

SUN MICROSYSTEMS

NC05Q1 Launch Keynote

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Chairman and CEO

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Welcome to our Santa Clara campus in the auditorium. It's a nice old room—a lot of legacy here. A lot of psychology work was done here and my talk is going to be more focused on psychology and, what we call at Sun—anthropology. It's all about the culture changes that need to take place in our industry.

As many of you have heard me say, our industry is as screwed up as any industry in the world (except maybe healthcare, which loses every patient eventually). So for us, the bar is really low and we're trying to move the world along to the network is the computer.

What I want to talk about is how we move from the legacy environment that we have today to this new and more modern way of doing it.

Now we had to do a lot of things, not the least of which was to get some of our own internal shop in order. We worked pretty hard over the last year getting our cost structure in line, focusing in on our core competencies and getting our back office out into the

partners' front office. We had way too many facilities so we brought our headcount way more in line with our revenues. We got quality fixed and in a big time way customer satisfaction is very very different.

It was really hard when we were growing 40% to 60% per year to keep everybody happy and to ship product that worked like we wanted it to. We think we've got a pretty good handle on that.

2004 was also a big year in the way of products, partnerships and strategic announcements. If you look on the partnership front, there are some pretty interesting partnerships. I bet you never thought we'd do the Microsoft thing, but we did it—announcing a huge partnership with Fujitsu for the next generation SPARC mainframe scale up architecture, the advanced product line.

We've done a lot with EDS and CSC and all the other systems integrators as they've figured out it's mankind versus IBM Global Services (and we're kind of the leader of mankind on that particular effort). What other partnerships am I missing? AMD, which is another pretty impressive new partnership as we move aggressively into the x86 space. Oracle was a big early adopter of the Solaris x86 strategy and, in fact, the whole multi-platform strategy was a big change for us in 2004 as people finally figured out we were serious. Getting Andy back, full-time, working with John Fowler and the whole scale-out team has really made people understand that we're very, very serious about being multi-platform. This not only with our Web services stack, but also with our operating system and with the systems we will support, including support for Red Hat to say Solaris. And all of our x86 products actually are certified to run—yes you guessed it—Windows.

So there you have it. Quite a big change from that perspective. What else?

Financially, the results are a lot better than they've been for quite awhile: we grew in the first half of this fiscal year, made money (GAAP profit last quarter), and grew our cash bucket again up to \$7.5 billion, cash flow positive 15 straight years now from operations.

So the financial house is as usual. That's not a big change, we just continued moving forward.

Storage is looking good. The new 6920 is being well received. So anyhow, I could go on and on. Solaris 10 was launched last year—lots of product.

The absolute—not by-product, but absolute—product of all of the R&D that we started during the bubble with our appetite, granted a little bigger than it should have been, is this. We were just kind of straight-lining the growth that we were looking on, but we made a conscious decision over the last three or four years to protect that R&D

investment, follow through on those investments and what you were starting to see in 2004 was a big, big year in terms of delivering all of those new products.

Now we changed the focus, the image, the strategy, the perspectives and the product lines big-time during that year. It's the year we've been able to show some results and we all understand that. We understand that we have to deliver, not only the promises we made from a product and services perspective, but also to our shareholders' growth and - consistent growth and profitability while maintaining the focus on cash that we always have.

The first month has been quite busy in this calendar year already with the biggest news being the open sourcing of Solaris.

We've been talking about how, and I know Greg you must have said it five years ago, we were going to open source and everybody goes, "yeah yeah yeah." Well we actually did it and we did it OSI approved. We did it in a very aggressive way and even—well, not even—the loudest skeptics and just about everybody except the absolutely 12 Sigma skeptics out there now understand we're serious and believable. Now, we're the major enterprise donor in the open source community by a lot.

After donating to the CDDL licensees patent protection on 1,600 plus Sun OS patents, we experienced a very, very impressive leap forward - pricings from zero-right-to-use. You don't need to buy service if you don't want it. We offer service with all of the best features of Solaris 10 available in the open source community.

Today you'll see a lot of new work that we're going to be presenting and we're really on the threshold of a new era. We turn 24 on the 24th of this month, which is really hard for me, personally, to believe. That just doesn't seem right. But, you know, we're kind of on Release 1.24 of the tag line, "the network is the computer." You're going to see a lot of very interesting announcements around subscription pricing models to take the JES pricing model forward. You're also going to see lots of new products and technologies. You're going to see a new way to engage the customer with our client solutions strategies, new reference architectures and methodologies to give you a full and complete infrastructure, without having to go off and invent your own.

You're going to see the results of a ton of R&D, again about \$0.5 billion every quarter as we do these network computing launches on a fairly regular basis.

I believe that as we head into our 24th birthday, that when I look back—this is what happens when you get old, you start talking historically—we're heading into the fourth big era of Sun Microsystems. We obviously started as a technical workstation company and you remember when we made that big transition from workstations to actually taking the monitors off, calling them servers, building out our service business and that was a

really nice run for another eight years.

Then, all of a sudden, with Java, the browser and the dot-com era, we really rode the whole Java Web services play big time for another eight years.

It's not to say that any of the three are no longer there, but we're adding a fourth kind of new card out there and it's the Sun Grid. We think this is going to be a pretty interesting play as we go forward and I encourage everybody to stay tuned and pay attention because it is going to be different.

This new era is going to require some characteristics of the players and one is scale. If you're going to truly do utility computing, scale matters. Small utility companies are not terribly useful. A very small water utility company is called a well—not very useful.

And you don't have small. I mean, in fact, if you look in the telephone utility business, the consolidation continues to happen, even this week. Scale matters. Financial strength. We're going to be in the analyst call this week and a lot of people are going to ask me what are you going to do with that \$7.5 billion? Well, it isn't exactly burning a hole in my pocket. It's not a bad thing to have in your war chest as you go forward in this environment.

Relationships matter. I just ripped through a whole bunch of really key relationships with Fujitsu, TI, AMD, Intel with partners as well as competitors.

No one company can provide all of the utility and we're going to need network service providers, the systems integrators, and all the rest of it.

But it isn't just the bilateral one-to-one relationships that matter. Communities matter. A lot of people think we're late to the open sourcing game. That's a marketing challenge we have, but I like to kind of make the Al Gore statement that we invented community development and open sourcing. I don't think that's terribly unreasonable when you think back on how Sun got started really. We started doing open source even before we got incorporated 24 years ago with Bill Joy doing BSD Berkeley software distribution at Berkeley. In fact, that's when we founded Sun OS, which was the core environment for Solaris 24 years ago.

We took open source TCP/IP, blew away LAN Manager, DEC Net, IPX, Token Ring, and all the rest of them. NFS wasn't even close as we opened south net environment.

The whole UNIX community development, the Java community development, (Genie), (Juxta), (Enom), Mozilla, the entire JDS stack, Openoffice.org, StarOffice—you name it. We've been doing community development and innovating. Now CDDL is evaluating on how, as well as what, we do in the community development environment.

When it's mankind versus .NET, or mankind versus IBM Global Services, I'll bet on mankind every time. In fact, we have that. No, sure, I'd love to be what mankind was against, but we finished college and business school and got a late start.

So standardization will matter and is one of the challenges we're going to face (and I get to the anthropology piece here). Every time we go visit an IT organization and say, "Here's the grid," they say, "Well, does it run my WebSphere? Or does it run my EMC Storage?" Does it run my whatever and they have some other little tweak, or it runs on HP UX, or whatever, and we have to keep coming back to them and say, "That's 110 volts. You can have any color car you want as long as it's black." Only water comes out of the spigot and that's what utilities provide—standardization.

That's how you get your cost down; that's how you take your cost down anywhere from one-to-three orders of magnitude. A bus seat is a bus seat. You don't get special radio—you've got to bring that along yourself. So you're going to see that happen.

When you get to standardization, all of a sudden, markets start happening. This is the powerful win as you get a bid ask environment and make no mistake, it is electricity that is the commodity, not the generators. Any of you who have been an investor in GE over the last 20 years will understand that there's nothing "commodity" about the GE power systems division; there's a lot of technology, a lot of innovation and anything but a commodity if you look at the cash generation of the GE power business. Electricity is a commodity in this market, so you'll market it and therefore R&D does matter.

If you've looked, we've brought the cost structure down big time in this company, while protecting the R&D investment.

I've not yet met a customer who has said to me, "Oh Scott stop innovating. Cut back on R&D. We hate all that new good, low-cost, high performance, newly functional, easy to use, less complex stuff. Please stop." I have not heard that speech yet.

I get it regularly, on email and other things, and I can read about it, but I haven't yet met a customer who's fired up about that. They want to see us profitable. They want to see us growing. They want to see us generating cash, but they want us to continue to innovate. And, if you're going to play in the commodity space, my favorite example is pineapples. Dole is kicking butt with their newly engineered pineapple, "Gold," and gaining huge share. Now who'd have thunk? I mean, if they can do R&D on a pineapple, surely we can do R&D on the Web infrastructure.

So those of you who think we're in the commodity business, I always chuckle when I see that word, choice matters. I don't care what the Hanging Chads, or whatever, do. We believe customers want choice. They're demanding choice and they're going to get

choice.

Every interface we've ever done has been open, published and adopted by some or all in the computer industry, including today and I've challenged all of our competitors to stand up and tell me, "All right, tell me what interface at Sun is proprietary. And, as the leader of donators and innovation in the open source community, tell me you can say our implementation—even our SPARC architecture—is open source effectively through SPARC international."

This is the most open choice based, integratable computer technology company in the world and that's why the font is bigger with Sun there.

Then finally, the last piece that I would share with you, that we paid a lot attention to and again I've said this many times, I did not have to go write an email to all of my employees that safety, security and privacy matter. That was a given. As soon as we said, "the network is the computer," the first thing that we told our engineers was safety, security, privacy are issues that we can't sweep under the rug, deal with later, or patch our way to. It has to be built into the architecture.

If you look at the genius of what James Gosling and the other inventors of Java did, you'll see that they assumed the network, sandboxes and security models that would allow you to operate safely in a network environment.

That's why we invested in trusted Solaris. That's why we did Java card for secure authentication. That's why we're the number one player in the LDAP directory marketplace and have the number one identity management architecture and why you'll see all the reference architectures and methodology focus on things like secure portal, secure messaging because safety, security and privacy is a big deal.

So without further adieu—I'm just kind of the warm up act, to kind of bring you all up to where we are today over the last 24 years—I'd like to kind of outline what we're going to do today.

We're going to talk about components, solutions and great services that wrap around those components and solutions.

But what we're really here to talk about is the utility—the grid. This model is not new; it's not unique. There are many grids out there : the water grids, the power grids, the highway grids and, my favorite, the sewer. I think that's one I'd choose first if I had to choose one. We're all about coming up with this new grid that comes out of the wall and is in the information age. For the information utility—and we're trying to do it simply, you've heard of those Dollar Stores—we're charging \$1.00 per CPU hour. A buck for CPU hour and a buck for Gigabyte month.

As a result, we are all about the dollar bill and the dollar bill here is, “What can you do with a buck?” And there you go—we got one guy taking a picture. This was the photo opp.

So you may think that that’s all there is to it—that you get a buck. Well, we’ve decided that we should have probably the cheapest giveaway in the history of the company. So just understand that this is a cheap giveaway, but it’ll probably be the most useful giveaway we’ve ever given you. You all are going to get a buck, a real fungible buck, that you can go on the grid and buy a whole CPU hour, or a Gigabyte month, depending on what you want.

So no, most of them are signed by me so you can keep it or not—I didn’t actually write on the bill because I didn’t want to get arrested. It’ll say, “What can you do with a buck?” You can go buy an hour on the grid or, as I will encourage to do with my signature is, buy some Sun stock.

There will be ten of you lucky folks who will have a dollar bill that says “Go Grid” signed by me and, if on your way out and you check in, you’ll get a special door prize—for those lucky ten. You’ll have a little green dot and it’ll say “Go Grid.”

So look under your seat. Reach down under there. There’ll be some guy and a dollar bill with a little signature on it and that’s your little give away. There you have it. That’s like a real dollar there. There you have it.

So you should have gotten a little blue sheet that might be stuck there and you’ll see that. If you don’t have a green dot on, it you just get the dollar. That’s it. Did anybody get a winner? Raise your hand if you got a winner. I’m just wondering what my...shareholders are not allowed. No I mean you can keep it. So I’m just wondering whether we got ten of them out—Mark Tremblay. There you go. So on your way out—employees find an analyst or a press person or somebody. You know, employees are not eligible.

So now having warmed up the crowd and done the big giveaway, that’s the only giveaway you’re getting today, I’d like to turn it over to somebody who I think has just done an awesome job here in driving some real energy and is a cohort here as we break the rules. I’d like to introduce Chief Operating Officer and President of Sun Microsystems, Jonathan Schwartz.