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Annex Bulletin 2007-30

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IBM to Offer Sun's Operating System on Its Mainframes, System x Servers

Sun's Solaris to Shine on IBM's Polaris

Potential Boost to Mainframe Demand, Sun's Software Revenues? More Than Meets the Eye?

SCOTTSDALE, Aug 16, 2007 - It started with Java in the 1990s. And now, Sun has begun casting an ever longer shadow on the IT industry, striking first a deal with Google and now with IBM, too. The two companies announced



today that Sun's Solaris (operating system) will also shine on Big Blue's increasingly "greener" [Polaris mainframes](#) (System z). Solaris will also become the X-factor on IBM's



Intel-based server farms (System x).

The deal appears good for Sun and even better for IBM. Sun will get additional software revenues. IBM will gain because the Solaris ecosystem will help boost the already strong demand for IBM mainframes and the System x.

"We're thrilled to be working with IBM to bring the Solaris OS to the broadest market possible - they are a natural partner for Sun," said Jonathan Schwartz, president and CEO of Sun Microsystems. "This relationship represents a tectonic shift in (Sun's approach to) the marketplace," Schwartz added in today's press conference.

"The relationship we have with IBM is really the strongest we have with any (IT) player in the marketplace"

Jonathan Schwartz, Sun's CEO

Schwartz said that Sun has been on a journey for several years now to separate Solaris from its hardware business. With this IBM deal, Big Blue now becomes Sun's first Tier-1 distributor for Solaris.

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The Solaris 10 OS, for example, has the largest installed base of any UNIX or Linux OS, [Sun boasts at its webs site](#), including an application catalog of over 4,000 unique titles from more than 2,000 independent software vendors (see [Sun release, Jan 2007](#)). Sun has sold about 10 million Solaris licenses in the last two years alone. And now, IBM will get a chance to cherry-pick the most promising among the ubiquitous Solaris users to try to get them to migrate to its already thriving mainframe and Intel hardware platforms.

"Solaris is a wonderful addition to what we already have," said Bill Zeitler, senior vice president in charge of all IBM hardware. "(This deal) shows commitment to offer our clients a choice. Our differentiator is choice."



And what's in it for Sun? More business; bigger revenues, its CEO believes. "Once we separated our software and hardware businesses we've sold more of both," said Schwartz answering an analyst question. "We've seen the days of tying the hardware and software, and it just doesn't work (anymore)," he added.

According to David Boyes, the head of Sine Nomine, a company that helped IBM port Linux to the System z, the Solaris move would help reassure (Sun's) StorageTek customers of continued mainframe commitment by Sun, and shore-up Sun's lost ground in the last four years with Solaris deployments in large enterprises ([click here](#) for Boyes' presentation on this).

More Than Meets the Eye? Should IBM Acquire Sun?

And what about the Unix competition? There has been no mention of Solaris on System p or Unix in the release. Would today's deal not diminish the opportunity for Sun new server sales? Possibly. So why would Sun do it? We don't know for sure. Maybe the Polaris revenue boost is enough? Or maybe there is more to come? Like porting Solaris to the System p. We think that would make sense for both companies.

"That's certainly something I would like to see happen," said IBM's Zeitler, answering a question during the press conference.

Sun's Schwartz did not disagree. "The relationship we have with IBM is really the strongest we have with any (IT) player in the marketplace," he said. He added that he and Bill (Zeitler) both hoped that it would open doors to "maximum market opportunities." And that may include a Unix deal, too.

A soup-to-nuts IBM-Sun partnership could end up being a better deal for both - whether IBM acquires Sun, or enters into some sort of a joint venture deal that would eliminate the Unix competition between the two hardware platforms. Sun would then be able to save a ton of development money that's been going into the hardware competition with IBM. And IBM would gain huge influence on the industry, especially at the low end, where it is weak.

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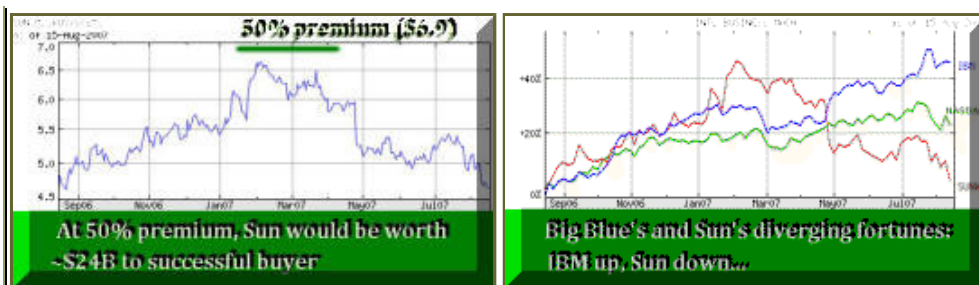
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And if IBM were to buy Sun, how much would such an acquisition cost? Probably about \$24 billion, assuming a (hefty) 50% premium over the current market cap at just over \$16 billion. The \$6.9 share price (50% premium) would actually be only slightly above the 52-week high that Sun's shares reached in January (see above charts). So it's not like the would-be buyer would be grossly overpaying for the company.

By the way, we first talked about Sun as a potential takeover target over four years ago (see "[Let the M&A Games Begin](#)," [Annex Bulletin 2003-20](#), June 2003). Its price back then was just a tad higher than today's).

Given IBM's improving and Sun's declining market fortunes, such a deal would probably boost both stocks. All IBM would need to do is stop throwing tens of billions of dollars in stock buybacks for a while, and voila... Big Blue would own a software company "par excellence."

A software company? Yes. Sure, Sun has servers and designs chips; good chips at that (see below). But somebody else always manufactures them (Fujitsu, Texas Instruments in the past). So why not IBM?

Furthermore, we have been saying for years that Sun's real "crown jewel" is its software, not its hardware:

"It took innovation mixed with hucksterism to accomplish Sun's Java marketing feat. 'Interest in Java had a 'halo effect' on Sun,' the [Investors Business Daily](#) noted in a February 1997 report... It would not be an exaggeration to suggest that, in terms of perceptions, Sun's has now replaced Apple as the IT industry's innovation foundry in most people's minds. Which has undoubtedly indirectly bolstered Sun's other businesses."

(An excerpt from "[Coffee Beans & Sun Spots](#)," [Annex Bulletin 98-33](#), Aug 1998)

That was nine years ago. And just yesterday, in a clear challenge to Microsoft's popular Office software, Sun announced that Google has begun distributing its StarOffice suite of word processing, spreadsheet and other workplace-oriented programs *for free*, as part of the Google Pack download.

Sun Googling for Microsoft

By adding Sun's software, Google is giving a valuable endorsement to a server and software maker that has struggled to return to sustained profitability ever since. Just how ubiquitous Sun's software already is can be seen from the fact that its OpenOffice suite has been



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downloaded about 100 million times.

In reciprocal move, Sun has also added Google search capabilities to all of its StarOffice products. That will allow users to run online Google searches right out of their word processing documents.

"It's a paradigm shift," Sun's executive vice president in charge of software, Rich Green, told the AP in an Aug 15 interview. "It brings together office productivity, networking and search into one offering."

The initial partnership between the Silicon Valley neighbors (Sun and Google) was originally announced in October 2005.

Still Chipping at Hardware

Despite its obvious software prowess, and unimpressive hardware results, Sun continued to chip at its processor business. Only last week (Aug 7), the company announced a chip that is very good at executing multiple "threads," sequences of programming instructions carried out simultaneously. Sun's new chip, formally called UltraSparc T2 (also known by the code name Niagara 2), can execute as many as 64 at once.

Sun Chief Executive Jonathan Schwartz predicted Niagara 2 will jump-start sales of Sun-designed chips to companies, including makers of such varied products as networking devices, TV set-top boxes and cars.



Jonathan Schwartz

"It's great to have the fastest microprocessor on earth," he reportedly told the [Wall Street Journal \(Aug 7\)](#).

Well, that's a stretch. IBM's new Power6 chip, with a record-setting clock speed of 4.7 gigahertz, really deserves the title of the world's fastest microprocessor (see "[IBM's First 'Green' Chip](#)," May 21). So Sun could save itself a lot of trouble and expense if it were to join forces with IBM. Remember the old adage, "if you can't beat them, join them?"

Sun says its operating system, Solaris, is good at breaking tasks into threads, as is other Sun software based on its Java programming language. And now that Big Blue can offer it on its hardware platforms, that means it will be also good for IBM from now on.

Happy bargain hunting!

Bob Djurdjevic

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