

Reuters, Tuesday April 7 2009

- Sun shares fall 22.7 pct after IBM talks collapse
- Sun says committed to leadership team, growth strategy
- Analysts fear Sun will share same fate as Yahoo
- Some investors expect talks to resume (Adds Sun statement, lawyer comments, background)

By Ritsuko Ando and Jim Finkle

NEW YORK/BOSTON, April 6 (Reuters)

Shares of Sun Microsystems Inc tumbled 23 percent after it rejected a \$7 billion buyout bid from IBM , leaving the smaller server and software maker vulnerable to lawsuits from shareholders nervous about its viability as a stand-alone company.

Amid expectation that the collapse of deal talks with IBM could put pressure on Sun Chief Executive Jonathan Schwartz, Sun said in an e-mailed statement on Monday that it would stand by its leadership team and growth strategy.

While some on Wall Street held out hopes for bargaining to resume, a source with knowledge of the matter said that talks broke down over the weekend after Sun turned down International Business Machines Corp's offer of up to \$9.40 per share.

Sun shares fell to \$6.56 from their close last week at \$8.49. But they remain above the \$4.97 level before the talks with IBM were first reported on March 18.

Many analysts said a sale to IBM may have been the best move for Sun, which has been losing share to rivals like IBM and Hewlett-Packard Co , and the breakdown underscored Sun's significantly weaker position at the bargaining table.

"It looks like they're in somewhat of a dilemma. Its operational history of the past four to eight quarters doesn't seem to be working well for them, nor have their efforts to sell assets," said Tom Smith, analyst at S&P Equity Research. He downgraded Sun's shares to "sell" from "hold" and lowered its 12-month price target to \$6 from \$9.50.

Wall Street on average expects Sun to report a third straight quarter of losses, excluding special items, for the quarter ended in March, despite efforts to control costs, according to Reuters Estimates.

Banking sources say Sun has been shopping itself for the past several months, and it appears IBM was the only bidder that came forward.

Failed negotiations with IBM could mean Sun would have to contend with an even lower offer, or worse, none at all.

Some analysts said Sun could sell itself in parts to software companies which do not want, or cannot afford, the whole company. Many said such sales would likely bring in less than a sale of the whole company.

Credit default swaps insuring Sun's debt jumped to around 143 basis points, or \$143,000 per year for five years to insure \$10 million in debt, from around 95 basis points on Friday, according to Markit Intraday.

ANOTHER YAHOO?

Some predicted Sun could face anger from shareholders in the same way that Yahoo Inc co-founder and previous Chief Executive Officer Jerry Yang did after he rejected Microsoft Corp's \$47.5 billion bid last year. Yang eventually stepped down under strong criticism.

"We sure hope that shareholders don't experience a Yahoo," said Keith Wirtz, president and chief investment officer at Fifth Third Asset Management, which owns both Sun and IBM shares.

Sun declined to confirm or comment on the latest developments, but said it would stand by its leadership team. Schwartz had replaced Scott McNealy as CEO in 2006. McNealy, one of the founders of the Silicon Valley start-up, stayed on as chairman.

"As a policy Sun does not comment on rumors or speculation. What we can say is that Sun is committed to its leadership team, growth strategy and building value for its shareholders," Sun said in the statement.

While IBM had been negotiating the price downwards, according to a source, the last bid still represented a premium of up to 89 percent on Sun's shares before deal talks were first reported in mid-March.

"Given the size of the premium and the fact that Sun's board has presided over a decline in the company's stock price over the last eight years from over \$250 per share to less than \$5, we believe that Sun is likely to face significant shareholder unrest, similar to what occurred when Yahoo declined Microsoft's offer," Sanford C. Bernstein analyst Toni Sacconaghi said in a research note.

But Donald Zakarin, chairman of litigation at law firm Pryor Cashman LLP in New York, said any shareholder lawsuit may face difficulty unless it can prove that Sun's board was opposed to any deal and that it did not reasonably consider an offer. Neither Sun nor IBM has issued any public statements on their talks.

"It would be hard to suggest in this case that Sun's board was not interested in selling," he said.

BRINKMANSHIP

Some said the breakdown of the talks might just be brinkmanship and the two sides could come back to the table.

"We don't think the final chapter of this conversation's been written," said Wirtz, adding that shareholders would likely demand an explanation if talks didn't resume.

"If there's no deal, all shareholders of Sun want to hear an articulation of why this company will work independently. A lot of people own the stock and you may see some noisy investors," he said.

But analysts said that further negotiations could prove lengthy and weigh on Sun's shares. Even if the two sides agreed to a deal soon, they would likely face intense regulatory scrutiny due to the strong position a combined company would have in the high-end server market.

Many said IBM had less to lose either way, as the company has fared relatively well despite the current economic downtrend, helped by aggressive cost cuts and a shift from hardware to higher-margin technology services.

Analysts have said IBM could benefit from buying Sun by bolstering its market share in high end servers against competitors such as Hewlett-Packard Co . But they also said Sun's assets, such as its Java programming language and Solaris operating system, were "nice to have" for IBM, rather than crucial for future growth.

IBM shares fell 0.65 percent at \$101.56 on Monday, but outperformed the Nasdaq's decline of 0.93 percent.

(Additional reporting by Martha Graybow) (Reporting by Ritsuko Ando and Jim Finkle, editing by Tiffany Wu, Gerald E. McCormick and Bernard Orr) Printable version