



January 2011

SAIC (B): The Recent Years (2003-Present)

SAIC Changes Leadership

After thirty-four years, Dr. J. Robert Beyster stepped down as President and CEO of SAIC. On Nov 3, 2003, Kenneth Dahlberg was elected as his successor. Dr. Beyster continued to serve as Chairman of the Board of Directors until the 2004 annual shareholder's meeting.

Prior to joining SAIC as CEO, Dahlberg served as Executive Vice President of the Information and Technology Group at General Dynamics Corporation, a \$25B defense and aerospace contractor. Earlier in his career, Dahlberg worked at Raytheon International and the Hughes Aircraft Corporation. He holds degrees in electrical engineering from Drexel University and the University of Southern California.

In announcing the appointment of Mr. Dahlberg, Dr. Beyster commented:

SAIC employee-owners have shared in the company's growth and success since I founded the company more than 34 years ago. I am confident Ken will work with the management team to ensure the company's continued success, and strengthen SAIC's business strategies and employee-ownership culture.

Dr. Beyster was unaware of the implications of his departure for the SAIC company culture.

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Cases are written as the basis for class discussion and not to illustrate either the effective or ineffective handling of an administrative situation. This case was written from public sources, the book *The SAIC Solution*, and with support from the Foundation for Enterprise Development. Copyright, 2010, the University of Michigan College of Engineering Center for Entrepreneurship.

New Leader, New Structure

In May 2005, SAIC changed its external tagline from “An Employee-Owned Company” to “From Science to Solutions”. The original tagline was retained for a period of time for use with internal communications.

In October 2006 SAIC conducted an initial public offering (IPO) of common stock, selling approximately \$1.1B of new equity in the company to 'public' institutional investors including mutual funds and pension plans. After the IPO, these public shareholders would own 20% of SAIC, with current and former SAIC employees continuing to own 40% directly and another 40% through their employee retirement plans. All pre-IPO owners received preferred shares as part of the IPO process that carried 10 votes per share, providing this class of shareholder voting control of the company.

*Summary financial statements for SAIC for the three years immediately before the IPO are presented in **Exhibit 1**.*

Employee communications during this period were particularly important. Below are excerpts from an internal memo that was circulated to employees:

The IPO was conducted to provide liquidity to our shareholders and to allow us to use publically-traded stock to pursue acquisitions. We believe that much of our success can be attributed to our culture of employee ownership and to the entrepreneurial spirit to growing our business that this inspires in our employee owners.

Throughout the IPO process, we continued to encourage all of our employees to focus on the long term and not on the share price either at or right after the IPO. One of the greatest challenges in an IPO is communications, especially in a company that has been very open with employees. One of the great ironies is that you have to become more private as you become more public.

Following the offering, SAIC began to trade on the NYSE under the symbol SAI. On the first day after the offering, the stock traded at \$17.75 per share, resulting in a compound growth rate of over 40% per year in the value of the founders' original equity investment in the company. Consequently, the company paid a one-time special dividend of \$2.0B to all the employee shareholders at the time (approximately 35,000 people).

In 2009 the SAIC shareholders voted to convert the company's preferred stock (held by the original investors and the employee-owners) into common stock. As a result of this conversion and their sale of stock/diversification since the IPO, employees no longer held majority voting control in the company. They, along with the original investors and the employee retirement plan, became minority shareholders.

*Summary financial statements for SAIC for the years 2007-2009 are presented in the company's most recent annual report as **Exhibit 2**.*

In 2009, SAIC recruited Walter P. (Walt) Havenstein to replace Dahlberg, who retired as CEO¹. Immediately prior to joining SAIC, Mr. Havenstein was a senior executive at BAE Systems, a \$34B aerospace and defense contractor. He holds a degree in aeronautical engineering from the United States Naval Academy and another in electrical engineering from the U.S. Naval Postgraduate School. Havenstein served as an officer in the U.S. Marine Corps for 12 years before holding executive positions of increasing responsibility at ITT, Raytheon, Lockheed Martin, and BAE Systems.

Continued Growth

In the late 2000s, SAIC began a series of acquisitions, adding approximately 3-5 new companies per year. Acquisitions were used to extend corporate capabilities, expand into new markets (e.g. energy, cyber security, logistics), and further diversify the business. For example, in 2009, in order to more aggressively enter into new technology markets, SAIC acquired R.W. Beck Group, a management consulting firm specializing in managing complex engineering, energy and infrastructure projects, and in 2010 Cloud Shield Technologies, an IT-network cyber security company. Future growth was expected to continue from internal (organic) growth initiatives as well as "add-on" acquisitions.

*The company's mission and values statement is attached as **Exhibit 3**.*

By the end of 2009, revenues were up 8% from 2008, and operating profits of \$867M were up 12% from 2008. Headcount was 45,000, with 96% of revenues coming from governmental contracts.² The only numbers that declined during this time were the number of groups and business units at SAIC. By 2010, SAIC had consolidated into 3 groups with fewer than 15 business units. The idea was that less groups and business units would create more alignment within the company and allow SAIC to better serve its customers and markets.

Despite the positive numbers, it was clear that SAIC's growth had slowed. Since going public, SAIC's stock price had hardly moved (see **Exhibit 4**) and it was becoming increasingly difficult to find companies to acquire at the right valuation.

Looking Toward the Future

¹ Mr. Dahlberg retired at SAIC's compulsory retirement age of 65 after six years of service as the company's CEO. Mr. Thomas Young, a retired executive at Lockheed Martin and a long time member of the board of directors at SAIC, became chairman of the board at the company's 2010 annual shareholder's meeting.

² This increase in % of revenues coming from governmental contracts was primarily due to the sale of Telcordia in 2005.

As Mr. Havenstein looked to the future, he knew that he had to do everything he could to restore growth. To do this, SAIC could not necessarily rely on the approaches it used to get to where it was. The company was now at a much larger scale, growth in its primary markets and customer base had slowed and the company was accountable to a more diverse group of stakeholders as a public company. To grow, Mr. Havenstein felt strongly that Business Units would need to approach the market in a significantly more integrated manner than in the past, bringing diverse capabilities to bear on solving customer problems.

In order to achieve sustainable, long-term growth, Mr. Havenstein needed to answer several questions: Should the company restructure to be better integrated across business units or should it keep business units running independently and achieve integrated customer solutions in some other manner? What incentive system would best work to motivate employees, especially given that many employees' stock option grants were out-of-the-money and given that stock incentives had been both concentrated and reduced considerably in the aggregate since the IPO? What needed to change culturally within SAIC to be more competitive in the marketplace?

But Mr. Havenstein was certain about one thing: "SAIC remains committed to provide a company to attract and motivate professional people of high integrity who want to perform superior scientific and technical work and who want to have a stake and a voice in their company's development."

Proposed Questions:

1. What aspects of SAIC's entrepreneurial ownership culture are still relevant (or not) in the 21st century? Why or why not?
2. What aspects of SAIC should Mr. Havenstein be open to changing in the future, if any?
3. What organizational structure or other incentive approaches would allow SAIC to best harness the strengths of all business units to drive growth in an integrated manner?
4. What compensation packages, or other incentives, will motivate people with the skills necessary to grow the company to join? What kind of compensation would attract you to the company, in terms of salary, equity, bonus structure, and nonfinancial benefits?

Exhibit 1

Selected Financial Information 2004-2006					
\$ in Millions					
			<u>CY 2006</u>	<u>CY 2005</u>	<u>CY 2004</u>
Revenues			\$ 7,792.00	\$ 7,187.00	\$ 5,833.00
Cost of Revenues			\$ 6,801.00	\$ 6,283.00	\$ 5,053.00
Gross Profit			\$ 991.00	\$ 904.00	\$ 780.00
Selling and Administrative Expenses			\$ 494.00	\$ 416.00	\$ 485.00
Operating Income			\$ 497.00	\$ 488.00	\$ 395.00
EBITDA			\$ 563.00	\$ 519.00	\$ 438.00
Total Assets			\$ 5,655.00	\$ 6,010.00	

Source: Various SAIC Annual Reports

Exhibit 2

Selected Financial Information 2007-2009					
\$ in Millions					
			<u>CY 2007</u>	<u>CY 2008</u>	<u>CY 2009</u>
Revenues			\$ 8,060.00	\$ 8,926.00	\$ 10,070.00
Operating Income			\$ 572.00	\$ 673.00	\$ 776.00
Income from Continuing Operations			\$ 365.00	\$ 390.00	\$ 447.00
Diluted Earnings Per Share From Continuing Operations			\$ 1.00	\$ 0.92	\$ 1.08

Source: 2010 Annual Report

Exhibit 3

SAIC Mission and Values

Mission

- SAIC is a company of people dedicated to delivering best-value services and solutions based on innovative applications of science and technology.
- We commit to exceeding our customers' expectations for quality, responsiveness, and professional excellence while delivering within the agreed price and schedule.
- We maintain the highest standards of ethical behavior and professional integrity.
- We employ people of exceptional creativity, expertise, and determination who work closely with one another and with our customers.
- We pursue technical growth and market diversification to increase value for our customers and opportunity for our employees.
- We motivate and reward outstanding performance through our stock ownership system.
- We foster a working environment that encourages technical objectivity, professional and financial growth, and entrepreneurial freedom.

Values

How we achieve our mission is as important as the mission itself. Here are SAIC's core values that are the guides by which we navigate:

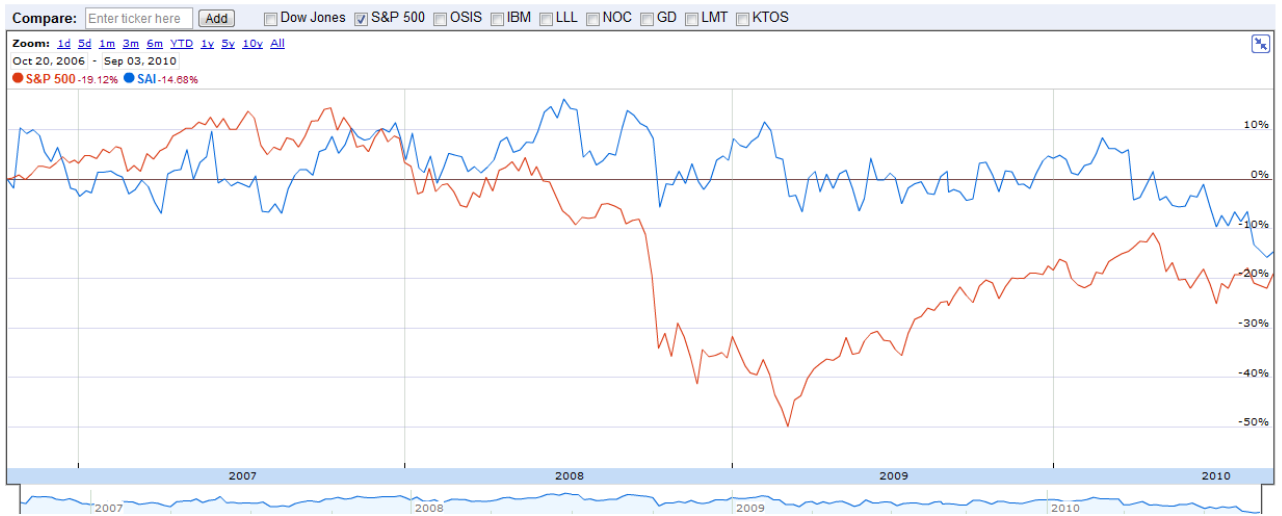
- **Technical and Professional Excellence:** We want to perform superior scientific and technical work. We demonstrate thought leadership and innovation through world class science, engineering and technology. We attract and develop leaders in their fields and encourage them to build businesses.
- **Customer Success:** We define our success by our customers' success. We are committed to delivering quality, meeting expectations and satisfying customers.
- **Ethics and Integrity:** Ethics is our foundation and constant commitment — unchanging and unwavering. We are accountable to lead by example and uphold the highest standards of integrity.
- **Entrepreneurial Freedom with Responsibility:** Our employees are empowered to be entrepreneurs, and to take balanced risks. SAIC provides employees with the freedom to pursue their interests and professional careers. We are responsible for successfully executing our business.
- **Culture of Ownership:** Our employee ownership culture is the cornerstone of SAIC. Employees who act like owners contribute significantly to our

success. Ownership builds employee satisfaction, commitment and retention — and these attributes are directly linked to customer satisfaction and a long term career at SAIC.

- **Importance of the Individual:** SAIC's people are our most important asset — we hire those with high capability and potential. We value the skills and expertise of a diverse work force. We strive to provide each person with the freedom to grow personally and professionally. We have a say in the management of our Company.

Source: SAIC

Exhibit 4 SAIC Stock Performance vs. S&P 500



Source: Google