4 billion, employed approximately 36,100 employees, and conducted business in over 100 countries. We were incorporated in California in February 1982 and reincorporated in Delaware in July 1987.

We can be reached on the Internet at http://www.sun.com. Our most recent annual report on Form 10-K and certain of our other filings with the Securities and Exchange Commission (SEC) are available in PDF format through our Investor Relations website at http://www.sun.com/aboutsun/investors. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are also available on the SEC website at http://www.sec.gov which can be reached from our Investor Relations website.

BUSINESS STRATEGY

Our business strategy is built around our singular focus on network computing, and the computer systems (hardware and software), network storage systems (hardware and software), and support services and professional and educational services that enable networking solutions for our customers which attack cost and complexity, accelerate service delivery and provide mobility with security. The core elements of our business strategy include:

An end-to-end architecture that extends our common Java technology-based programming environment and SPARC® (Scalable Processor Architecture) technology implementation from devices as small as smart cards and cell phones to large multi-million dollar systems.

On-going innovation in microprocessor architecture, systems design and software to help ensure continuing technology leadership and resulting price-performance advantage.

A commitment to open application programming interfaces.

A solution-based selling model with an emphasis on utilizing our end-to-end network computing architecture platform to integrate our products and services to address customers strategic business challenges and information technology needs.

A robust partner community, including independent software vendors (ISV), system integrators, resellers and original equipment manufacturers (OEM), which adds value to Sun products and services and extends our reach and expertise.

A leading services organization that enables Sun and our partners to deliver open, innovative solutions and optimize availability and capabilities of our customers IT environment.

End-to-End Architecture

Developing and deploying services over the network requires an infrastructure platform that is enterprise ready, developer rich and economically compelling. This means that rather than offering the customer just the cheapest server or storage array, we are focused on providing the optimal combination of software and hardware that will give the customer better

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value. With this strategy, we are focused on offering the customer a platform that entails lower annual administrative costs, developer training costs, and downtime costs, which decreases customers   total cost of ownership.

In fiscal 2003, we introduced a number of new products supporting our strategy as an end-to-end infrastructure platform company and we improved the performance of our UltraSPARC® III microprocessor across our low, mid and high-end server lines. The UltraSPARC III processor is fully binary compatible with our previous generation processor, so customers can run existing applications without the time and cost of rewriting applications. We also strengthened our Linux support by extending our x86 low-end server product line. We continued the deployment of our Solaris 9 Operating System, which creates significant benefits to customers by reducing system downtime and upgrade costs because it is designed to run existing applications currently running on previous Solaris Operating System releases.

In addition, we introduced a new line of highly dense, very manageable low-end servers, the Sun Fire blade platform. This line allows customers to mix, match and manage different systems in a heterogeneous environment such as SPARC and x86 architectures, Solaris and Linux operating systems, and specialty blades in the same physical system. These servers are part of our broader strategy to deliver highly dense racks of low cost and very manageable server groups that are based on open application programming interfaces.

Our Sun ONE platform consists of Sun s powerful and scalable software, including the Solaris Operating System, Sun ONE middleware products and the Sun ONE Studio development environment. It also builds upon our well-established Java technology to help enable the creation and deployment of Sun ONE Services on Demand (i.e., the ability to provide information, data and applications anywhere, anytime and on any device, using open application programming interfaces that will work with a wide array of operating systems and applications).

Innovation

We believe that in order to be a leading developer of enterprise and network computing products and technologies, we must continue to invest and innovate. As indicated by our research and development investments of approximately 11-16% of annual revenues during each of the last three fiscal years, we are continually focused on technological innovation. Over the past few years, we have made significant investments in several of our product and services technologies, including investments in:

  the highly scalable UltraSPARC processor and systems architecture including our next generation processors that enable chip multithreading to drive throughput computing at the processor level;

  our highly reliable and scalable Solaris Operating System;

  mission critical clustering, messaging, directory and web services infrastructure software;

  the cross-platform Java software development environment, spanning smart cards, cellular handsets, set top boxes, desktop computers, and servers   used by our customers and independent software vendors;

  virtualization, provisioning, and monitoring software architecture for network computing resource optimization and systems management simplification;

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our highly scalable enterprise servers, from entry level to data center class; and

network-based storage systems and software, including Sun HighGround storage management software and Sun QFS and Sun SAM-FS software.

Many of these technologies provide us with a competitive advantage and differentiation in the marketplace. We believe by investing in research and development, we are able to develop and deliver more valuable systems technology to our customers, and therefore, are able to generate better long-term profit margins on our products. We intend to continue our investments into new computing technologies and are focused on continuing to develop and deliver leading-edge network computing products based upon our innovations.

Open Application Programming Interfaces (APIs)

From inception, we have focused on developing products and technologies based upon open APIs. We believe the real power in computing lies in the ability to freely access and share information over the network, while unconstrained by proprietary software and hardware standards.

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The need for open APIs is at the heart of the Internet s development. We believe that without them, too many proprietary software and hardware protocols cause both incompatibility and cost issues, making it too difficult and uneconomical for individuals and organizations to fully access and harness the network. Through open APIs, we believe application adoption and service deployments over the network will grow more quickly, which will increase the workload on the network, leading to increased demand for our computer systems. In addition, by adhering to open APIs, we are able to deliver more flexible and compatible systems products to our customers, reducing administrative costs and adding to the demand for our systems. For example, we have created technologies, such as the Network File System (NFS), UltraSPARC architecture and the Java technologies, providing customers with flexibility for their networking environments, and facilitating industry growth. In addition, through our Sun ONE software platform, we have extended our well-established Java technology platform and utilized Web industry standards including XML (Extensible Markup Language), SOAP (Simple Object Access Protocol), UDDI (Universal Description, Discovery and Integration) and WSDL (Web Services Description Language).

Solutions-Based Selling Model

Our sales force is focused on selling our products and services via a solutions-based selling model whereby we offer an integrated and consistent set of end-to-end networking architecture platform solutions to the marketplace. These solution sets currently encompass three core competencies: the Data Center (including Storage), Java Web Services, and Edge Computing. These competencies line up directly with the three key strategies we present to our customers as part of the Sun vision attacking cost and complexity, accelerating service delivery and enabling mobility with security. We believe our solutions-based selling approach allows us to engage with our customers over the entire life cycle of their key infrastructure projects, which brings our expertise to bear in accelerating the delivery of sustainable value from the products and services we produce.

Partner Community

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 its customers. We have established relationships with leading independent software vendors (independent software vendors are a part of nearly all solutions our customers implement), value-added resellers, OEMs, channel development providers, independent distributors, computer systems integrators and service delivery partners 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.

Global Services

We provide expertise in network computing through a broad range of global services including support services to help ensure high satisfaction and availability of our customers mission-critical systems. In addition, our professional and educational services enable our customers to architect, implement and deploy systems within their IT environments and provide system/network management, education consulting, skills migration and training.

BUSINESS ORGANIZATION

Our organization is centered around the functional competencies needed to design, develop and deploy the major elements of our infrastructure solutions. Our Global Sales Operations organization manages and has primary responsibility for our field sales, relationships with our selling partners, technical sales support, and sales operations. Our Marketing and Strategy Organization is responsible for corporate strategy and strategic planning and development, product marketing strategy, pricing strategy and execution, public and analyst relations, advertising and branding, go-to-market activities and acquisitions and strategic investments activities. Our Worldwide Operations organization manages and oversees manufacturing operations of Sun and our partners and is responsible for logistics operations. Our research and development investments comprise organizations focused on the development of computer systems (specifically organizations responsible for the development of processors and network products, enterprise systems products, volume systems products, and software) and network storage systems products. Our Sun Services organization is responsible for services including design, implementation and operation of enterprise and Internet computing environments, systems integration and support, and professional and educational services.

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SALES, MARKETING AND DISTRIBUTION

We sell end-to-end networking architecture platform solutions, including products and services, in most major markets worldwide through a combination of direct and indirect channels. We also offer component products such as 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 resellers.

Our sales force serves the telecommunications, government, financial services, manufacturing, education, retail, life sciences, media and entertainment and healthcare industries. We organize our sales coverage resources within four Time Zone groups, which consist of U.S., International Americas, EMEA (Europe Middle East and Africa) and APAC (Asia, Australia and New Zealand) comprising 22 geographically-based selling units. We have approximately 100 sales and service offices in the United States and an additional 150 sales and service offices in 45 other countries. In addition, we use independent distributors in over 100 countries. In general, our sales coverage model calls for independent distributors to be deployed in partnership with our direct sales force. However, in some smaller markets, independent distributors may be our sole means of sales, marketing and distribution.

Our relationships with resellers and distributors (collectively our Channel Partners) are very important to our future revenues and profitability. Channel relationships accounted for more than 61% of our revenues during fiscal 2003 and more than 65% in fiscal 2002. Our sales force is compensated on a channel-neutral basis to reduce potential conflict between our sales force and channel partners. Our partners include:

systems integrators, both government and commercial, who serve the market for large commercial projects requiring substantial analysis, design, development, implementation and support of custom solutions;

channel development providers who supply our products and provide product marketing and technical support services to our smaller resellers;

ISVs and resellers who provide added value in the form of software packages, proprietary software development, high-end networking integration, vertical integration, vertical industry expertise, training, installation and support;

OEMs who integrate our products with their hardware and software; and

independent distributors who primarily serve foreign markets in which we do not have a direct presence.

We have a wide range of marketing activities. Our marketing and strategy organization oversees Sun s strategic planning, determines product and pricing strategy; coordinates advertising, demand creation and public relations activities; maintains strategic partnerships with major independent software vendors; performs competitive analyses; and negotiates and supports acquisition and investment transactions.

Revenues from outside the United States were approximately 56% of our total net revenues in fiscal 2003 and 53% and 52% in fiscal 2002 and 2001, respectively. Direct sales we make outside of the United States are generally priced in local currencies and can be subject to currency exchange fluctuations. The net foreign currency impact on net revenues and operating results cannot be precisely measured because of the various hedging strategies we employ, however because of the general weakening of the U.S. dollar our best estimate of the foreign exchange benefit approximated 4% on total net revenues for fiscal 2003.

Some of our sales to international customers are made under export licenses that must be obtained from the United States Department of Commerce. In addition, all of our export transactions are subject to U.S. export control laws, and certain transactions could require prior approval of the U.S. Department of Commerce. Protectionist trade legislation in either the United States or other countries, such as a change in the current tariff structures, export compliance laws or other trade policies, could adversely affect our ability to sell or to manufacture in international markets. Furthermore, revenues from outside the United States are subject to inherent risks, including the general economic and political conditions in each country. See Item 3. Legal Proceedings, for a description of certain matters currently pending before the U.S. Department of Commerce, Bureau of Industry and Security, Office of Export Enforcement (BIS).

The countries primarily contributing to our international sales are Japan, Germany and the United Kingdom (UK). Japan represented approximately 8% of our total net revenues in fiscal 2003, 9% in fiscal 2002 and 10% in fiscal 2001. Germany represented approximately 8% of our total net revenues in fiscal 2003, 7% in fiscal 2002 and 6% in fiscal 2001. The UK represented approximately 7% of our total net revenues in fiscal 2003, 7% in fiscal 2002 and 8% in fiscal

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2001. Over the past three years, Japan s revenues have declined while sales in Germany increased from the previous fiscal year and revenues in the United Kingdom were stable as a percentage of total net revenues. Sales to telecommunication and information technology manufacturing industries, primarily through Channel Partners, together represent a significant portion of Sun s revenues in Japan.

Sales to General Electric Company (GE) and its subsidiaries in the aggregate accounted for approximately 11%, 12% and 13% of our fiscal 2003, 2002 and 2001 total net revenues, respectively. More than 90% of the revenue attributed to GE was generated through GE subsidiaries acting as either a reseller or financier of our products. Sales through MRA Systems, Inc., a channel development partner and a GE subsidiary, consisted of 9%, 8% and 10% of total net revenues in 2003, 2002 and 2001, respectively. As a channel development partner, MRA Systems, Inc. acts as a distributor of our products to resellers who in turn sell those products to end-users. Our business could be adversely affected if GE or another significant customer terminated its business relationship with us or significantly reduced the amount of business it did with us. See Note 15 to the Consolidated Financial Statements for additional information concerning sales to international customers and business segments.

Our product order backlog at June 30, 2003 was $705 million, as compared with $841 million at June 30, 2002. Our backlog includes orders for which a delivery schedule within six months has been specified by the customer and shipped products for which revenue has not been recognized. Backlog levels vary with demand, product availability 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 are not a reliable indicator of future operating results.

MANUFACTURING AND SUPPLY

Worldwide Operations manages company-wide purchasing of materials used in producing Sun products, assists in product design enhancements, oversees our own 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 mid to high-end systems. For all other systems, we rely on external manufacturing partners. We manufacture in California, Oregon and Scotland, and distribute from California, the Netherlands and Japan. We have continued efforts to simplify the manufacturing process by reducing the diversity of system configurations offered and increasing the standardization of components across product types. In addition, we have continued to increase our focus on quality through the appointment of a Chief Quality Officer in fiscal 2003 and the implementation of new quality control processes that are intended to proactively identify 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 result in delays of product shipments.

We depend on many suppliers for the necessary parts and components to manufacture our products. There are a number of vendors producing the parts and components that we need. However, there are some components that can only be purchased from a single vendor due to price, quality, or technology reasons. For example, we depend on Texas Instruments for our SPARC® microprocessors and several other companies for custom integrated circuits. If we were unable to purchase the necessary parts and components on acceptable terms from a particular vendor and we had to find a new supplier for such parts and components, our new and existing product shipments could be delayed, adversely affecting our business and operating results. Similarly, our ability to purchase components in sufficient quantities to meet customer demand could impact our future operating results. Further, we also face the risk of ordering too many components, or conversely, not enough components, because orders are generally based on forecasts of customer orders rather than actual orders, which subjects us to inventory risk.

PRODUCT DEVELOPMENT

Our research and product development programs are intended to sustain and enhance our competitive position by incorporating the latest worldwide advances in hardware, software, graphics, networking, data communications and storage technologies. In addition, we may extend our product offerings and intellectual property through acquisitions of businesses or technologies or other arrangements with our partners. Sun s 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 system software platforms for Internet and intranet applications, telecommunications and next-generation service provider networks, developing advanced workstation, server and storage architectures, as well as designing application-specific integrated circuits. We devote

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substantial resources to software development as we believe it provides and will continue to provide significant competitive differentiation.

We conduct research and development principally in the United States, United Kingdom, France, Ireland, Germany, Japan, Norway and India. Research and development (R&D) expenses were $1,837 million, $1,832 million and $2,016 million in fiscal 2003, 2002 and 2001, respectively.

PRODUCTS

Our products consist of Computer Systems and Network Storage systems.

COMPUTER SYSTEMS

Our Computer Systems products and technologies, including our full line of scalable workgroup and enterprise servers, our UltraSPARC microprocessors and our software, are integrated systems, designed, developed and produced for network computing environments.

Servers.   We offer a full range of servers from our data center/high-performance computing servers through our entry server systems and blade systems.

High-end servers.   Our high-end servers, the Sun Fire 15K and the Sun Fire 12K, are designed to offer greater performance and lower total cost of ownership than mainframe products and are used for consolidations, application migrations, data mining and warehousing, custom applications, on-line transaction support, enterprise resource planning, high performance technical computing and databases. The Sun Fire 15K server is one of the most scalable UNIX® platform-based systems in the marketplace and incorporates our UltraSPARC III microprocessor, mainframe features such as dynamic partitioning (Dynamic System Domains) and a supercomputer-class Gigaplane-XB interconnect.

Mid-range servers.   Our midrange servers, including our Sun Fire 3800, Sun Fire 4800 and Sun Fire 6800 servers, provide reliability, availability and scalability to address the needs of data centers and enterprise-scale network computing at a moderate cost. These servers utilize the UltraSPARC III processor and Solaris 9 Operating System and feature enhanced processing power. They are available with various options in processor and memory expandability, hardware redundancy and component accessibility. In fiscal 2003, we introduced the Sun Fire 1280 server which uses the UltraSPARC III processor and is built to deliver the most multiprocessing capability further down in our family of mid-range Sun Fire servers.

Entry server systems.   We also offer entry server systems, including our Sun Fire V480 and Sun Fire V880 servers, that deliver network computing in a compact, low-cost package. Our entry server systems are differentiated by their size, their processor architecture (SPARC or x86), their form factor (rackable or stand-alone systems) and the environment for which they are targeted (general purpose or specialized systems). During fiscal 2003, we introduced two new general purpose entry systems, the Sun Fire V240 server and the Star Fire V210 server, and our first line of entry level x86 servers, including the Sun Fire V60 server, and the Sun Fire V65 server, which provide high density scalable solutions for both Solaris and Linux operating systems. We also introduced our first blade systems offering. Our blade systems combine high density hardware architecture and system management software. They allow for management of a pool of heterogeneous, modular, single board

servers, such as SPARC and x86 architectures, Solaris and Linux operating systems, and specialty blades, as one computing environment.

Processors and Network Products. The UltraSPARC microprocessors provide the computing power of most of Sun s systems. We have three series of processors that use the SPARC architecture: 1) The UltraSPARC s-Series processors power the high-end and midrange server products from Sun, as well as power desktops. These CPUs offer our highest level of performance, scalability and leading-edge RAS; 2) The UltraSPARC i-Series processors offer a higher level of integration on the central processing unit enabling the price and performance design points deployed in Sun s workgroup servers, rack mount servers, and high performance desktops; and 3) The UltraSPARC e-Series processors balance cost, power consumption and performance, enabling economical 64-bit server and desktop solutions while maintaining binary compatibility with all SPARC processors, past and present.

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

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Solaris Operating System (OS).   The Solaris OS is a high performance, highly reliable, scalable and secure operating environment for SPARC and x86 platforms that is easy to install and use, is optimized for the Java platform and supports more than 12,000 applications. It is optimized for enterprise computing, Internet and intranet business requirements, powerful databases and high performance technical computing environments. The Solaris 9 OS, our latest release of the Solaris OS, creates a services platform by combining traditional operating systems functionality with application services and identity management (management of user identities over the Internet or complex corporate networks so that users can use a single sign-on to be authenticated and authorized to access multiple files). Solaris 9 OS integrates many Sun ONE middleware elements making it easier to build and deploy application and web services based on Java and XML technologies. Our Trusted Solaris OS provides a high level of privacy and reduces the risk of security violations on a commercial-grade OS. Trusted Solaris OS is available for both SPARC and x86 platforms.

Java.   Our Java platform application environment allows development of application software independent of the underlying operating system or microprocessor. Java technology allows a developer to write applications once for a wide range of platforms and devices. Our Java platforms are based on a common core architecture and include the Java 2 Platform, Standard Edition (J2SE) technology used on personal computers and workstation clients and available on Solaris OS, Linux, HP-UX, AIX, Tru64 Unix, Windows, MacOS X and other platforms; Java 2 Platform, Enterprise Edition (J2EE) technology used to develop and deploy webservices which enable secure, robust and interoperable business applications; Java 2 Platform, Micro Edition (J2ME) technology, which extends Java technology to 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.

Developer tools.   We develop and market software development tools designed to aid in application development and integration. The Java 2 Software Development Kit enables developers to create and run both applets (miniature applications written in the Java programming language) that run inside a web browser and applications that run outside of a browser. Our Sun ONE Developer Platform provides a desktop-to-mainframe development and test environment for programming in C, C++ and Java programming languages.

Sun ONE middleware and Desktop.   Our Sun ONE software enables enterprises to leverage their information and applications into services offered on intranets and the Internet. Our Sun ONE middleware software includes application, directory, identity, integration, calendar, messaging and portal services for multiple platforms, including the Solaris OS, Windows NT, HP-UX, AIX and Linux operating systems. Our desktop software includes our StarOffice office productivity suite which has a fully integrated set of applications including word processing, spreadsheet, graphic design, presentations, database access, HTML editor, mail/news reader, event planner and formula editor tools. It runs on most major operating environments and platforms, including the Solaris OS, Microsoft Windows, Linux, OS/2, and Java platform.

N1 .   N1 software is our vision and architectural blueprint for reducing the cost and complexity of managing enterprise data centers by allowing a data center to work like a single system by combining foundation resources (e.g. servers, storage and network devices) with virtualization, provisioning, policy and automation, and monitoring. During fiscal 2003, we introduced the N1 Provisioning Server 3.0 Blades Edition, a comprehensive management environment for the Sun Fire Blade Platform that automates configuration and deployment tasks.

Desktops and Workstations.   Our desktops and workstations provide powerful solutions for a wide range of business and technical activities such as software development, mechanical design, financial analysis and education. Our product line includes 64-bit workstations, graphics accelerator boards and thin client SunRay products. In fiscal 2003, we introduced the Sun Fire V880z visualization system that combines the performance of the Sun Fire V880 server and the new high performance XVR-4000 graphics accelerator for demanding high-end visualization applications.

NETWORK STORAGE

Our Network Storage systems integrate servers, storage and software to support heterogeneous environments.

Storage Systems. Our high-end data storage systems provide a platform for direct attach storage or storage area network (SAN) solutions. They are designed for extreme availability, performance, scalability, connectivity and manageability. Our high-end data storage systems combine Hitachi Data Systems high-end storage products with our resource management and file management software under an OEM agreement with HDS first signed in fiscal 2002.

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We offer a wide range of flexible, scalable mid-range storage systems which support high-performance computing and enterprise SAN implementations, as well as storage virtualization technology. In fiscal 2003, we introduced the Sun StorEdge 6320 system, which delivers performance, flexibility and high availability for clustered environments such as high-performance computing and decision support systems, and the Sun StorEdge 6120 array, which combines modular platform design and intuitive SAN-wide manageability.

Our Sun StorEdge products for workgroup applications offer a flexible, compact, cost-effective approach for growing storage demands. Their building-block architecture is designed to allow users to expand and customize as needed, offering performance and flexibility at low cost for a variety of environments for increased return on investment. In fiscal 2003, we introduced the Sun StorEdge 3510 array, which combines advanced RAID technology with industry-standard fiber-channel technology in a scalable package, and the Sun StorEdge 3310 series.

Storage Software. Our Sun StorEdge software is an integral part of our complete storage solutions. Our Sun StorEdge software is based on the Sun ONE architecture and comprises an open, integrated and automated storage management software family. The Sun StorEdge software suites are focused on availability, utilization, performance and storage resource management.

SERVICES

Our services team provides expertise in helping our customers deploy network computing environments through a broad range of services, including Support services (support for hardware and software) and Professional and Educational services. Sun Services assists customers globally, provides support services to nearly a million units under contracts in more than 100 countries, training more than 400,000 students annually, and providing consulting, integration and operations assistance to IT organizations worldwide.

SUPPORT SERVICES

The SunSpectrum[SM] Support services product offerings allow customers the power and flexibility to customize their support services contracts. Customers can choose from four levels of support that range from mission critical to self-support. This service is sold separately or packaged with hardware, software and peripherals as a single-price support service. Each contract type is specifically designed to enable high availability and continuous operation for our customers. Our resources in the field for direct services are complemented by third-party service providers who primarily deliver hardware support services such as spares inventories and manpower. Investments by these third-party service providers help us expand our geographic coverage without additional fixed cost investments on our part. Software support is primarily delivered by our software support engineers.

PROFESSIONAL AND EDUCATIONAL SERVICES

Sun Professional services provides a suite of technical consulting and systems integration services to help customers architect, implement, and manage complex network computing environments. Our highly trained Professional services team specializes in providing customers with advanced systems, software, storage, and network architecture design consulting, platform integration, enterprise systems management and operation such as network security and identity management, wireless network-based systems, and advanced Sun ONE and Java software integration solutions. We provide people, processes and technology and we partner with third-party systems integrators, to deliver solutions tailored to meet our customers needs. Our technical and project management experts help design IT architectures and plan migrations from legacy systems to network computing or help customers upgrade existing network computing environments. Additionally, to keep customer

computing environments operating at peak performance, operations experts help customers manage the complexity of heterogeneous systems and networks.

Our Educational services group develops and delivers integrated learning solutions for enterprises, IT organizations, and individual IT professionals. These solutions help ensure that the necessary talent is available and properly aligned to meet our clients network computing needs, as well as business objectives. Sun learning solutions include education consulting services, learning management technologies, multi-mode learning content and professional certifications.

COMPETITION

We compete in the computer hardware, 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

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Machines Corporation (IBM), Hewlett-Packard Company (HP), EMC Corporation (EMC), Fujitsu and the Fujitsu-Siemens joint venture company. We also compete with companies who distribute systems based on microprocessors manufactured by Intel Corporation (Intel) and the Windows family of operating systems software developed by Microsoft Corporation (Microsoft). These competitors include Dell Inc. and HP, in addition to Intel and Microsoft.

Customers make buying decisions based on many factors, including new product and service offerings and features; product performance; availability and quality of support and other services; price; platform; quality; reliability 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. We believe competition has intensified over the last fiscal year and will continue to remain intense. 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 have encouraged the use of SPARC technology as a standard in the computer marketplace by licensing much of the technology, and promoting open interfaces to the Solaris OS, as well as by offering microprocessors and enabling technologies to third party customers. As a result, several licensees, including Fujitsu and the Fujitsu-Siemens joint venture company, also offer products based on the Solaris OS and the SPARC architecture that compete directly with our products. We have also worked to make our Java programming language a standard for complex networks. We develop applications, tools and systems platforms, as well as work with third-parties to create products and technologies, in order to continue to enhance the Java platform s capabilities. As part of this effort, we license Java technology which widely encourages competitors of Sun to also develop products competing with these applications, tools and platforms. If we are unable to compete effectively, our business could be harmed.

PATENTS, TRADEMARKS AND INTELLECTUAL PROPERTY LICENSES

We have used, registered, and/or applied to register certain trademarks and service marks to distinguish genuine Sun 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 also believe that patents are of less competitive significance than factors such as innovative skills and technological expertise. From time to time we have been notified that we may be infringing certain patents or other intellectual property rights of others. Several pending claims are in various stages of evaluation. With the exception of the matters further disclosed at Item 3. Legal Proceedings of this report, we believe no material litigation has arisen from these claims. We are evaluating the desirability of entering into licensing agreements in certain of these cases. 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 litigation arising out of such claims, could adversely affect our business.

EMPLOYEES

As of September 15, 2003, we had approximately 36,100 employees (at June 30, 2003 we had approximately the same number of employees). We depend on key employees and face competition in hiring and retaining qualified employees. Our employees are vital to our success, and our

key management, engineering and other employees are difficult to replace. Although we have entered into a limited number of employment contracts with certain current and former executive officers, we generally do not have employment contracts with our key employees. Further, we do not maintain key person life insurance on any of our employees. As our stock price has decreased and because we offer equity-based incentive compensation, our ability to continue to offer competitive compensation packages to current employees has been negatively impacted. Consequently, these pressures have affected our ability to attract and retain highly qualified personnel. If these adverse conditions continue, we may not be able to retain highly qualified employees in the future and this could harm our business. In addition, new regulations implemented by The Nasdaq National Market requiring shareholder approval for all stock option plans as well as new regulations implemented by the New York Stock Exchange prohibiting NYSE member organizations from giving a proxy to vote on equity-

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compensation plans unless the beneficial owner of the shares has given voting instructions could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult to grant stock options or require us to expense options granted to employees, we may incur increased compensation costs or find it difficult to attract, retain and motivate employees, either of which could materially and adversely affect our business.

ITEM 2.   PROPERTIES

At June 30, 2003, Sun s worldwide facilities represented aggregate floor space of 15.3 million square feet, of which 5.6 million square feet was owned and 9.7 million square feet was leased. We had an aggregate floor space of 10.6 million square feet in the United States, of which 4.9 million square feet was owned and 5.7 million square feet was leased. In the 45 other countries in which we occupy space we had an aggregate of 4.7 million square feet, of which 0.7 million square feet was owned and 4.0 million square feet was leased.

At June 30, 2003, our owned properties consisted of:

Location	Square Footage of Facility	Square Footage Under Construction
Bagshot, England	25,995	n/a
Broomfield, Colorado	916,045	n/a
Burlington, Massachusetts	699,723	62,500
Farnborough (Guillemount Park), England	270,088	n/a
Linlithgow, Scotland	420,148	n/a
Menlo Park, California	1,022,088	n/a
Newark, California	1,404,309	n/a
Santa Clara, California	816,240	n/a
Total	5,574,636	62,500

In addition to the above-noted   Square Footage Under Construction,   we have approximately 1.6 million square feet of facilities available for future construction. We continually evaluate our facility requirements in light of our business needs and stage the future construction accordingly. In addition, we own approximately 38 acres of undeveloped land in Austin, Texas.

Starting in fiscal 2001, we committed to vacate properties, in the U.S and internationally, according to our restructuring and facility exit plans (Plans). 135 properties were selected to be vacated under these Plans, representing an aggregate square footage of 3.3 million square feet. At June 30, 2003, on a worldwide basis related to our Plans, we had an aggregate of 1.6 million square feet that was vacant and 0.7 million square feet that was being subleased to non-Sun businesses. Of these amounts, in the U.S. 1.2 million square feet was vacant and 0.5 million square feet was being subleased to non-Sun businesses and internationally we had 0.4 million square feet that was vacant and 0.2 million square feet that was being subleased to non-Sun businesses.

Additionally, at June 30, 2003, 35 properties representing 0.4 million square feet remained to be exited under the Fiscal 2003 Restructuring Plan and will be vacated no later than December 28, 2003.

Substantially all of our facilities are used jointly by our Product group, Sun Services group, Global Sales Operations and other functions. Our manufacturing facilities are located in Linlithgow (Scotland), Beaverton (Oregon) and Newark (California).

ITEM 3.   LEGAL PROCEEDINGS

On February 11, 2002, Eastman Kodak Company (Kodak) filed a civil lawsuit against us, Eastman Kodak Company v. Sun Microsystems, Inc., Civil Action No. 02-CV-6074, in the United States District Court for the Western District of New York. On March 22, 2002, Kodak filed a First Amended Complaint, which asserts that some of our products, including those relating to our Java technology, infringe one or more claims of U.S. Patent No. 5,206,951, U.S. Patent No. 5,421,012, and U.S. Patent No. 5,226,161 (collectively, the Kodak Patents). Kodak further alleges that we have

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contributed to and induced infringement of one or more claims of the Kodak Patents. Kodak seeks injunctive relief against future infringement, unspecified damages for past infringement, and attorney s fees and costs. We have filed an Answer with the court, denying infringement of any valid and enforceable claim of any of the Kodak Patents. We also filed counter-claims, seeking a declaratory judgment of noninfringement, invalidity and/or unenforceability of the Kodak Patents. We further allege that Kodak s claims are barred in whole or in part by the doctrines of estoppel, laches and patent exhaustion, and that we have license and/or sublicense rights to the Kodak Patents. Discovery is ongoing, and the parties recently submitted briefs regarding claim construction. Trial has not been scheduled. Based on our analysis of the Kodak patents, applicable law, and discussions over many months with Kodak, we believe this suit is without merit and, accordingly, we will defend ourselves and pursue our counterclaims vigorously. At this time, we cannot forecast with reasonable certainty the potential costs associated with an adverse outcome of this matter.

On March 8, 2002, we filed suit against Microsoft Corporation (Microsoft) in the United States District Court for the Northern District of California, pursuant to United States and State of California antitrust laws. In our lawsuit and in subsequent filings in that case, we allege that Microsoft has engaged in illegal conduct, including efforts to acquire, maintain and expand a number of illegal monopolies; illegal tying arrangements; illegal exclusive dealings; copyright infringement; unreasonable restraints of trade; and unfair competition. Our requested remedies include: (1) preliminary injunctions requiring Microsoft to distribute our binary implementation of the Java Runtime Environment as part of Windows XP and Internet Explorer (must carry remedy) and to stop the unlicensed distribution of Microsoft s Virtual Machine for Java technology (copyright infringement remedy); (2) a permanent injunction to restore competition to the markets in which Microsoft is unlawfully attempting to acquire, maintain and expand a number of monopolies; and (3) compensation for losses we suffered as a result of Microsoft s unlawful actions. The case was transferred to the District of Maryland and combined with other cases pending against Microsoft for consolidated pretrial proceedings, in the case entitled Microsoft Corp. Windows Operating System Antitrust Litigation, MDL-1332. At the conclusion of the pretrial proceedings, the case will return for trial to the Northern District of California. On January 15, 2003, Judge Motz granted us two preliminary injunctions, ordering Microsoft to implement our requested must carry remedy for shipments of Windows XP and granting our requested copyright infringement remedy. Judge Motz also reversed an earlier order dismissing two of our claims and denied Microsoft s remaining motions to dismiss. On June 26, 2003, a three-judge panel of the Court of Appeals reversed and remanded Judge Motz s ruling with respect to the must carry injunction and upheld Judge Motz s ruling with respect to the copyright infringement injunction. We are considering various alternatives related to the Court of Appeals rulings, including asking Judge Motz to modify his order to meet the concerns raised by the Court of Appeals. Microsoft has filed counterclaims against us, alleging unfair competition and breach of a settlement agreement between the parties related to Microsoft s use of our Java technology. Microsoft is also appealing an earlier ruling regarding whether and to what extent they are precluded from relitigating findings made in the United States antitrust case. We believe that Microsoft s counterclaims are without merit and intend to present a vigorous defense. At this time, we cannot forecast with reasonable certainty the potential costs associated with an adverse outcome with respect to Microsoft s counterclaims.

In early February 2002, Sun and two of its subsidiaries received several charging letters from the United States Department of Commerce, Bureau of Industry and Security, Office of Export Enforcement (BIS) claiming that we had violated export control regulations. The letters relate to sales in 1998 in Egypt and in 1997 to a reseller in Hong Kong for subsequent resale in the People s Republic of China. On April 16, 2003, the BIS provided us with a charging letter documenting nineteen additional charges, which involved alleged violations of certain record keeping requirements. The relevant export statutes provide for monetary penalties and in some cases denial of export privileges and exclusion from practice before the BIS if a violation is found. The BIS has submitted a settlement proposal which would include a monetary penalty and a suspended one-year denial of export privileges. The proposed denial would not be enforced if there were no violations during the one year suspension period. BIS approval would be required for transactions involving export, re-export or transfer of items subject to the relevant export regulations and involving the specific entities involved in the Egyptian and People s Republic of China transactions which were the subject of the original 2002 charging letters. We would be entitled to an administrative hearing in the event the BIS should allege that a further violation has taken place. In August 2003, we received verbal notice from the BIS that they were considering filing two additional charges, both of which would address alleged violations related to certain recordkeeping requirements with respect to certain exports to Syria. In order to fully investigate and address the possible new charges, we requested and received an extension of time until October 31, 2003 to file a formal response to all the charging letters or otherwise resolve the matters through a negotiated resolution. We are involved in ongoing settlement

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discussions with the BIS and continue to believe it is reasonably likely that we will reach a negotiated resolution. However, absent a negotiated resolution, an administrative hearing would be set and, in such case, we would assert a vigorous defense. We believe that any monetary penalties would not have a material adverse effect on our financial position, results of operations or cash flows for any fiscal year or fiscal quarter. A denial of export privileges, including any revocation of the proposed suspended denial, would have a material adverse effect on our business.

ITEM 4.   SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of stockholders of Sun during the fourth quarter of fiscal 2003.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following sets forth certain information regarding our Executive Officers as of September 15, 2003.

Name	Age	Position
Scott G. McNealy	48	Chairman of the Board of Directors, President and Chief Executive Officer
Crawford W. Beveridge	57	Executive Vice President, People and Places, and Chief Human Resources Officer
Mark A. Canepa	48	Executive Vice President, Network Storage Products
John D. Croll	46	Senior Vice President, General Counsel and Secretary
Robyn M. Denholm	39	Vice President and Corporate Controller
H. William Howard	69	Senior Vice President, Chief Information Officer
Neil A. Knox	50	Executive Vice President, Volume Systems Products
Clark H. Masters	54	Executive Vice President, Enterprise Systems Products
Eugene G. McCabe	50	Senior Vice President, Worldwide Operations
Stephen T. McGowan	55	Chief Financial Officer and Executive Vice President, Corporate Resources
Michael H. Morris		