

SAIC, Inc.  
Form 10-Q  
September 03, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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Form 10-Q

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(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended July 31, 2010

or

**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: 001-33072

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SAIC, Inc.

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-3562868**  
(I.R.S. Employer  
Identification No.)

**1710 SAIC Drive, McLean, Virginia**  
(Address of principal executive offices)

**22102**  
(Zip Code)

**(703) 676-4300**

(Registrant's telephone number, including area code)

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N/A

(Former name, former address and

former fiscal year, if changed since last report)

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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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 13, 2010, the registrant had 371,687,345 shares of common stock, \$.0001 par value per share, issued and outstanding.

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

## SAIC, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three Months Ended July 31		Six Months Ended July 31	
	2010	2009	2010	2009
	(in millions, except per share amounts)			
Revenues	\$ 2,794	\$ 2,749	\$ 5,479	\$ 5,398
Costs and expenses:				
Cost of revenues	2,388	2,369	4,740	4,664
Selling, general and administrative expenses	133	159	259	309
Operating income	273	221	480	425
Non-operating income (expense):				
Interest income	1		1	1
Interest expense	(19)	(19)	(37)	(38)
Other income (expense), net	(2)		(2)	3
Income from continuing operations before income taxes	253	202	442	391
Provision for income taxes	(95)	(77)	(159)	(149)
Income from continuing operations	158	125	283	242
Discontinued operations (Note 1):				
Income (loss) from discontinued operations before income taxes	53	(3)	51	(4)
Benefit (provision) for income taxes	(22)	1	(20)	1
Income (loss) from discontinued operations	31	(2)	31	(3)
Net income	\$ 189	\$ 123	\$ 314	\$ 239
Earnings per share (Note 2):				
Basic:				
Income from continuing operations	\$ .42	\$ .32	\$ .74	\$ .60
Income (loss) from discontinued operations	.08	(.01)	.08	
	\$ .50	\$ .31	\$ .82	\$ .60
Diluted:				
Income from continuing operations	\$ .42	\$ .31	\$ .74	\$ .60
Income (loss) from discontinued operations	.08		.08	(.01)
	\$ .50	\$ .31	\$ .82	\$ .59

See accompanying notes to condensed consolidated financial statements.

## SAIC, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	July 31, 2010	January 31, 2010
	(in millions)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 604	\$ 861
Receivables, net	2,032	2,044
Inventory, prepaid expenses and other current assets	320	288
Total current assets	2,956	3,193
Property, plant and equipment (less accumulated depreciation and amortization of \$394 million and \$383 million at July 31, 2010 and January 31, 2010, respectively)	382	389
Intangible assets, net	130	106
Goodwill	1,548	1,434
Deferred income taxes	87	103
Other assets	71	70
	<b>\$ 5,174</b>	<b>\$ 5,295</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,118	\$ 1,191
Accrued payroll and employee benefits	484	512
Income taxes payable	14	
Notes payable and long-term debt, current portion	3	3
Total current liabilities	1,619	1,706
Notes payable and long-term debt, net of current portion	1,102	1,103
Other long-term liabilities	173	195
Commitments and contingencies (Notes 9 and 10)		
Stockholders' equity:		
Common stock, \$.0001 par value, 2 billion shares authorized, 372 million and 388 million shares issued and outstanding at July 31, 2010 and January 31, 2010, respectively	2,077	2,096
Additional paid-in capital	241	239
Retained earnings	(38)	(44)
Accumulated other comprehensive loss	2,280	2,291
Total stockholders' equity	<b>\$ 5,174</b>	<b>\$ 5,295</b>

See accompanying notes to condensed consolidated financial statements.

## SAIC, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

## AND COMPREHENSIVE INCOME

(UNAUDITED)

	Shares of common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss (in millions)	Total	Comprehensive income
Balance at January 31, 2010	388	\$ 2,096	\$ 239	\$ (44)	\$ 2,291	
Net income			314		314	\$ 314
Other comprehensive income, net of tax				6	6	6
Issuances of stock	8	56			56	
Repurchases of stock	(24)	(139)	(312)		(451)	
Excess tax benefits from stock-based compensation		13			13	
Stock-based compensation		51			51	
Balance at July 31, 2010	<b>372</b>	<b>\$ 2,077</b>	<b>\$ 241</b>	<b>\$ (38)</b>	<b>\$ 2,280</b>	<b>\$ 320</b>

See accompanying notes to condensed consolidated financial statements.

## SAIC, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended July 31	
	2010	2009
	(in millions)	
Cash flows from operations:		
Net income	\$ 314	\$ 239
Loss (income) from discontinued operations	(31)	3
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	51	44
Stock-based compensation	51	51
Excess tax benefits from stock-based compensation	(13)	(14)
Impairment losses		1
Other items	2	1
Increase (decrease) in cash and cash equivalents, excluding effects of acquisitions and divestitures, resulting from changes in:		
Receivables	16	(70)
Inventory, prepaid expenses and other current assets	(16)	11
Deferred income taxes	(4)	1
Other assets	2	4
Accounts payable and accrued liabilities	(99)	(13)
Accrued payroll and employee benefits	(24)	(8)
Income taxes payable	2	18
Other long-term liabilities	(2)	4
Total cash flows provided by operations	249	272
Cash flows from investing activities:		
Expenditures for property, plant and equipment	(35)	(28)
Acquisitions of businesses, net of cash acquired of \$1 million in fiscal 2011	(140)	(9)
Net receipts for purchase price adjustments related to prior year acquisitions		8
Other	1	10
Total cash flows used in investing activities	(174)	(19)
Cash flows from financing activities:		
Payments on notes payable and long-term debt	(1)	(16)
Sales of stock and exercises of stock options	22	34
Repurchases of stock	(445)	(276)
Excess tax benefits from stock-based compensation	13	14
Total cash flows used in financing activities	(411)	(244)
Increase (decrease) in cash and cash equivalents from continuing operations	(336)	9
Cash flows from discontinued operations:		
Cash used in operating activities of discontinued operations		(1)
Cash provided by investing activities of discontinued operations	81	2
Increase in cash and cash equivalents from discontinued operations	81	1
Effect of foreign currency exchange rate changes on cash and cash equivalents	(2)	5
Total increase (decrease) in cash and cash equivalents	(257)	15
Cash and cash equivalents at beginning of period	861	936
Cash and cash equivalents at end of period	\$ 604	\$ 951

See accompanying notes to condensed consolidated financial statements.



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SAIC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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**Note 1 Summary of Significant Accounting Policies:**

*Nature of Operations and Basis of Presentation*

SAIC, Inc. is a provider of scientific, engineering, systems integration and technical services and solutions to all branches of the U.S. military, agencies of the U.S. Department of Defense, the intelligence community, the U.S. Department of Homeland Security and other U.S. Government civil agencies, state and local government agencies, foreign governments and customers in select commercial markets.

The condensed consolidated financial statements include the accounts of SAIC, Inc. and all majority-owned and 100%-owned subsidiaries (collectively referred to as the Company), including Science Applications International Corporation. All intercompany transactions and accounts have been eliminated in consolidation. The Company recognized revenues of \$1 million on sales to unconsolidated affiliates during the six months ended July 31, 2010. The Company recognized revenues of \$6 million and \$11 million on sales to unconsolidated affiliates during the three and six months ended July 31, 2009, respectively.

The accompanying financial information has been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2010. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting periods. Estimates have been prepared by management on the basis of the most current and best available information at the time of estimation and actual results could differ from those estimates.

In the opinion of management, the financial information as of July 31, 2010 and for the three and six months ended July 31, 2010 and 2009 reflects all adjustments, which consist of normal recurring adjustments, necessary for a fair presentation thereof. Operating results for the three and six months ended July 31, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2011, or any future period.

Unless otherwise noted, references to years are for fiscal years ended January 31. For example, the fiscal year ending January 31, 2011 is referred to as "fiscal 2011" in these notes to condensed consolidated financial statements.

*Discontinued Operations*

The Company's results of discontinued operations for the three and six months ended July 31, 2010 reflect an after-tax net gain of \$31 million related to the settlement of an arbitration proceeding brought against Telkom South Africa by the Company's former subsidiary, Telcordia Technologies, Inc. (Note 9).

*Revenue Recognition Accounting Change*

The Company's revenues are generated primarily from contracts with the U.S. Government, commercial customers, and various international, state and local governments or from subcontracts with other contractors engaged in work with such customers. The Company performs under various types of contracts, which include firm-fixed-price, time-and-materials, fixed-price-level-of-effort, cost-plus-fixed-fee, cost-plus-award-fee and cost-plus-incentive-fee contracts.

*Accounting Change.* Prior to February 1, 2010, the Company recognized revenues on cost-plus-fixed-fee, time-and-materials and fixed-price-level-of-effort contracts with the U.S. Government primarily based on contract costs incurred to date compared with total estimated costs at completion (cost-to-cost method), which is an input method of percentage-of-completion that relied heavily on management's estimates of contract revenues and contract costs at completion. Effective February 1, 2010, the Company changed its method of revenue recognition for

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cost-plus-fixed-fee, time-and-materials and fixed-price-level-of-effort contracts with the U.S. Government to the methods described below. Contract costs will continue to be expensed as incurred under these contracts.

Cost-plus-fixed-fee contracts Revenue is recognized on the basis of partial performance as costs are incurred plus an estimate of applicable fees as the Company becomes contractually entitled to reimbursement of costs and the applicable fees pursuant to the guidance in Accounting Standards Codification (ASC) 912-605-25 Contractors-Federal Government Recognition of Fees Under Cost-Plus-Fixed-Fee Contracts.

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SAIC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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**Time-and-materials contracts** Revenue is recognized using the percentage-of-completion method of accounting utilizing an output measure to measure progress toward completion based on the hours provided in performance under the contract multiplied by the negotiated contract billing rates, plus the negotiated contract billing rate of any allowable material and subcontract costs and out-of-pocket expenses.

**Fixed-price-level-of-effort contracts** These contracts are substantially similar to time-and-materials contracts except they require a specified level of effort over a stated period of time. Accordingly, the Company recognizes revenue in a manner similar to time-and-materials contracts whereby the Company uses the percentage-of-completion method of accounting utilizing an output measure. The Company measures progress toward completion based on the hours provided in performance under the contract multiplied by the negotiated contract billing rates, plus the negotiated contract billing rate of any allowable material costs and out-of-pocket expenses.

The revenue recognition change impacts contracts accounting for approximately two-thirds of the Company's revenues. The Company believes the change is to an alternative accounting principle that is preferable because it better reflects the economic substance and earnings process under these arrangements. This change was facilitated by the implementation of a new information technology system.

Although this change impacts contracts accounting for approximately two-thirds of the Company's revenues, the result of the accounting change was immaterial to the Company's consolidated financial position and results of operations for all periods presented because the resulting measurement of the progress toward completion under the two methods is not significantly different. Accordingly, the cumulative effect of the accounting change was recognized in the consolidated statement of income in the first quarter, rather than retrospectively applied to the prior period consolidated financial statements.

**Revenue Recognition. Cost-plus-fixed-fee contracts** Revenue is recognized on cost-plus-fixed-fee contracts with the U.S. Government on the basis of partial performance equal to costs incurred plus an estimate of applicable fees earned as the Company becomes contractually entitled to reimbursement of costs and the applicable fees.

**Time-and-materials contracts** Revenue is recognized on time-and-materials contracts with the U.S. Government using the percentage-of-completion method of accounting utilizing an output measure of progress. Revenue is recognized on time-and-materials contracts with non-U.S. Government customers using a proportional performance method. Under both of these methods, revenue is recognized based on the hours provided in performance under the contract multiplied by the negotiated contract billing rates, plus the negotiated contract billing rate of any allowable material and subcontract costs and out-of-pocket expenses.

**Fixed-price-level-of-effort contracts (FP-LOE)** These contracts are substantially similar to time-and-materials contracts except they require a specified level of effort over a stated period of time. Accordingly, the Company recognizes revenue on FP-LOE contracts with the U.S. Government in a manner similar to time-and-materials contracts whereby the Company measures progress toward completion based on the hours provided in performance under the contract multiplied by the negotiated contract billing rates, plus the negotiated contract billing rate of any allowable material costs and out-of-pocket expenses.

**Cost-plus-award-fee/cost-plus-incentive fee contracts** Revenues and fees on these contracts with the U.S. Government are primarily recognized using the percentage-of-completion method of accounting, most often based on the cost-to-cost method. The Company includes an estimate of the ultimate incentive or award fee to be received on the contract in the estimate of contract revenues for purposes of applying the percentage-of-completion method of accounting.

**Firm-fixed-price contracts** Revenues and fees on these contracts that are system integration or engineering in nature are primarily recognized using the percentage-of-completion method of accounting utilizing the cost-to-cost method.

Revenues from services and maintenance contracts, notwithstanding contract type, are recognized over the term of the respective contracts as the services are performed and revenue is earned. Revenues from unit-priced contracts are recognized as transactions are processed based on objective measures of output. Revenues from the sale of manufactured products are recorded upon passage of title and risk of loss to the

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customer, which is generally upon delivery, provided that all other requirements for revenue recognition have been met.

The Company also uses the efforts-expended method of percentage-of-completion using measures such as labor dollars for measuring progress toward completion in situations in which this approach is more representative of the progress on the contract. For example, the efforts-expended method is utilized when there are significant amounts of materials or hardware

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SAIC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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procured for the contract that is not representative of progress on the contract. Additionally, the Company utilizes the units-of-delivery method under percentage-of-completion on contracts where separate units of output are produced. Under the units-of-delivery method, revenue is generally recognized when the units are delivered to the customer, provided that all other requirements for revenue recognition have been met.

The Company also evaluates its contracts for multiple elements, and when appropriate, separates the contracts into separate units of accounting for revenue recognition.

The Company provides for anticipated losses on contracts by recording an expense during the period in which the losses are determined. Amounts billed and collected but not yet recognized as revenues under certain types of contracts are deferred. Contract costs incurred for U.S. Government contracts, including indirect costs, are subject to audit and adjustment through negotiations between the Company and government representatives. The Company has agreed upon and settled indirect contract costs through fiscal 2004. Revenues on U.S. Government contracts have been recorded in amounts that are expected to be realized upon final settlement.

The Company's accounts receivable include unbilled receivables, which consist of costs and fees billable upon contract completion or the occurrence of a specified event, the majority of which is expected to be billed and collected within one year. Unbilled receivables are stated at estimated realizable value. Contract retentions are billed when the Company has negotiated final indirect rates with the U.S. Government and, once billed, are subject to audit and approval by government representatives. Consequently, the timing of collection of retention balances is outside the Company's control. Based on the Company's historical experience, the majority of retention balances are expected to be collected beyond one year.

Contract claims are unanticipated additional costs incurred but not provided for in the executed contract price that the Company seeks to recover from the customer. Such costs are expensed as incurred. Additional revenue related to contract claims is recognized when the amounts are awarded by the customer.

In certain situations, primarily where the Company is not the primary obligor on certain elements of a contract such as the provision of administrative oversight and/or management of government-owned facilities or logistical support services related to other vendors' products, the Company recognizes as revenue the net management fee associated with the services and excludes from its income statement the gross sales and costs associated with the facility or other vendors' products.

*Selling, General and Administrative Expenses*

The Company classifies indirect costs incurred within or allocated to its Government segment as overhead (included in cost of revenues) and general and administrative expenses in the same manner as such costs are defined in the Company's disclosure statements under U.S. Government Cost Accounting Standards. Effective with the beginning of fiscal 2011, the Company updated its disclosure statements with the Defense Contract Management Agency, resulting in certain costs being classified differently either as overhead or as general and administrative expenses on a prospective basis. This change has caused a net increase in reported cost of revenues and a net decrease in reported SG&A expenses in fiscal 2011 as compared to fiscal 2010; however, total operating costs were not affected by this change.

*Supplementary Cash Flow Information*

Supplementary cash flow information, including non-cash investing and financing activities, for the periods noted was as follows:

Six Months Ended  
July 31  
2010      2009

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	(in millions)	
Stock exchanged upon exercise of stock options	\$ 30	\$ 68
Stock issued for settlement of accrued employee benefits	\$ 4	\$ 3
Decrease in accrued stock repurchases	\$ (24)	\$
Fair value of assets acquired in acquisitions	\$ 167	\$ 9
Less: cash paid in acquisitions, net of cash acquired of \$1 million in fiscal 2011	(140)	(9)
Liabilities assumed in acquisitions	\$ 27	\$
Cash paid for interest	\$ 35	\$ 35
Cash paid for income taxes	\$ 157	\$ 108

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

*Accounting Standards Updates Issued But Not Yet Adopted*

In October 2009, the Financial Accounting Standards Board (FASB) issued an update to *Revenue Recognition Multiple-Deliverable Revenue Arrangements*. This update removes the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, replaces references to fair value with selling price to distinguish from the fair value measurements required under the *Fair Value Measurements and Disclosures* guidance, provides a hierarchy that entities must use to estimate the selling price, eliminates the use of the residual method for allocation, and expands the ongoing disclosure requirements. This update is effective for the Company beginning February 1, 2011 and can be applied prospectively or retrospectively. The Company is currently evaluating the effect that adoption of this update will have, if any, on the Company's consolidated financial position and results of operations when it is adopted.

In October 2009, the FASB issued an update to *Software Multiple-Deliverable Revenue Arrangements*. This update amends the existing accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and nonsoftware components that function together to deliver the tangible product's essential functionality are excluded from the scope of software revenue guidance. In addition, this update provides guidance on how a vendor should allocate consideration to deliverables in an arrangement that includes both tangible products and software and enhances the disclosure requirements related to these arrangements. This update is effective for arrangements entered into or materially modified by the Company after January 31, 2011 and can be applied prospectively or retrospectively. The Company is currently evaluating the effect that adoption of this update will have, if any, on the Company's consolidated financial position and results of operations when it is adopted.

Other new accounting standards and updates issued but not effective until after July 31, 2010, are not expected to have a significant effect on the Company's consolidated financial position or results of operations.

**Note 2 Earnings Per Share (EPS):**

In calculating EPS using the two-class method, the Company is required to allocate a portion of its earnings to its unvested stock awards containing nonforfeitable rights to dividends or dividend equivalents. Basic EPS is computed by dividing income less earnings allocable to unvested stock awards by the basic weighted average number of shares outstanding. Diluted EPS is computed similar to basic EPS, except the weighted average number of shares outstanding is increased to include the dilutive effect of outstanding stock options and other stock-based awards.

A reconciliation of the income used to compute basic and diluted EPS for the periods noted was as follows:

	Three Months Ended July 31		Six Months Ended July 31	
	2010	2009	2010	2009
	(in millions)			
Income from continuing operations, as reported	\$ 158	\$ 125	\$ 283	\$ 242
Less: allocation of undistributed earnings to unvested stock awards	(5)	(4)	(10)	(8)
Income from continuing operations, for computing EPS	\$ 153	\$ 121	\$ 273	\$ 234
Net income, as reported	\$ 189	\$ 123	\$ 314	\$ 239
Less: allocation of undistributed earnings to unvested stock awards	(7)	(4)	(11)	(8)
Net income, for computing EPS	\$ 182	\$ 119	\$ 303	\$ 231

A reconciliation of the weighted average number of shares outstanding used to compute basic and diluted EPS for the periods noted was as follows:

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	Three Months Ended July 31		Six Months Ended July 31	
	2010	2009	2010	2009
	(in millions)			
Basic weighted average number of shares outstanding	<b>363</b>	384	<b>369</b>	388
Dilutive common share equivalents stock options	<b>2</b>	4	<b>2</b>	4
Diluted weighted average number of shares outstanding	<b>365</b>	388	<b>371</b>	392



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	Six Months Ended July 31	
	2010	2009
Expected term (in years)	<b>3.8</b>	3.9
Expected volatility	<b>25.1%</b>	30.6%
Risk-free interest rate	<b>2.1%</b>	1.5%
Dividend yield	<b>0%</b>	0%

The weighted average grant-date fair value of stock options granted during the six months ended July 31, 2010 and 2009 using the Black-Scholes option-pricing model was \$3.96 and \$4.78, respectively.

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Stock option activity for the six months ended July 31, 2010 was as follows:

	Shares of stock under stock options  (in millions)	Weighted average exercise price  \$	Weighted average remaining contractual term  (in years)	Aggregate intrinsic value (in millions)  \$
Outstanding at January 31, 2010	31.6	16.26	2.0	66
Options granted	5.3	17.44		
Options forfeited or expired	(1.3)	15.64		
Options exercised	(6.1)	13.83		32
Outstanding at July 31, 2010	<b>29.5</b>	<b>17.00</b>	<b>2.4</b>	<b>19</b>
Exercisable at July 31, 2010	<b>15.3</b>	<b>16.05</b>	<b>1.3</b>	<b>18</b>

*Vesting Stock Awards.* Vesting stock award activity for the six months ended July 31, 2010 was as follows:

	Shares of stock under stock awards  (in millions)	Weighted average grant- date fair value  \$
Unvested at January 31, 2010	12.1	18.60
Awards granted	4.4	17.42
Awards forfeited	(0.6)	18.20
Awards vested	(2.9)	19.30
Unvested at July 31, 2010	<b>13.0</b>	<b>18.07</b>

The fair value of vesting stock awards that vested during the six months ended July 31, 2010 and 2009 was \$53 million and \$42 million, respectively.

*Performance-Based Stock Awards.* Performance-based stock award activity for the six months ended July 31, 2010 was as follows:

	Expected number of shares of stock to be issued under performance- based stock awards  (in millions)	Weighted average grant- date fair value  \$
Outstanding at January 31, 2010	0.6	18.35
Awards granted	0.5	17.42
Awards forfeited	(0.1)	18.11
Outstanding at July 31, 2010	<b>1.0</b>	<b>17.88</b>

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Increases or decreases in the expected number of shares to be issued may occur due to changes in the expected level of achievement of the performance goals over the life of the awards. As of July 31, 2010, there have been no vesting events for performance-based stock awards.

### **Note 4 Acquisitions:**

*Cloudshield Technologies, Inc.* On February 5, 2010, the Company acquired all of the outstanding equity interests of Cloudshield Technologies, Inc., a provider of cyber security and management solutions services, for a preliminary purchase price of \$141 million paid in cash, subject to contractual adjustments. This acquisition enhances the Company's cyber security offerings and positions the Company to bring to market deep packet inspection solutions for high speed networks, enabling it to better meet emerging customer requirements. The preliminary purchase price allocation resulted in goodwill of \$114 million (none of which is tax deductible) and identifiable intangible assets of \$41 million. Identifiable intangible assets consisted of finite-lived intangible assets of \$24 million (amortizable over a weighted average life of four years) and in-process research and development intangible assets of \$17 million that will become amortizable upon completion of the related technology. The Company has not yet obtained all of the information required to complete the purchase price allocations related to this acquisition. The final purchase price allocation will be completed after the information identified by the Company has been received.

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

*Reveal Imaging Technologies, Inc.* Subsequent to July 31, 2010, the Company acquired all of the outstanding equity interests of Reveal Imaging Technologies, Inc., a provider of threat detection products and services, for a preliminary purchase price of \$230 million, subject to contractual adjustments. This acquisition enhances the Company's existing homeland security solutions portfolio by adding U.S. Transportation Security Administration approved explosive detection systems for baggage screening to its passenger and cargo inspection systems product offerings.

These acquisitions, which individually and in the aggregate were not material business combinations, were both in the Government segment.

**Note 5 Goodwill and Intangible Assets:**

The changes in the carrying value of goodwill by segment were as follows:

	Government	Commercial (in millions)	Total
Goodwill at January 31, 2010	\$ 1,403	\$ 31	\$ 1,434
Acquisition	114		114
Foreign currency translation		(1)	(1)
Adjustments	1		1
Goodwill at July 31, 2010	<b>\$ 1,518</b>	<b>\$ 30</b>	<b>\$ 1,548</b>

Goodwill adjustments in fiscal 2011 resulted from the finalization of purchase price allocations related to prior year acquisitions.

Intangible assets, including those arising from preliminary estimates of assets acquired relating to acquisitions, consisted of the following:

	July 31, 2010			January 31, 2010		
	Gross carrying value	Accumulated amortization	Net carrying value (in millions)	Gross carrying value	Accumulated amortization	Net carrying value
Finite-lived intangible assets:						
Customer relationships	\$ 121	\$ 57	\$ 64	\$ 119	\$ 48	\$ 71
Software and technology	77	36	41	58	31	27
Other	2	1	1	2	1	1
Total finite-lived intangible assets	<b>200</b>	<b>94</b>	<b>106</b>	179	80	99
Indefinite-lived intangible assets:						
In-process research and development	20		20	3		3
Trade names	4		4	4		4
Total indefinite-lived intangible assets	<b>24</b>		<b>24</b>	7		7
Total intangible assets	<b>\$ 224</b>	<b>\$ 94</b>	<b>\$ 130</b>	\$ 186	\$ 80	\$ 106

Amortizable intangible assets with a gross carrying value of \$3 million became fully amortized during the six months ended July 31, 2010 and are no longer reflected in the gross carrying value after becoming fully amortized. Amortization expense related to amortizable intangible assets was \$8 million and \$17 million for the three and six months ended July 31, 2010, respectively, and \$6 million and \$13 million for the three and six months ended July 31, 2009, respectively.

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There were no goodwill or intangible asset impairment losses during the three and six months ended July 31, 2010 and 2009.

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

The estimated annual amortization expense related to amortizable intangible assets as of July 31, 2010 was as follows (in millions):

Fiscal Year Ending January 31	
2011 (remainder of the fiscal year)	\$ 16
2012	26
2013	22
2014	18
2015	9
2016 and thereafter	15
	\$ 106

Actual amortization expense in future periods could differ from these estimates as a result of future acquisitions, divestitures, impairments, the outcome and timing of completion of in-process research and development projects, adjustments to preliminary valuations of intangible assets and other factors.

**Note 6 Financial Instruments:**

The Company had cash and cash equivalents of \$604 million as of July 31, 2010. The Company's cash equivalents were primarily comprised of investments in several large institutional money market funds that invest primarily in bills, notes and bonds issued by the U.S. Treasury, U.S. Government guaranteed repurchase agreements fully collateralized by U.S. Treasury obligations and U.S. Government guaranteed securities. The Company's cash equivalents are recorded at historical cost which equals fair value based on quoted market prices (Level 1 input as defined by the accounting standard for fair value measurements).

The Company utilizes foreign currency forward contracts to manage foreign currency exchange rate risk related to receipts from customers, payments to suppliers and certain intercompany transactions denominated in currencies other than the Company's (or one of its subsidiaries') functional currency. As of July 31, 2010, outstanding foreign currency forward contracts had an aggregate notional amount of \$19 million with an immaterial fair value. Since the foreign currency forward contracts do not qualify as cash flow hedges in accordance with the accounting standard for derivative and hedging instruments, gains and losses are recognized in earnings immediately. During the three and six months ended July 31, 2010 and 2009, the Company recognized a net gain from foreign currency forward contracts (included in other income, net) of less than \$1 million. The Company does not use derivatives for trading or speculative purposes.

The Company's notes payable and long-term debt consisted of the following:

	July 31, 2010	January 31, 2010
	(in millions)	
\$550 million 6.25% notes due fiscal 2013	\$ 550	\$ 549
\$300 million 5.5% notes due fiscal 2034	296	296
\$250 million 7.125% notes due fiscal 2033	248	248
Capital leases and other notes payable	11	13
	<b>1,105</b>	1,106
Less: current portion	3	3
Total	<b>\$ 1,102</b>	\$ 1,103

The fair value of long-term debt is determined based on interest rates available for debt with terms and maturities similar to the Company's existing debt arrangements (Level 2 input as defined by the accounting standard for fair value measurements). The fair value of notes payable

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and long-term debt was \$1.18 billion and \$1.16 billion as of July 31, 2010 and January 31, 2010, respectively.

These notes contain financial covenants and customary restrictive covenants, including, among other things, restrictions on the Company's ability to create liens and enter into sale and leaseback transactions. The Company was in compliance with all covenants as of July 31, 2010.

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 7 Comprehensive Income and Accumulated Other Comprehensive Loss:**

The components of comprehensive income for the periods noted were as follows:

	Three Months Ended		Six Months Ended	
	July 31		July 31	
	2010	2009	2010	2009
	(in millions)			
Net income	\$ 189	\$ 123	\$ 314	\$ 239
Other comprehensive income:				
Foreign currency translation adjustments		7	(3)	15
Deferred taxes		(3)	1	(5)
Foreign currency translation adjustments, net of tax		4	(2)	10
Reclassification of realized loss on settled derivative instruments to net income	1		1	
Deferred taxes				
Reclassification of realized loss on settled derivative instruments to net income, net of tax	1		1	
Pension liability adjustment	(1)	(5)	10	(5)
Deferred taxes		2	(3)	2
Pension liability adjustment, net of tax	(1)	(3)	7	(3)
Total other comprehensive income, net of tax		1	6	7
Comprehensive income	\$ 189	\$ 124	\$ 320	\$ 246

The Company sponsors a defined benefit pension plan for eligible employees of its United Kingdom subsidiary that primarily performed services on a specific customer contract, which expired on March 31, 2010. As of January 31, 2010, the pension plan had an underfunded projected benefit obligation of \$42 million and an unrecognized actuarial loss (pre-tax) of \$50 million. In April 2010, employees then performing services on the customer contract transferred to a successor contractor following contract expiration. These employee transfers gave rise to a curtailment gain, resulting in a reduction in the unrecognized actuarial loss (a component of accumulated other comprehensive loss) in the amount of \$8 million (pre-tax) during the six months ended July 31, 2010.

The components of accumulated other comprehensive loss were as follows:

	July 31,	January 31,
	2010	2010
	(in millions)	
Foreign currency translation adjustments, net of taxes of \$3 million and \$2 million as of July 31, 2010 and January 31, 2010, respectively	\$ (4)	\$ (2)
Unrecognized net loss on settled derivative instruments associated with outstanding debt, net of taxes of \$4 million as of July 31, 2010 and January 31, 2010	(5)	(6)
Unrealized loss on defined benefit plan, net of taxes of \$11 million and \$14 million as of July 31, 2010 and January 31, 2010, respectively	(29)	(36)
Total accumulated other comprehensive loss, net of taxes of \$18 million and \$20 million as of July 31, 2010 and January 31, 2010, respectively	\$ (38)	\$ (44)

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As of July 31, 2010, \$1 million of the unrealized net loss on settled derivative instruments (pre-tax) will be amortized and recognized as interest expense during the next 12 months.

## SAIC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

**Note 8 Business Segment Information:**

The interim business segment information for the periods noted was as follows:

	Three Months Ended July 31		Six Months Ended July 31	
	2010	2009	2010	2009
	(in millions)			
Revenues:				
Government segment	\$ 2,704	\$ 2,634	\$ 5,284	\$ 5,170
Commercial segment	91	117	198	231
Intersegment elimination	(1)	(2)	(3)	(3)
Total revenues	\$ 2,794	\$ 2,749	\$ 5,479	\$ 5,398
Operating income (loss):				
Government segment	\$ 274	\$ 217	\$ 483	\$ 421
Commercial segment	2	12	3	19
Corporate and Other segment	(3)	(8)	(6)	(15)
Total operating income	\$ 273	\$ 221	\$ 480	\$ 425

As described in more detail in Note 16 of the notes to consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2010, the majority of corporate expenses are reflected in the Government and Commercial segments based on agreed-upon allocations to the business units or as required by U.S. Government Cost Accounting Standards. The Corporate and Other segment reflects corporate costs that are unallowable under U.S. Government Cost Accounting Standards and the net effect of various items that are not directly related to the business unit's operating performance in the Government or Commercial segments.

**Note 9 Legal Proceedings:***National Center for Critical Information Processing and Storage Contract*

The U.S. Department of Justice filed a complaint against the Company and several other defendants in June 2009 relating to the solicitation and award of a task order to provide information technology support services to the National Center for Critical Information Processing and Storage run by the Naval Oceanographic Command Major Shared Resource Center (MSRC) located at the Stennis Space Center in Mississippi. This matter originated with a lawsuit filed under seal by a former government employee pursuant to the *qui tam* provisions of the civil False Claims Act. The Company was awarded the task order at issue in April 2004. The Justice Department's complaint alleges that prior to the release of the task order solicitation, the Company's employees and other eventual teammates met with government employees and obtained non-public information not provided to other potential bidders for this work, or received such information in advance of other bidders, giving the Company and its team an unfair advantage in competing for the task order. The complaint further alleges that the former MSRC director and deputy director took actions calculated to favor the Company in the bidding process. In its complaint, the government seeks approximately \$116 million in damages, which represents the aggregate amount of all payments received by the Company under this task order, plus the trebling of such damages and penalties under the False Claims Act.

The Company has cooperated with the government's investigation of this matter since the government initially contacted the Company in September 2006. The Company also conducted its own internal review of the allegations made by the government. Based on the Company's internal review, discussions with the government and the results of discovery thus far, the Company believes the government's claims lack merit and intends to vigorously defend itself against the allegations raised in the complaint. The parties are conducting discovery, which is currently scheduled to conclude by October 2010. Due to the early stage of this case, the outcome is uncertain. The Company has recorded a liability for an insignificant amount related to this matter as of July 31, 2010. However, there is a reasonable possibility of additional exposure to loss

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estimated to be up to approximately \$230 million, representing the amount of the trebling of the claim for damages minus the value received by the customer, plus penalties. As the case progresses, many factors will affect the ultimate amount of the potential loss if the Company is not successful in its defense of this lawsuit, including the results of discovery, the outcome of pre-trial motions, and the court's rulings on certain legal issues, such as the applicable measure of damages. An adverse outcome could have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows.

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SAIC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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*Telkom South Africa*

The Company's former Telcordia subsidiary instituted arbitration proceedings before the International Chamber of Commerce (ICC) against a customer, Telkom South Africa, in March 2001 as a result of a contract dispute. Pursuant to the definitive stock purchase agreement for the fiscal 2006 sale of Telcordia, the Company is entitled to receive the net proceeds from any settlement after deduction for the tax liability incurred by Telcordia. In July 2010, Telcordia and Telkom South Africa settled all claims related to these arbitration proceedings. Under the settlement, Telkom South Africa paid \$80 million plus certain value added taxes (VAT). During the three and six months ended July 31, 2010, the Company recognized an after-tax net gain of \$31 million in discontinued operations, which is net of estimated amounts owed to Telcordia and certain other expenses related to this settlement.

*Greek Government Contract*

*Background and Arbitration.* In May 2003, the Company entered into a firm-fixed-price contract with the Hellenic Republic of Greece (the Customer) to provide a Command, Control, Communications, Coordination and Integration System (the System) to support the 2004 Athens Summer Olympic Games (the Olympics) and to serve as the security system for the Customer's public order departments following completion of the Olympics. The System was to be completed, tested, and accepted by September 1, 2004, at a price of approximately \$199 million. The contract also requires the Company to provide five years of System support and maintenance and ten years of radio network services and contains an unpriced option for an additional five years of network services.

The Customer took delivery of the System for use and operation during the Olympics which began in August 2004. The Customer performed acceptance testing on each of the subsystems comprising the System and alleged certain omissions and deviations in its test reports. The Company and the Customer executed contract modifications in March and September 2007 which established and clarified specific requirements, contract terms, and a payment schedule under which the System would be completed as well as a scheduled reduction of the advance payment and performance bonds maintained by the Company in favor of the Customer.

In November 2008, the Customer accepted the System in writing pursuant to the requirements of the modified contract. At the time, the Customer determined that the System substantially complied with the terms of the contract and accepted the System with certain alleged minor omissions and deviations. The Customer valued the omissions and deviations at \$27 million, and the modified contract established a process for negotiating the final amount of the omissions and deviations. Approximately \$1 million of this amount relates to work performed directly by the Company and the balance relates to work performed by the Company's subcontractors. Upon System acceptance, the Company invoiced the Customer for approximately \$18 million, representing the undisputed portion of the contract balance owed to the Company. The Customer has not paid this final invoice or reduced the advance payment and performance bonds as required by the modified contract, and has refused to initiate the contractually required process to resolve the remaining alleged omissions and deviations.

In June 2009, the Company initiated arbitration before the ICC against the Customer seeking redress for these breaches of contract by the Customer. Under the terms of the Greek contract, disputes are subject to ultimate resolution by binding arbitration in Greece before a panel of three Greek arbitrators. In December 2009, the arbitration panel was selected. The Company seeks (i) aggregate damages in excess of \$92 million for payment of amounts owed and other claims and damages, (ii) recovery of advance payment and performance bond amounts totaling \$25 million and (iii) costs and expenses associated with the arbitration. The Customer filed an answer to the complaint denying liability on various grounds. In April 2010, the Customer filed a supplementary answer asserting set-off claims against amounts sought by the Company and issued a letter purporting to disapprove of its November 2008 acceptance of the System. Due to the complex nature of the legal and factual issues involved, the outcome of the arbitration is uncertain.

*Financial Status and Contingencies.* As a result of the significant uncertainties on this contract, the Company converted to the completed-contract method of accounting and ceased recognizing revenues for the System development portion of this contract in fiscal 2006. No profits or losses were recorded on the Greek contract during the three and six months ended July 31, 2010 and 2009. As of July 31, 2010, the Company has recorded \$124 million of losses under the Greek contract, reflecting the Company's estimated total cost to complete the System,

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assuming the Greek contract value was limited to the cash received to date. Based on the complex nature of this contractual situation and the difficulties encountered to date, significant uncertainties exist and the Company is unable to reliably estimate the ultimate outcome. Examples of these uncertainties include receipt of the remaining payments, the amount of additional cost that may be required to complete the contract, the release of the remaining bonds, changes in the political representatives from the Greek government involved with the project, and subcontractor performance and legal compliance issues. The Company may reverse a portion of the losses from the Greek contract if it receives future payments as required under the modified Greek contract.

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The Company has \$15 million of receivables relating to VAT as of July 31, 2010 that the Company has paid and believes it is entitled to recover either as a refund from the taxing authorities or as a payment under the Greek contract. The Company has invoiced the Customer for \$33 million for VAT and the Customer has failed to make payment. If the Customer fails to pay the outstanding VAT amounts or the Company is unable to recover the amount as a refund from the taxing authorities, the Company's total losses on the Greek contract could increase.

The Company has met certain advance payment and performance bonding requirements as discussed above through the issuance of euro-denominated standby letters of credit. The maximum value of the standby letters of credit outstanding under this contract was approximately \$250 million, which has been reduced over time as the Customer has accepted portions of the System and services provided by the Company. In May 2010, the Customer issued a letter purporting to terminate the portion of the contract relating to delivery of the System and to confirm the Company's ongoing obligations to provide network services and System support and maintenance under the contract. Shortly thereafter, the Customer drew, and the Company funded, \$25 million on the Company's standby letters of credit relating to the delivery of the System. As of July 31, 2010, there were \$7 million in standby letters of credit outstanding relating to the support and maintenance of the System. The Company is seeking recovery of the amounts drawn by the Customer on the standby letters of credit in the ongoing arbitration. The principal subcontractor has provided to the Company euro-denominated standby letters of credit in the amount of \$25 million as of July 31, 2010, of which \$19 million relates to the delivery of the System. The Company may draw on the subcontractor's standby letters of credit under certain circumstances by providing a statement to the responsible bank that the subcontractor has not fulfilled its obligations under the subcontract. The Company continues to believe that the loss recorded to date is sufficient to account for the ultimate outcome of this contractual situation and therefore no additional loss is expected to be recorded as a result of the draw on the standby letters of credit.

Additionally, Siemens AG (Siemens), the parent corporation of the Company's principal subcontractor has been subject to a number of investigations focusing on alleged improper payments to government officials and political parties in a number of countries, including Greece. The scope of the Greek government's investigation includes allegations that (i) improper payments were made by Siemens in connection with the Greek contract and (ii) the Company/Siemens team misrepresented to the Greek State prior to contract award its technical capabilities and ability to perform the Greek contract within the contractual performance period. The Company has taken a number of actions to determine that it had no involvement in any improper payments that may have been made by Siemens in connection with the Greek contract. If the Greek government's investigation ultimately determines that improper payments were made in connection with the Greek contract, or that the Company/Siemens team misrepresented its technical capabilities, the legal compliance and political issues that this would raise could impact the Company's subcontractor's ability to perform the subcontract and the Company's ability to perform the Greek contract. This could have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows.

*Nuclear Regulatory Commission*

The U.S. Department of Justice filed a lawsuit against the Company in September 2004 in the U.S. District Court for the District of Columbia alleging civil False Claims Act violations and breach of contract by the Company on two contracts that the Company had with the Nuclear Regulatory Commission (NRC). The complaint alleges that the Company's performance of several subcontracts on separate U.S. Department of Energy (DOE) programs, the participation of a Company employee in an industry trade association, and certain other alleged relationships created organizational conflicts of interest under the two NRC contracts. The Company disputes that the work performed on the DOE programs and the alleged relationships raised by the government created organizational conflicts of interest. In July 2008, the jury found in favor of the government on the breach of contract and two False Claims Act counts. The jury awarded a nominal amount of \$78 in damages for breach of contract and \$2 million in damages for the False Claims Act claims. The judge entered the judgment in October 2008, trebling the False Claims Act damages and awarding a total of \$585,000 in civil penalties. The Company has appealed to the U.S. Court of Appeals for the District of Columbia Circuit. Pending the outcome of the appeal, the Company has recorded a liability for the full judgment amount of \$7 million for this matter as of July 31, 2010.

*Other*

The Company is also involved in various claims and lawsuits arising in the normal conduct of its business, none of which, in the opinion of the Company's management, based upon current information, will likely have a material adverse effect on the Company's consolidated financial

position, results of operations or cash flows.

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SAIC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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**Note 10 Other Commitments and Contingencies:**

*VirnetX, Inc.*

In fiscal 2007, the Company transferred several patents to VirnetX, Inc. In return, the Company received certain license rights and the right to receive, subject to certain caps and other limitations, royalties on VirnetX sales and a percentage of the consideration received in certain acquisitions and in patent infringement or enforcement claims against certain third parties, including Microsoft Corporation.

In May 2010, VirnetX and Microsoft entered into a settlement and license agreement to settle all claims asserted by VirnetX against Microsoft in two lawsuits. Under the agreement, Microsoft made a one-time payment to VirnetX of \$200 million in cash in exchange for dismissal of both lawsuits and VirnetX granting to Microsoft a worldwide, irrevocable, nonexclusive, non-sublicensable fully paid up license under VirnetX's patents. Under the Company's agreement with VirnetX, the Company was entitled to receive 35% of the proceeds from the settlement of litigation with Microsoft after reduction for out-of-pocket costs, including legal fees and expenses, of VirnetX and the Company incurred in connection with the litigation. The Company received a royalty payment of \$56 million in connection with this agreement, which was recognized as revenue, and reimbursement of approximately \$3 million of legal fees and costs it incurred in connection with the litigation. The Company also paid \$2 million as a royalty to the customer for which it developed some of the patented technologies to satisfy the Company's obligation under the initial customer contract.

*DS&S Joint Venture*

In March 2006, the Company sold its interest in DS&S, a joint venture in which the Company owned a 50% interest. As part of the sale, the Company agreed to indemnify the purchaser for certain legal costs and expenses, including those related to a government investigation involving DS&S and any litigation resulting from that investigation up to the sum of the sales price of \$9 million plus \$1 million received by the Company in repayment of a loan owed by DS&S. As of July 31, 2010, the Company has deferred the potential \$9 million gain on this sale pending resolution of the indemnification obligation.

*Acquisition Indemnification Claims*

Following the closing of an acquisition in December 2006, the Company identified a number of potential indemnification claims against the sellers. The claims against the sellers include the failure of the acquired company to comply with certain terms of contracts with the U.S. Government that required the acquired company in certain circumstances to provide price reductions for goods and services if it charged other customers a price lower than the prices it charged those customers at the time of contract award (the price reductions claims). The Company has disclosed this apparent non-compliance by the acquired company to the government and is fully cooperating with the government's ongoing review of the matter. In January 2010, the sellers filed for arbitration in accordance with the terms of the acquisition agreement to resolve the Company's indemnification claims and seek release of approximately \$6 million of the purchase price that was being held in escrow as security for these claims. In July 2010, the Company and the sellers signed a term sheet to settle all outstanding indemnification claims, except for the price reductions claims. The Company expects to enter into a formal settlement agreement with the sellers consistent with the term sheet. The Company continues to have its indemnification rights relating to the price reductions claims in accordance with the acquisition agreement and the parties expect to maintain a reduced escrow fund as security for these claims following completion of the formal settlement agreement. Based on its current expectations, the Company believes that it has adequate recourse against the sellers for any expected liability to the government that may result from the price reductions claims.

*Government Investigations and Reviews*

The Company is routinely subject to investigations and reviews relating to compliance with various laws and regulations, including those associated with organizational conflicts of interest, with respect to its role as a contractor to agencies and departments of the U.S. Government and in connection with performing services in countries outside of the United States. Adverse findings in these investigations or reviews can lead

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to criminal, civil or administrative proceedings and the Company could face penalties, fines, repayments or compensatory damages. Adverse findings could also have a material adverse effect on the Company's business, consolidated financial position, results of operations and cash flows due to its reliance on government contracts.

U.S. Government agencies, including the Defense Contract Audit Agency (DCAA) and others, routinely audit and review a contractor's performance on government contracts, indirect rates and pricing practices, and compliance with applicable contracting and procurement laws, regulations and standards. They also review the adequacy of the contractor's compliance with government standards for its accounting and management internal control systems, including: control environment and overall accounting system, general information technology system, budget and planning system, purchasing system, material management and accounting system, compensation system, labor system, indirect and other direct costs system, billing system and estimating system used for pricing on government contracts. Significant audits currently underway include the Company's control environment and overall accounting, billing and indirect and other direct cost systems, as well as reviews of the Company's compliance with certain U.S. Government Cost Accounting Standards.

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SAIC, INC.

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Both contractors and the U.S. Government agencies conducting these audits and reviews have come under increased scrutiny. For example, it was determined that the audit procedures the DCAA used in reviewing some of the Company's systems were not in compliance with the requirements of Generally Accepted Government Auditing Standards. As a result, in April and July 2009, the DCAA rescinded its most recent audit reports on the Company's accounting, billing, and indirect cost systems issued in 2005 and 2006 and is currently auditing these systems again. The current audits and reviews have become more rigorous and the standards to which the Company is held are being more strictly interpreted, increasing the likelihood of an audit or review resulting in an adverse outcome. During the course of its current audits, the DCAA is closely examining and questioning several of the Company's long established and disclosed practices that it had previously audited and accepted, increasing the uncertainty as to the ultimate conclusion that will be reached. Government audits and reviews may conclude that the Company's practices are not consistent with applicable laws and regulations and result in adjustments to contract costs and mandatory customer refunds. Such adjustments can be applied retroactively, which could result in significant customer refunds. In addition, the Company changed its indirect rate structure used in its indirect cost system and its direct labor bid structure used for its estimating system for fiscal 2011 and future years. These changes are currently being reviewed by the DCAA.

The Company's failure to obtain an adequate determination of its various accounting and management internal control systems, including its recent changes to indirect cost and direct labor estimating systems, from the responsible U.S. Government agency could significantly and adversely affect its business, including its ability to bid on new contracts and its competitive position in the bidding process. Failure to comply with applicable contracting and procurement laws, regulations and standards could also result in the U.S. Government imposing penalties and sanctions against the Company, including suspension of payments and increased government scrutiny that could delay or adversely affect the Company's ability to invoice and receive timely payment on contracts, perform contracts or compete for contracts with the U.S. Government.

The Company's indirect cost audits by the DCAA have not been completed for fiscal 2005 and subsequent fiscal years. Although the Company has recorded contract revenues subsequent to fiscal 2004 based upon costs that the Company believes will be approved upon final audit or review, the Company does not know the outcome of any ongoing or future audits or reviews and adjustments, and if future adjustments exceed the Company's estimates, its profitability would be adversely affected. The Company has recorded a liability of \$24 million for its current best estimate of net amounts to be refunded to customers for potential adjustments from such audits or reviews of contract costs incurred subsequent to fiscal 2004.

*Tax Audits and Reviews*

The Company files income tax returns in the United States and various state and foreign jurisdictions and is subject to routine compliance reviews by the Internal Revenue Service (IRS) and other taxing authorities. The Company has effectively settled with the IRS for fiscal years prior to and including fiscal 2008. Effective fiscal 2011, the Company is participating in the IRS Compliance Assurance Process (CAP), in which the Company and the IRS endeavor to agree on the treatment of all tax positions prior to the return being filed, thereby greatly reducing the period of time between return submission and settlement with the IRS.

During the next 12 months, it is reasonably possible that resolution of these reviews by taxing authorities, both domestic and international, could be reached with respect to \$2 million of the Company's unrecognized tax benefits, depending on the timing of ongoing examinations, any litigation and expiration of statute of limitations, either because the Company's tax positions are sustained on audit or because the Company agrees to their disallowance and pays the related income tax. These unrecognized tax benefits are primarily related to certain recurring deductions customary for the Company's industry. As of July 31, 2010, the Company had liabilities for uncertain tax positions of \$29 million, including \$2 million related to discontinued operations.

During the six months ended July 31, 2010, the Company's uncertain tax positions were reduced by \$20 million resulting from the resolution of certain tax uncertainties. While the Company believes it has adequate accruals for uncertain tax positions, the tax authorities may determine that the Company owes taxes in excess of recorded accruals or the recorded accruals may be in excess of the final settlement amounts agreed to by the tax authorities.

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The Company is subject to periodic audits by government agencies for taxes other than income taxes. The Company does not believe that the outcome of any other such tax matters would have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

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*Letters of Credit and Surety Bonds*

The Company had outstanding letters of credit aggregating to \$45 million at July 31, 2010, principally related to guarantees on contracts with foreign government customers. The Company also has outstanding surety bonds in the amount of \$283 million, principally related to performance and payment bonds. Of the total outstanding letters of credit, \$7 million was related to certain advance payment and performance bonding requirements on a firm-fixed-price contract with the Greek government.

*Other*

The U.S. Department of Defense is in the process of restructuring one of the Company's largest programs, Army Brigade Combat Team Modernization. As a result of this restructuring, certain efforts associated with the program were terminated for convenience by the U.S. Department of Defense in July 2009 and January 2010. The Company received an undefinitized change order which required the Company to submit a restructure proposal. The Company submitted its restructure proposal to its prime contractor in April 2010 and the prime contractor submitted its restructure proposal to the customer in May 2010. The Company continues to perform on this program in accordance with the revised scope of work under a reduced provisional billing rate that allows the Company to receive a lesser amount of the projected fee on an interim basis. As of July 31, 2010, the Company has recognized revenues of approximately \$220 million under the undefinitized change order. The future volume and profitability of this program is dependent on the outcome of the change order negotiations.

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SAIC, INC.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion and analysis of our financial condition and results of operations and quantitative and qualitative disclosures about market risk should be read in conjunction with our condensed consolidated financial statements and related notes. The following discussion contains forward-looking statements, including statements regarding our intent, belief, or current expectations with respect to, among other things, trends affecting our financial condition or results of operations, backlog, our industry, government spending and the impact of competition. Such statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors. Some of these factors include, but are not limited to, the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010, as may be updated periodically through subsequent quarterly reports on Form 10-Q. Due to such uncertainties and risks, you are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to update these factors or to publicly announce the results of any changes to our forward-looking statements due to future events or developments.*

*Unless otherwise noted, references to years are for fiscal years ended January 31. For example, we refer to the fiscal year ending January 31, 2011 as fiscal 2011.*

**Overview**

We are a provider of scientific, engineering, systems integration and technical services and solutions to all branches of the U.S. military, agencies of the U.S. Department of Defense (DoD), the intelligence community, the U.S. Department of Homeland Security and other U.S. Government civil agencies, state and local government agencies, foreign governments and customers in select commercial markets. We use the terms Company, we, us, and our to refer to SAIC, Inc. and its consolidated subsidiaries.

Our business is focused on solving issues of national and global importance in the areas of defense, intelligence, homeland security, logistics and product support, energy, environment and health. We also plan to focus our investments to expand our business in areas such as: intelligence, surveillance and reconnaissance, cyber security, logistics, energy, and health technology. Our significant long-term management initiatives include:

achieving internal, or non-acquisition related, annual revenue growth through better leveraging of key differentiators across our Company and the deployment of resources and investments into higher growth markets;

improving our operating income margin through strong contract execution and growth in higher-margin business areas, as well as continued improvement in our information technology (IT) systems infrastructure and related business processes for greater effectiveness and efficiency across all business functions;

investing in our people, including enhanced training and career development programs, with a focus on retention and recruiting; and

disciplined deployment of our cash resources and use of our capital structure to enhance growth and shareholder value through strategic acquisitions, share repurchases and other uses as conditions warrant.

Key financial highlights and events, including progress against these initiatives, during the three months ended July 31, 2010 include:

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Revenues for the three months ended July 31, 2010 increased 2% over the same period in the prior year. Internal revenue growth (as defined in Non-GAAP Financial Measures ) contracted 1%. Internal revenue growth was negatively impacted by one less business day in the current year as compared to the same period in the prior year (representing a 2% decline in revenues), fewer new contract starts resulting from lower bookings in recent periods, lower demand for materials on a number of programs and the expiration of a customer contract in our Commercial segment. This was partially offset by a \$56 million royalty payment received during the three months ended July 31, 2010.

Operating income as a percentage of revenues increased by 1.8%, or 23%, from 8.0% for the three months ended July 31, 2009 to 9.8% for the three months ended July 31, 2010 primarily due to a \$56 million royalty payment received during the three months ended July 31, 2010.

Income from continuing operations for the three months ended July 31, 2010 increased \$33 million, or 26%, over the same period in the prior year primarily due to the royalty receipt offset by the resulting increase in the provision for income taxes of \$18 million.

Diluted earnings per share (EPS) from continuing operations for the three months ended July 31, 2010 increased \$.11 per share, or 35%, as compared to the same period in the prior year primarily due to the increase in income from continuing operations and a decline in the diluted weighted average number of shares outstanding of 23 million, or 6%, primarily due to stock repurchases.

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SAIC, INC.

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Cash and cash equivalents increased \$36 million during the three months ended July 31, 2010 primarily due to \$111 million generated from operations, including a \$56 million royalty payment received, and \$82 million in discontinued operations received from settlement of an arbitration proceeding brought against Telkom South Africa by our former subsidiary, Telcordia Technologies, Inc., partially offset by cash used to repurchase our stock totaling \$154 million.

Net bookings (as defined in *Key Financial Metrics Bookings and Backlog*) were approximately \$2.7 billion for the three months ended July 31, 2010. Total backlog was \$16.0 billion at July 31, 2010 as compared to \$16.1 billion at April 30, 2010.

#### Reportable Segments

We have three reportable segments: Government, Commercial and Corporate and Other. Our operating business units are aggregated into the Government or Commercial segments, depending on the nature of the customers served, the contractual requirements and the regulatory environment governing the business unit's operations. Except with respect to *Results of Operations Discontinued Operations* and *Net Income and Diluted EPS*, all amounts in this *Management's Discussion and Analysis of Financial Condition and Results of Operations* are presented for our continuing operations. For additional information regarding our reportable segments, see *Item 1. Business* in Part I and Note 16 of the notes to consolidated financial statements contained in our Annual Report on Form 10-K for the fiscal year ended January 31, 2010.

#### Key Financial Metrics

*Bookings and Backlog.* We received net bookings worth an estimated \$2.7 billion and \$5.9 billion during the three and six months ended July 31, 2010, respectively. Bookings generally represent the estimated amount of revenue to be earned in the future from funded and unfunded contract awards that were received during the period, net of any adjustments to previously awarded backlog amounts. We calculate net bookings as the period's ending backlog plus the period's revenues less the prior period's ending backlog and less the backlog obtained in acquisitions during the period.

Backlog represents the estimated amount of future revenues to be recognized under negotiated contracts as work is performed. We segregate our backlog into two categories as follows:

*Funded Backlog.* Government segment funded backlog primarily represents contracts for which funding is appropriated less revenues previously recognized on these contracts. Government segment funded backlog does not include the unfunded portion of contracts where funding is incrementally appropriated or authorized on a quarterly or annual basis by the U.S. Government and other customers, even though the contract may call for performance over a number of years. Commercial segment funded backlog represents the full value on firm contracts, which may cover multiple future years, under which we are obligated to perform, less revenues previously recognized on these contracts.

*Negotiated Unfunded Backlog.* Negotiated unfunded backlog represents estimated amounts of revenue to be earned in the future from (1) negotiated contracts for which funding has not been appropriated or otherwise authorized and (2) unexercised priced contract options. Negotiated unfunded backlog does not include any estimate of future potential task orders expected to be awarded under indefinite-delivery/indefinite-quantity (IDIQ), U.S. General Services Administration (GSA) Schedule, or other master agreement contract vehicles.

The estimated value of our total backlog as of the dates noted was as follows:

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	July 31, 2010	January 31, 2010
	(in millions)	
<b>Government segment:</b>		
Funded backlog	\$ 5,254	\$ 4,684
Negotiated unfunded backlog	10,042	10,168
Total Government segment backlog	\$ 15,296	\$ 14,852
<b>Commercial segment:</b>		
Funded backlog	\$ 530	\$ 568
Negotiated unfunded backlog	166	155
Total Commercial segment backlog	\$ 696	\$ 723
<b>Total:</b>		
Funded backlog	\$ 5,784	\$ 5,252
Negotiated unfunded backlog	10,208	10,323
Total backlog	\$ 15,992	\$ 15,575

Total backlog may fluctuate from period to period depending on our success rate in winning contracts and the timing of contract awards, renewals, modifications and cancellations.

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**SAIC, INC.**


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The DoD is in the process of restructuring one of our largest programs, Army Brigade Combat Team Modernization. As a result of this restructuring, certain efforts associated with the program were terminated for convenience by the DoD in July 2009 and January 2010. We received an undefinitized change order which required us to submit a restructure proposal. We submitted the restructure proposal to our prime contractor in April 2010 and the prime contractor submitted its restructure proposal to the customer in May 2010. We continue to perform on this program in accordance with the revised scope of work under a reduced provisional billing rate that allows us to receive a lesser amount of the projected fee on an interim basis. The future volume and profitability of this program is dependent on the outcome of the change order negotiations. Included within the Government segment backlog above is approximately \$50 million in funded backlog and \$445 million in negotiated unfunded backlog related to this program, which represents our best estimate of our remaining effort under this restructured contract. Of these amounts, we expect to recognize revenues of approximately \$120 million during the remainder of fiscal 2011.

We expect to recognize a substantial portion of our funded backlog as revenues within the next 12 months. However, the U.S. Government may cancel any contract at any time. In addition, certain contracts with commercial customers include provisions that allow the customer to cancel at any time. Most of our contracts have cancellation terms that would permit us to recover all or a portion of our incurred costs and potential fees for work performed.

*Contract Types.* Our earnings and profitability may vary materially depending on changes in the proportionate amount of revenues derived from each of the following types of contracts:

Cost-reimbursement contracts provide for reimbursement of our direct contract costs and allocable indirect costs, plus a fee. These contracts include cost-plus-fixed-fee, cost-plus-award-fee and cost-plus-incentive-fee contracts.

Time-and-materials (T&M) contracts typically provide for negotiated fixed hourly rates for specified categories of direct labor plus reimbursement of other direct costs. Fixed-price-level-of-effort (FP-LOE) contracts are substantially similar to T&M contracts except they require a specified level of effort over a stated period of time.

Firm-fixed-price (FFP) contracts provide for a fixed price for specified products, systems and/or services.

For additional information regarding the types of contracts used, including advantages and disadvantages of each type of contract, see Item 1. Business Contract Types in Part I of our Annual Report on Form 10-K for the fiscal year ended January 31, 2010.

The following table summarizes revenues by contract type as a percentage of total revenues for the periods noted:

	Six Months Ended July 31	
	2010	2009
Cost-reimbursement	47%	48%
T&M and FP-LOE	30	31
FFP	23	21
Total	100%	100%

Revenues from FFP contracts increased by 2% primarily due to a \$56 million royalty payment received during the three months ended July 31, 2010.

*Revenue Mix.* We generate revenues under our contracts from (1) the efforts of our technical staff, which we refer to as labor-related revenues, and (2) the materials provided on contracts and efforts of our subcontractors, which we refer to as M&S revenues. M&S revenues are generated

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primarily from large, multi-year systems integration contracts and contracts in our logistics and product support business area, as well as through sales of our proprietary products, such as our border, port and mobile security products. While our border, port and mobile security products are more profitable than other M&S revenues, these products represent a small percentage of our M&S revenues and the majority of our M&S revenues generally have lower margins than our labor-related revenues. The following table presents changes in labor-related revenues and M&S revenues for the periods noted:

	Three Months Ended July 31			Six Months Ended July 31	
	2010	Percent change	2009	2010	2009
	(dollars in millions)				
Labor-related revenues	<b>\$ 1,570</b>	%	\$ 1,577	<b>\$ 3,179</b>	\$ 3,148
<i>As a percentage of revenues</i>	<i>56%</i>		<i>57%</i>	<i>58%</i>	<i>58%</i>
M&S revenues	<b>1,224</b>	4	1,172	<b>2,300</b>	2,250
<i>As a percentage of revenues</i>	<i>44%</i>		<i>43%</i>	<i>42%</i>	<i>42%</i>

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M&S revenues increased primarily due to a \$56 million royalty payment received during the three months ended July 31, 2010. The labor-related revenues were relatively consistent for the three and six months ended July 31, 2010 as compared to the same periods in the prior year.

### Results of Operations

The following table summarizes our results of operations for the periods noted:

	Three Months Ended July 31			Six Months Ended July 31		
	2010	Percent change	2009	2010	Percent change	2009
	(dollars in millions)					
Revenues	\$ 2,794	2%	\$ 2,749	\$ 5,479	2%	\$ 5,398
Cost of revenues	2,388	1	2,369	4,740	2	4,664
Selling, general and administrative expenses:						
General and administrative (G&A)	76	(25)	101	153	(26)	206
Bid and proposal (B&P)	44	2	43	81	4	78
Internal research and development (IR&D)	13	(13)	15	25		25
Operating income	273	24	221	480	13	425
<i>As a percentage of revenues</i>	9.8%		8.0%	8.8%		7.9%
Non-operating expense, net	(20)		(19)	(38)		(34)
Income from continuing operations before income taxes	253	25	202	442	13	391
Provision for income taxes	(95)	23	(77)	(159)	7	(149)
Income from continuing operations	158	26	125	283	17	242
Income (loss) from discontinued operations, net of tax	31		(2)	31		(3)
Net income	\$ 189	54	\$ 123	\$ 314	31	\$ 239

We classify indirect costs incurred within or allocated to our Government segment as overhead (included in cost of revenues) and G&A expenses in the same manner as such costs are defined in our disclosure statements under U.S. Government Cost Accounting Standards. Effective with the beginning of fiscal 2011, we updated our disclosure statements with the Defense Contract Management Agency, resulting in certain costs being classified differently as either overhead or G&A expenses on a prospective basis. This change has caused a net increase in reported cost of revenues and a net decrease in reported G&A expenses in fiscal 2011 as compared to fiscal 2010; however, total operating costs were not affected by this change.

**Revenues.** Our revenues increased \$45 million, or 2%, and \$81 million, or 2%, for the three and six months ended July 31, 2010, respectively, as compared to the same periods in the prior year. Internal revenue growth (as defined in Non-GAAP Financial Measures ) contracted by 1% for the three and six months ended July 31, 2010 due to a decline in internal revenue growth in both the Government and Commercial segments for the reasons discussed below. This decline was partially offset by a \$56 million royalty payment received during the three and six months ended July 31, 2010 in the Government segment. The internal revenue growth rate for the three months ended July 31, 2010 was also negatively impacted by one less business day in the current year as compared to the same period in the prior year (representing a 2% decline in revenues).

The following table summarizes changes in segment revenues for the periods noted:

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	Three Months Ended July 31			Six Months Ended July 31		
	2010	Percent change	2009	2010	Percent change	2009
	(dollars in millions)					
Government segment revenues	<b>\$ 2,704</b>	3%	\$ 2,634	<b>\$ 5,284</b>	2%	\$ 5,170
<i>As a percentage of total revenues</i>	<i>97%</i>		<i>96%</i>	<i>96%</i>		<i>96%</i>
Commercial segment revenues	<b>91</b>	(22)	117	<b>198</b>	(14)	231
<i>As a percentage of total revenues</i>	<i>3%</i>					